

Framework
for
Supervisory Information
Sharing
paper

Framework for Supervisory Information Sharing

I. Purpose and objectives

1. This paper outlines a general framework for facilitating information-sharing between supervisors of regulated entities within internationally active financial conglomerates. This paper is the result of the work of a Task Force established by the Joint Forum on Financial Conglomerates to examine the structure and operations of several large internationally active financial conglomerates (hereinafter referred to as the Task Force). Although the focus was on large international groups, the Joint Forum believes that the lessons drawn could also apply to smaller conglomerates or conglomerates that operate domestically.
2. Given the internationalisation of financial markets and the growth of emerging market economies, the paper draws attention to the need for enhancing communication links which currently exist primarily within each supervisory sector and facilitating information sharing between supervisors involved in the supervision of international financial conglomerates.
3. This paper is intended to complement the work of the Joint Forum on a number of topics relating to supervisory issues arising from the operations of financial conglomerates, e.g. the *Capital Adequacy Principles* paper, the *Fit and Proper Principles* paper, the *Coordinator* paper, and the *Principles for Supervisory Information Sharing* paper. The observations and recommendations in this paper should be considered in conjunction with those documents.
4. The framework presented takes account of existing networks of information sharing whereby information flows along established channels of communication¹, particularly between supervisors in the same sector. Numerous bilateral arrangements exist between supervisors providing for the flow of general and specific supervisory information, in some cases in respect to individual financial conglomerates. This paper is intended to facilitate the evaluation, and where necessary, enhance and expand those information flows.

¹For example, in the European Union there are arrangements for sharing information between supervisors in different sectors and in different countries based on harmonised minimum confidentiality requirements (including with supervisors outside the EU provided certain conditions with respect to confidentiality are met).

II. Definitions

5. The following definitions are provided for the purposes of this paper:

Corporate legal structure is defined as the legal framework of entities that make up the conglomerate.

Business activities structure is defined as the way in which the conglomerate organises and operates the primary business activities in which it is engaged.

Management structure is defined as the form of direct supervision and oversight exercised by management on the corporate and business activities structures, and on the corporate control functions of the conglomerate.

Corporate control functions are defined to be risk measurement, monitoring and control systems and include internal and external audit, financial control, compliance, human resources, and information technology.

The **Primary supervisor** is generally considered to be the supervisor of the parent or the dominant regulated entity in the conglomerate, for example, in terms of balance sheet assets, revenues or solvency requirements. Where the identity of the primary supervisor is not clear, the relevant supervisors should work cooperatively to identify, on a case by case basis, an appropriate information sharing structure.

III. Background and observations of the Task Force

6. The Task Force was established by the Joint Forum for the purpose of enhancing its understanding of the operations of internationally active financial conglomerates and the impact of their rapidly changing and global nature on supervisory approaches.

7. The Task Force studied fourteen conglomerates which are diverse in their business activities, the extent of their international reach and in the complexities of their organisational structures. The Task Force has reviewed and refined the questionnaire that participants in the mapping exercise used to compile information. The Conglomerate Questionnaire which consists of a users guide, a glossary of terms, the questionnaire itself and the matrix form for recording findings is attached as Annex A.

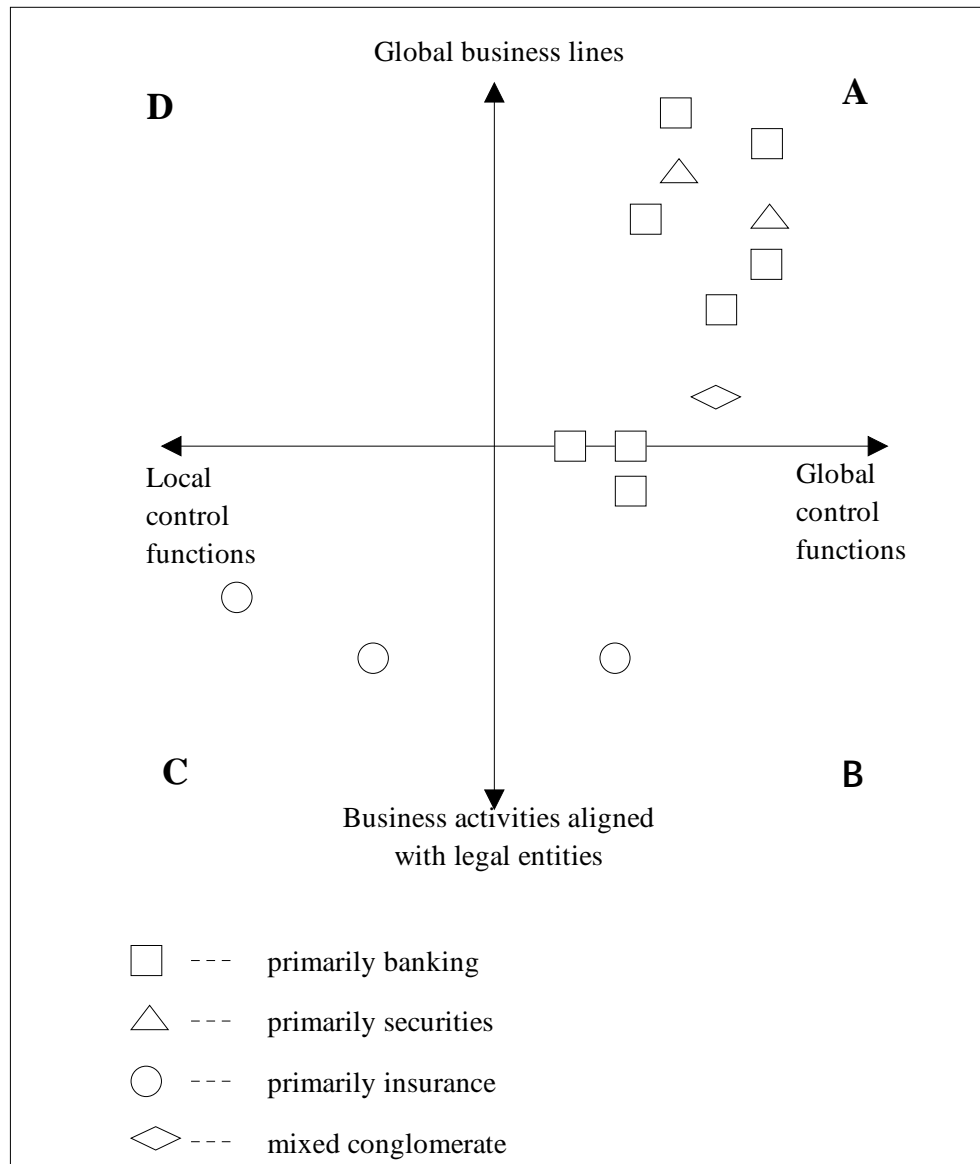
8. The Task Force also collected detailed information on supervisory objectives and approaches and on the authority of supervisors to share information in the countries represented in the Joint Forum. This information, which was collected through the completion of a Supervisory Questionnaire and recorded in a matrix format, has been shared amongst the supervisory agencies represented on the Joint Forum and provides a solid foundation to assist supervisors in each sector to better understand colleagues' responsibilities and their *modus operandi*.

9. Financial conglomerates take a wide variety of structures. Conglomerates may have a large number of legal entities, primarily as a result of historical, tax and regulatory considerations. Some conglomerates indicated a desire to simplify their business lines and legal entity structures by bringing them together, but viewed regulatory, fiscal and legal impediments as obstacles.

10. The Task Force examined the different structures of the conglomerates mapped to assess the implications of those structures on supervision and on the sharing of supervisory information between supervisors.

11. There are two key dimensions which tend to have particular implications for the supervision of regulated entities within financial conglomerates namely, 1) the organisation of business activities along business lines versus along the corporate legal structure and 2) the organisation of corporate control functions on a global or centralised basis versus on a local basis. The focus of the Task Force in classifying financial conglomerates into quadrants is based on these two key dimensions.

12. The findings of the exercise carried out with respect to the fourteen conglomerates mapped are plotted into the following chart using a quadrant categorisation. The X axis relates to the organisation of the conglomerate's controls, with local controls at one end and global controls at the other. The Y axis relates to the organisation of the management structure, along business lines at one pole and legal entity structure at the other.



13. The positioning of conglomerates within the particular quadrants, or bridging quadrants, does not result from a mathematical exercise. Rather, the position of individual conglomerates reflects the judgement of the Task Force members in the mapping exercise, based on an assessment of information collected during the exercise.

14. The proportion of conglomerates, whether primarily banking, securities or insurance or mixed, falling into a particular quadrant is strictly a function of the particular sample of conglomerates participating in the mapping exercise. Choosing a different sample of

conglomerates could result in a different proportion of conglomerates falling in one or the other quadrant.

15. Given the dynamic nature of diversified financial groups, the categorisation of a conglomerate in a particular quadrant is a determination at a point in time. The structure of business activities and of corporate control functions can shift over time, sometimes rather quickly, and the categorisation would need to be reviewed through the supervisory process.

IV. Framework for Identifying Supervisory Information Needs

16. The principal features of conglomerates categorised in each of the four quadrants and an indication of supervisory issues arising in respect to financial conglomerates in each quadrant are set out below.

17. Financial conglomerates tend to develop their own corporate identities and management styles and will not always have an obvious position in any one of the four quadrants. The supervisory issues outlined in this paper will need to be viewed within the context of the particular circumstances of each conglomerate.

18. The quadrant analysis and classification are designed to highlight supervisory information needs and to underscore the importance of information sharing. However, irrespective of the quadrants, information sharing is important to assist supervisors in supervising the operations of the conglomerate under their jurisdiction.

Quadrant A: Global business lines, global control functions

19. A conglomerate in Quadrant A organises its business activities along the products and services that it provides and the resulting business line structure may bear little relationship to the corporate legal structure. The matrix management approach generally found in Quadrant A conglomerates assigns management "front office" responsibilities along business lines, which cut across legal entities, geographic regions, and sometimes across business lines themselves. Management "back office" responsibilities for corporate control functions cut across both business lines and the legal entities. The corporate control functions are organised largely at head office or in a separate special purpose entity, although there is necessarily local involvement in control processes. The legal entity structure is highly influenced by tax and regulatory considerations.

20. Several issues arise for the supervisors involved in the oversight of entities in a Quadrant A conglomerate. Issues for the various supervisors may differ somewhat because key risk management and control functions for entities they oversee may be located in another jurisdiction - frequently, but not necessarily always, at head office. However, there is an enhanced need for all supervisors to understand the complexities of transactions and arrangements that are extensively used to transfer risk and income intra-group between affiliates in the "global" structure. Information exchange is useful in order for an overall view to be taken, because an individual supervisor may often see only part of the management matrix (a business line or a geographical area or a legal entity).

21. The information issues for supervisors involve understanding of, access to and responsibility for assessment of:

- the business strategy of the conglomerate, especially in business lines conducted by a given supervised legal entity,
- the matrix management structure and the extent to which global risk management and global business management are evaluated by the various supervisors,
- the group corporate structure,
- the key risks in other entities, including unregulated entities, and potential impact on parent and other regulated entities,
- the organisation of global corporate control functions and their effectiveness especially outside a particular supervisor's statutory jurisdiction,
- the local controls to assess the reliability of information being fed into the global risk management systems and the quality of those systems,
- intra-group exposures and transactions.

Quadrant B: Business activities aligned with legal entities, global control functions

22. In a Quadrant B conglomerate the business activities are aligned with the legal entities but corporate control functions are organised at the head office or in a separate dedicated legal entity. In addition, the management and boards of legal entities retain a substantial role, in some cases related directly to some business operations or specialised activities that are prevalent in a particular entity. Alternatively, the legal entities may be broadly responsible for their own business strategies and certain corporate control functions, but may be subjected to very close monitoring and oversight from their parent companies.

23. Several issues arise for the supervisors involved in the oversight of entities in a Quadrant B conglomerate. As is the case with Quadrant A conglomerates, the various supervisors have a need to assess the effectiveness of controls which may be located in a different country. The primary supervisor needs to be able to assess the adequacy of controls within the subsidiaries. For all supervisors, the issue is the division of management responsibilities centrally and in subsidiaries and the ensuing division of supervisory responsibilities. Additionally, the primary supervisor needs to understand how the local business strategies, derived and implemented on a legal entity basis, consolidate into a meaningful business strategy for the conglomerate as a whole.

24. The information issues for supervisors involve understanding of, access to and responsibility for assessment of:

- the group corporate structure,
- the key risks in other entities, including unregulated entities, and potential impact on parent and other regulated entities,
- management responsibilities and of the division thereof globally and locally,
- the organisation of global corporate control functions and their effectiveness, especially outside a particular supervisor's statutory jurisdiction where relevant,
- the local controls to assess the reliability of information being fed into the global risk management systems and the quality of those systems,
- the extent to which global risk management systems are evaluated by the various supervisors,
- intra-group exposures and transactions.

Quadrant C: Business activities aligned with legal entities, local control functions

25. The corporate structure of a Quadrant C financial conglomerate fully accords with management organisation. Also, the corporate control functions are aligned with the local legal entity structure, with few functions exercised globally. Local management operates rather autonomously from the parent entity.

26. Several issues arise for supervisors involved in the oversight of entities in a Quadrant C conglomerate. All supervisors need to understand the influence of the dominant or parent entity and the effectiveness of firewalls, particularly when there is an unsupervised holding company. The primary supervisor needs to have the ability to assess the effectiveness of local controls and the reliability of risk management information. Communication between supervisors will be important to assess the extent of de facto local and central controls. For all supervisors there is an enhanced need to understand group-wide risk exposures.

27. The information issues for supervisors involve understanding of, access to and responsibility for assessment of:

- the group corporate structure,
- the key risks in other entities, including unregulated entities, and potential impact on parent and other regulated entities,
- the group's approach to concentrations and control systems that reduce the need for global risk systems,
- intra-group exposures and transactions,
- the nature and scope of the group's local controls and/or firewalls.

Quadrant D: Global business lines, local control functions

28. A Quadrant D conglomerate is organised along business lines which cut across the legal entities but its corporate control functions are organised locally, within legal entities. This is an anomalous situation as the corporate controls located in legal entities are less integrated than the business line and therefore cannot fully monitor and control the risks in those business activities. This type of a conglomerate would carry inordinate risk that the controls that are intended to ensure the proper conduct of business would fail.

29. None of the conglomerates mapped were found to fall into Quadrant D. Determining that a conglomerate has the characteristics of a Quadrant D conglomerate may not be easy and can involve a high degree of subjective judgement by supervisors. For example, the group may describe itself as having centralised corporate control functions, and internal documentation may support that. But in reality, local management may not have effectively implemented the central controls, or they may even have circumvented them.

30. It may be difficult for the primary supervisor to discover this as access to controls in all localities may not be achievable on a practical basis. All supervisors therefore should be alert to this problem, particularly if the supervised legal entity is a major contributor to group profits, and inform the primary supervisor if concerns arise and assist in any ensuing analysis of the group. This emphasises the need for all supervisors to exchange information regularly in order to facilitate the assessment of the control environment.

Implications for supervisors and information sharing

31. In each type of conglomerate structure, it is clear that information sharing between supervisors is essential. Such information sharing will be useful in enhancing supervisors' understanding of the operations of the conglomerate and their effect on the regulated entity, and in assisting supervisors in determining the characteristics of the conglomerate in terms of the Quadrant structure. A conglomerate might describe itself to fit into Quadrants A, B or C but could actually be in D.

32. A prerequisite for assessing information sharing needs amongst supervisors is a good understanding of the organisational structures and business activities of the financial conglomerate. The findings and observations of the Task Force with respect to the participating conglomerates demonstrated that the conduct of a mapping exercise is an effective way to gain that understanding. It is acknowledged that this is but one supervisory tool available to further supervisors' understanding of complex financial conglomerates.

33. The Quadrant approach can be a useful tool in identifying situations where supervisors' information needs are increased or where management of conglomerates may not themselves be receiving sufficient information. For example, conglomerates which are theoretically managed on a global business line basis and have global corporate control functions (Quadrant A), but in fact still permit considerable local autonomy in some parts of the group and in practice are structured more along the lines of a Quadrant D conglomerate could raise supervisory concerns.

34. Supervisors need to be alert to highly autonomous local managers, weak global controls or any other evidence that theoretical and actual management structures are divergent. Other warning indicators might include separate audit arrangements and different accounting year ends among the conglomerate's legal entities.

35. Irrespective of the structure of the corporate and management organisation, and the corporate control functions of financial conglomerates, the key to ensuring that overall group management practice conforms to the understandings of individual supervisors is effective communication among supervisors, as no single supervisor is likely to have ready access to all pertinent information to fully understand and assess the conglomerate.

36. Supervisors should also exchange information regarding their own objectives and approaches. Familiarity with each other's supervisory techniques can facilitate mutual understanding and trust and sharing of information. The previously mentioned Supervisory Questionnaire is a useful tool for collecting information on supervisory objectives and approaches.

V. Exchange of Information Between Supervisors under Various Circumstances

A. Creation of a new conglomerate

37. The creation of a new conglomerate is usually an identifiable event which arises through merger, acquisition or the development of new businesses and may trigger the involvement of the supervisors with responsibility for the various legal entities in the new group. However, as groups expand and evolve they can also gradually develop the characteristics of a financial conglomerate. Supervisors therefore need to keep expanding groups under review. The emergence of a conglomerate will bring with it increased information needs for all supervisors involved including in instances relating to their authorisation, application or other supervisory processes.

38. Contact should be initiated among the relevant supervisors at the start of a conglomerate's life. The relevant supervisors should begin discussions to commence appropriate information sharing procedures with each other when the creation of a new conglomerate occurs.

39. It is important that measures be taken at that time to ensure that the structures of the conglomerate in terms of its corporate management and corporate control functions are well understood by the supervisors involved. One way of doing this would be for supervisors to undertake a mapping exercise, using the Conglomerate Questionnaire as previously referenced. Supervisors should weigh the advantages and disadvantages of the timing of a mapping exercise. In some cases it may be desirable to undertake such an exercise promptly whereas, in other cases, particularly in merger situations, it may be preferable to await the completion of the structural changes that usually result from such merger. Supervisors may also accomplish the desired goal of understanding a conglomerate via their supervisory approaches.

40. When a mapping exercise is conducted, it would normally be led by the primary supervisor with participation of other supervisors as deemed appropriate. The completed matrix record of findings which includes key information on the business and organisation of the conglomerate could be shared with the supervisors involved in the oversight of parts of the conglomerate.

41. The mapping exercise would, inter alia, facilitate the categorisation of the conglomerate in terms of the structure of management of its activities along business lines or legal entities and of its controls on local or global bases and determine its position within a quadrant.

42. Conducting a mapping exercise is also useful for supervisors in enhancing their understanding of each others' objectives, approaches and strategies. This could assist supervisors in establishing information sharing arrangements which are best suited to their individual needs, the nature of the business undertaken by the regulated entity for which they have responsibility and the nature and structure of the conglomerate itself.

B. Authorisation of a new activity or activity in a new supervisory jurisdiction

43. There are diverse supervisory approaches with respect to a financial conglomerate establishing a presence in a new jurisdiction. In some cases there may be a legal authorisation or approval process required whereby another supervisor will apply the relevant authorisation procedures for the new entity. In some cross-border sectoral arrangements, the prior consent of the primary supervisor is an integral part of the authorisation process, e.g. as set out in the Basle Committee's Minimum Standards. In other cases, there may be simply a notification requirement or no formal authorisation or approval requirement.

44. Irrespective of the mechanisms relating to the establishment of a presence in another jurisdiction, contact should be established between the relevant supervisors and efforts should commence to establish a supervisory relationship if one does not already exist. This could be an opportune time for supervisors to exchange information about their supervisory objectives and practices.

45. In order to facilitate the review process by another supervisor, the primary supervisor may provide appropriate information compiled through a mapping exercise or through the ongoing supervisory process for the conglomerate in question. If the supervisors concur, they may decide to jointly complete the Conglomerate Questionnaire.

46. A review of the existing arrangements for information exchanges should be carried out by the supervisors involved to ensure that there is a legal basis for the sharing of information and determine what impediments exist to such sharing of information, if any. Relevant supervisors should strive to develop or enhance, as necessary, formal or informal information sharing arrangements.

47. It is recognised that intra-sectorally, and in some cases cross-sectorally, there are many existing arrangements in place relating to such information exchanges. The proposals and recommendations in this paper are not intended to replace any such arrangements, but to supplement these information flows, as appropriate, where the financial entities in question are part of a financial conglomerate.

C. Developments in financial conglomerate structure

48. The dynamic nature of financial conglomerates necessitates that supervisors keep apprised of developments including the undertaking of significant new business or a restructuring of controls. New developments should be assessed to determine their impact on the structure of the conglomerate, including the conglomerate's categorisation within the quadrant framework. Changes to the structure which would tend to shift the conglomerate from one quadrant to another could have implications for the information sharing arrangements in place between supervisors. Supervisors need to keep apprised of changes to the conglomerate's structure and make appropriate adjustments to their supervisory approaches and information sharing arrangements. Such adjustments could result from ongoing supervision or from carrying out a new mapping exercise.

D. Ongoing supervision

i) Information needs with respect to the firm

49. The supervisors of regulated entities within a conglomerate have different information needs, determined by the legal and regulatory regimes within which they operate, their supervisory objectives and the nature of the business undertaken by the regulated entity in a particular jurisdiction. The primary supervisor is likely to have both the need for and access to the widest range of information, and other supervisors will often seek additional information or verification of information from the primary supervisor. All supervisors may have valuable insights or information to be shared with each other.

50. Supervisors need key descriptive information about the conglomerate: its organisational structure, management, financial condition, strategy and principal risks, and the main features of its policies, procedures and information systems for managing and controlling risk. This information may be included in organisation charts, financial statements, capital, liquidity and risk profiles, policy manuals and other written material. Also, discussion with the conglomerate's management may provide context for the information as well as management's perspective on the firm's strategy, risk profile and prospects. Supervisors also need sufficient financial and operational information to allow them to assess and determine how effectively a financial conglomerate is identifying, managing and controlling its risks and to recognise any incipient problems. The Conglomerate Questionnaire was found to be a useful way to obtain pertinent information about a conglomerate.

51. A general framework for identifying information needs, particularly the types of information that would be especially relevant for each type of conglomerate structure, is set

out in Section IV of this paper. However, in practice each financial conglomerate, although it may be structured along the lines of one or the other model, will be unique and the information needs of the primary and other supervisors will need to be assessed on an individual basis.

ii) Information needs with respect to supervisory activity

52. Key factors in the establishment of arrangements for the exchange of supervisory information relating to financial conglomerates are the supervisory objectives and approaches of the supervisors involved. A common understanding of these can be achieved through the completion of the Supervisory Questionnaire or from discussions among supervisors.

53. Supervisors of entities within financial conglomerates can benefit from familiarity with and understanding of the approaches of the supervisors of other entities within the conglomerate. Supervisory cooperation can also help to reduce unnecessarily duplicative or burdensome requirements and to ensure that the total supervisory strategy is sufficiently comprehensive. On an ongoing basis, it is useful for supervisors to be informed of other supervisors' planned oversight activities, including on-site inspections, in order to take these into account when planning their own oversight programme. Regularised communications regarding such oversight activities can be incorporated into information sharing arrangements among the supervisors of the entities within the financial conglomerate.

54. A review of the supervisory objectives and approaches, together with a review of the organisational structure and of the key risks of the conglomerate and of planned activities/coverage, will assist supervisors in identifying and assessing the level of supervision present within the financial conglomerate. Supervisory coverage can then be modified and adjusted, as necessary, to ensure appropriate oversight, without undue supervisory burdens and duplicative deployment of supervisory resources.

E. Identifying and Addressing Supervisory Concerns

55. Within a supervisory framework, a goal of the supervisors is to use information obtained on an ongoing basis to facilitate the understanding of the strategy, structure, financial position and performance of financial conglomerates, and to identify emerging problems that could affect regulated entities. A key objective is to identify problems early enough to encourage the management of regulated entities to take action to address concerns. This begins with a good baseline understanding of the regulated entity.

56. All supervisors need to consider adverse or out-of-the-ordinary developments of special interest, particularly as they may impact the regulated entities for which they have responsibility. Most supervisors have good access to financial information but see such data as lagging indicators of emerging problems.

57. Supervisors highly value the views and assessments of other supervisors. They are interested in being informed of the assessments and findings of relevant supervisors evaluating the risk taking activities of significant entities. In particular, supervisors will want to be informed of significant emerging issues and out-of-the-ordinary developments. Depending upon intercompany relationships within the conglomerate, other supervisors also have an interest in the relevant assessments and findings of other supervisors responsible for other entities. Communication of supervisory assessments could reduce the need for the exchange of excessive amounts of information and raw data.

58. Special emphasis should be given to information flows to the primary supervisor. This supervisor would normally be best equipped to assess developments and events which in isolation may not be of significant interest but which, in conjunction with other available information, could bring to light significant, potentially adverse trends. The timely communication of unusual findings and significant developments to the primary supervisor will permit their analysis and evaluation against other information and the assembly of the "supervisory puzzle". In particular supervisors should share information on issues of risk management and internal controls which could impact on the control environment of entities in other jurisdictions. On the other hand, since the primary supervisor may have the most comprehensive view of the "supervisory puzzle", it may be in the best position to alert other country supervisors to potential problems and to provide them with pertinent information.

59. The information needs of supervisors will intensify if emerging problems develop into more serious matters. This may relate to conglomerate-specific or broader market wide problems which may affect other financial institutions.

60. Once a problem develops into a matter for supervisory attention, information needs will likely move from understanding of the overall structure, financial condition, risk profile and corporate control functions and approaches of the financial conglomerate to increasingly specific and detailed information about the firm's risk exposures and risk management tactics, and the financial impact of current developments, especially those related to the current problem(s). Supervisors' needs will only be met if the financial conglomerate has in place good information systems which will permit accurate and detailed information to be retrieved in a timely and reliable manner.

61. In the face of very severe problems, highly detailed information may be needed, and communication between the firm and its key supervisors may be continuous. Examples of the types of information that may be useful in an emergency and on short notice are set out in Annex B. A key point in such situations is that financial conglomerates need to have the capacity to provide a potentially wide range of detailed information within short time frames.

62. The intensified need for timely and detailed information underscores the importance of developing a full understanding of the structure, strategy, and risk profile of the financial conglomerate by the relevant supervisors. Attention to the nature, quality and flexibility of management information systems and reporting should be part of the routine supervisory process. Equally important are good communication channels between the conglomerate's management and its supervisors in all its regulatory jurisdictions and amongst its supervisors.