



BERMUDA MONETARY AUTHORITY

DISCUSSION PAPER

Regulation of Financial Holding Companies

May 2018

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The views of our industry partners and other interested persons on the proposals set out in this paper are invited. Comments and suggestions are welcome and should be sent to the Authority, addressed to policy@bma.bm by 31st July 2018.

I. Introduction

The purpose of this Discussion Paper (DP) is to elicit discussion on and receive feedback on the structure of a regime for the regulation of Financial Holding Companies (FHCs) in Bermuda.

FHCs in Bermuda are arranged in many forms. In some cases, they hold the shares of financial groups of companies. In some instances, they are the operating bank or insurance company that acquires or holds, directly or indirectly, a controlling interest in a number of companies. It is common that the FHC is a non-operating FHC which does not itself perform any financial services.

The Authority undertook a review of FHC legislation from the UK and Singapore as well as a 2011 Consultation Paper (CP) issued by the Joint Forum, on the “*Principles for the Supervision of Financial Conglomerates*” which recognised the need for supervisors to take the FHC into account for the purpose of group or consolidated supervision. The scope of the Joint Forum’s suggested group was any group of companies under common control or dominant influence, including any financial holding company.

The Joint Forum is a tripartite group made up of the Basel Committee on Banking Supervision (Basel Committee), the International Organisation of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS). It was created to take forward work of common interest to the members. As such, it is not surprising that the trend internationally, as reflected in positions taken by the group, is moving toward a direct group supervision approach which includes the holding company.

In an effort to remain in line with international regulatory standards, the Bermuda Monetary Authority (the Authority or the BMA) has developed a group-wide supervision framework for its insurance groups which leverages its power over the local regulated company to indirectly influence the parent or head of the group. The Authority also performs consolidated supervision for its banking groups including those which have operations in other jurisdictions. The Authority is of the view that it needs a more formalised approach to financial group supervision,¹ including a more effective framework that allows for the consideration of the FHCs including licensing, regulation and the supervising of FHC structures.

¹ Financial Group supervision includes consolidated supervision of banks and other related financial companies.

It is against this backdrop that the Authority has decided to explore the approach of direct regulation of the parent financial holding company. The Authority welcomes recommendations, comments and any feedback that industry may deem of benefit to this project.

II. Background

1. For the purposes of this DP, a FHC is a company incorporated in Bermuda, which owns an operating financial services subsidiary but does not itself conduct financial services in the jurisdiction. Internationally, it is common for financial groups to be organised under holding companies. Growing international recognition of the role and importance of the FHC has prompted regulators in many jurisdictions to include the FHC in their scope of group supervision, either directly or indirectly, through a regulated entity like a bank or insurance subsidiary. The US, Australia and Canada are among the countries that have established legal frameworks for the regulation of FHCs.
2. Regarding the banking and financial groups in Bermuda, generally it is the Board of the ultimate parent undertaking (or parent holding company) that decides overall group strategy and organisation, risk management procedures and intra-group transactions including flows of capital and liquidity. Consequently, actions taken by a parent can affect the Bermuda regulated entity's ability to comply with its regulatory requirements. This could pose increased operational risks where the interests of the parent and subsidiary are not sufficiently aligned.
3. There are situations in Bermuda in which a parent holding company expands its risk profile by participating in certain investment activities and funds. While the BMA regulates and inspects financial institutions operating in or from within the jurisdiction it has no power over the non-operating holding company. Consequently, there are circumstances in which the Authority may wish to direct a parent undertaking of a regulated group to act, or refrain from acting, in a certain manner.
4. To support effective prudential oversight of financial groups, the BMA proposes FHC legislation. The new FHC Act is intended to achieve, among other things, the following:

- a) First, it would provide greater clarity to the industry and other stakeholders on the prudential standards and expectations applicable to financial groups held under the FHCs in Bermuda.
- b) Second, it would enable the BMA to strengthen prudential oversight of a financial group in the jurisdiction particularly in regards to mitigating intra-group contagion risk, preventing the multiple uses of capital within the group, and limiting group concentration risk exposures.
- c) Third, it would also help Bermuda meet the international standards on group-wide supervision.

III. Designation as a Regulated Financial Holding Company

5. A primary objective of FHC regulation is to strengthen prudential oversight of the financial group in Bermuda. To this end, the head of the financial group has to be identified and the boundaries of the financial group established for regulation. In the case of a financial group based in Bermuda, the head of the financial group would be the parent financial institution or highest level FHC incorporated in the jurisdiction. In some cases, it may be useful to also directly regulate an intermediate FHC within the group, particularly if the intermediate FHC holds Bermuda-based subsidiaries that the Authority assesses to be significant to Bermuda's financial system stability or the financial health of the group.

6. A key component of the proposed FHC Act would be the power for the Authority to be able to designate who the parent company is for supervisory purposes. This is intended for cases where it is assessed on a risk basis that there is an identified need to strengthen the overall effectiveness of group prudential oversight, and support the safety and soundness of the financial system. To this end, not all FHCs in Bermuda would be regulated by the Authority. The regulatory proposals in this CP would apply only to the FHC groups that are designated by the Authority on an as needed basis.

7. The FHC Act would set out the minimum assessment criteria which the Authority would consider in assessing whether an FHC should be designated for regulation. This includes whether the following conditions apply:

- (a) Ultimate parent of a Bermuda entity that is part of a financial group

Where the FHC is the ultimate parent of a Bermuda entity that is part of a financial group with a bank, insurance, or other regulated financial entity in Bermuda and the Authority is the home supervisor of the entity.

(b) Intermediate FHCs within a financial group

Where the FHC is an intermediate holding company of a financial group in Bermuda and the Authority is the home supervisor of a member of the group, then the significance of the bank, insurance or other regulated financial subsidiary in Bermuda to the financial system or to the intermediate FHC group would be evaluated.

c) In the case where there are no holding companies in Bermuda; and

(i) the financial group of which the intermediate FHC is a member is not subject to group-wide supervision by its home supervisor; and

(ii) the FHC's subsidiaries in Bermuda are significant to the local financial system, or to the intermediate FHC group.

Consideration would be given to the extent to which the parent holding company based overseas is subject to effective consolidated supervision by its home supervisor. Additionally, the Authority would justify regulation where it has assessed that it supports the stability of the Bermuda financial system or effective group prudential oversight. In rare circumstances and in an effort to exercise effective consolidated supervision, it may be necessary for the Authority to direct that a group establish an intermediate holding company in Bermuda.

8. As previously noted, **not all** FHCs would be designated for regulation. Instead, those that are not designated may be required to furnish the Authority with information that is necessary to carry out its oversight and supervision functions.

IV. Control of Shareholdings

9. The Authority notes the critical role played by banks and or other financial companies in Bermuda's financial system and the larger economy. As a result, specific shareholding thresholds are incorporated at which shareholders are required to obtain approval for their control of Bermuda incorporated banks and insurance companies.

10. Because FHCs, by definition, are the parent companies of banks as well as other financial subsidiaries and can exercise control over them, the Authority is of the view that it is pertinent that shareholders with substantial or controlling interest in those

FHCs be required to obtain the Authority's approval to do so. Accordingly, the FHC Act would require substantial and controlling shareholders of a designated FHC to obtain approval for their interests in a manner consistent with existing requirements under the Banking Act (BA) or other relevant Act. On receipt of an application for approval, an assessment of shareholder fitness and probity, and of the nature of their likely influence over the conduct of the designated FHC would be completed prior to the granting of an approval.

11. In addition, the FHC Act would provide for corporate governance regulations on the roles and responsibilities of directors, and the appointment of key persons such as the board/board chair of the FHC.

V. Regulation and Supervision of FHC Groups

12. The licensed Bermuda -based subsidiaries of Bermuda FHCs would continue to be regulated under the relevant act. To achieve consistency in the regulatory and supervisory approach towards financial groups, whether they are held under a Bermuda incorporated operating entity or a designated FHC, regulatory requirements under the BA and or other relevant Act would be reflected in the FHC Act, where appropriate. For example, an FHC group that comprises only banking entities would be subject to rules at the group level consistent with rules that apply to a banking group regulated under the BA.

13. The FHC Act would empower the Authority to prescribe prudential requirements to support the safety and soundness of the FHC group. These include:

- requirements on group-wide capital adequacy to ensure that the FHC group maintains financial resources commensurate with the group's business
- prudential limits on lending and investments to ensure that exposures are not unduly concentrated
- requirements for regular reporting on the finances and other information on the FHC group

14. The FHC Act would also provide for the Authority to conduct on-site inspections and investigations of the FHC and its subsidiaries.

15. In addition to prudential regulation, the FHC Act would contain enabling provisions to support the Authority's regulatory and supervisory framework. Key administrative provisions would include powers to:

- make regulations and issue directions
- require the submission of annual audited accounts of the FHC
- impose civil and administrative penalties on the FHC for the contravention of FHC regulations

16. The Authority notes that where these powers already exist in the respective prudential Acts then a consistent standard would apply. In particular, as is required in other financial acts, the Authority would issue its Statement of Principles on how it proposes to use its powers in the FHC Act regarding specific issues such as:

- in interpreting the minimum criteria
- in exercising its powers to register or cancel the registration of an FHC
- in exercising its power to grant or impose conditions on an FHC
- in exercising its power to obtain information, reports and to require the production of documents
- in exercising its powers to make adjustments to enhanced capital requirement, and available statutory capital and surplus
- in exercising its powers to issue directions to a registered person
- in exercising its discretion to determine whether to be a group supervisor
- in exercising its powers to impose a civil penalty

17. The Authority is aware that the issue of the regulation of financial holding companies is a complex one and the listed proposals are not intended to be an exhaustive list. Rather, they are a sample of the issues that must be considered. It is the Authority's plan that after a critical analysis of the feedback from our industry stakeholders is completed to follow up this DP with a CP and draft legislation.

VI. Summary of Proposals.

Proposal 1- Only FHCs designated by the Authority would be subject to the proposed FHC regulatory framework. A list of all designated FHCs would be published by the Authority on its website.

Proposal 2- In determining whether to designate a Bermuda-incorporated FHC for regulation, the Authority would consider the following conditions:

- (a) Whether the FHC is the parent of a financial group, that has a bank or insurance or other regulated financial subsidiary in Bermuda;
- (b) Whether the FHC is an intermediate FHC under a parent FHC or regulated financial institution in Bermuda and whose subsidiaries in Bermuda are significant to the jurisdictions financial system; or
- (c) In the case where there is no holding company in Bermuda; and
 - (i) the parent group of which the intermediate FHC is a member is not subject to group-wide supervision by its home supervisor; and
 - (ii) the FHC's subsidiaries in Bermuda are significant to the local financial system, or to the intermediate FHC group.

Proposal 3 - Non-designated FHCs incorporated in Bermuda with at least one regulated financial subsidiary in Bermuda may be required to submit information on the financial group to the Authority.

Proposal 4 - The scope of the group for a designated FHC would include, at a minimum:

- (a) in the case of a Bermuda parent FHC, the parent FHC and all Bermuda regulated subsidiaries;
- (b) in the case of an intermediate FHC in Bermuda that is part of a larger Bermuda based financial group, the intermediate FHC and all subsidiaries both local and overseas; and
- (c) in the case of a foreign-owned intermediate or ultimate FHC, the controlling intermediate FHC in Bermuda and all subsidiaries both local and overseas.

Proposal 5 - The shareholding and control thresholds would be consistent with the requirements stipulated in the BA or Insurance Act (IA), as appropriate.

Proposal 6 - Corporate governance requirements for FHCs would be consistent with those in other financial regulatory acts. For example, requirements for FHCs of insurance companies would be consistent with the requirements in the IA for insurers. The same situation would apply in the case of FHCs of banks. The FHC as the controlling parent entity is in a position to make key decisions, and profoundly influence the business direction and risk culture of the group. It is therefore necessary to ensure that its board of directors is suitably qualified, competent and able to discharge its oversight role effectively.

Proposal 7 - All FHC groups would be required to develop and maintain appropriate capital management policies, and capital planning processes that consider risk assessment on a group-wide basis. The FHC's board of directors would be responsible for approving and reviewing the capital management policies, and capital planning processes, as well as the capital plans and group-wide risk assessment.

VII. Glossary

Financial holding company (FHC) means -A non-operating company that holds as its subsidiary, a bank or an insurance company or other Bermuda regulated financial institution.

Ultimate parent financial holding company means-The financial holding company at the head of a financial group.

Intermediate financial holding company means-The financial holding company at the head of a subgroup within a larger financial group.

Controlling intermediate financial holding company means-An intermediate financial holding company deemed to exercise effective control over at least one Bermuda incorporated bank, an insurance company or other regulated financial institution.

Financial group means -A group of companies headed by an FHC or a bank or an insurance company and comprises every company in which the FHC, bank or insurance company acquires or holds, directly or indirectly, a controlling interest.

Controlling Interest -A reference to “controlling interest” in relation to an FHC shall mean:

- (a) any beneficial interest exceeding 10% of the total number of issued shares in a company;
- (b) control over more than 10% of the voting power in a company; or
- (c) any interest in a company, where the directors of the company are under an obligation, whether formal or informal, to act in accordance with the FHC’s directions, instructions or wishes, or where the FHC is in a position to determine the policy of the company.
