Commissioner Mairead McGuinness
Financial services, financial stability and Capital Markets Union
European Commission
1049 Bruxelles/Brussels
Belgium

Brussels, 1 March 2022

Dear Commissioner McGuinness,

The undersigned associations write to you to provide feedback on the publication of the European Commission's draft Capital Requirements Directive VI ('CRD VI').[1] We are groups representing institutions headquartered in international jurisdictions who are deeply committed to, and invested in, the European Union.

This letter provides views on the new requirements that we see as most challenging. These relate to the following proposed provisions: (i) article 21c requiring the establishment of branches or subsidiaries for the provision of banking services by third-country undertakings and (ii) articles 47 and 48 which would impose additional prudential requirements on third-country branches ('TCBs') in the EU.

We support the Commission's efforts towards harmonisation of banking supervision and standards across Member States, as this will bring enhanced transparency and strengthen supervision across the EU banking landscape. These provisions, however, must balance the objectives of bringing benefits to EU consumers, corporates and financial institutions through improved access, choices as well as reduced friction and costs in financial services.

We do not believe the Commission's proposals strike the right balance amongst these objectives as currently drafted. Rather, the Commission's proposals in CRD VI represent a major change from the current regulatory environment for third-country banks undertaking business in the EU. If implemented as currently drafted, it would have a detrimental impact on the ability of third-country banks to provide services to EU clients, leading to a reduction in choice, worsened prices for European firms as well as a reduction in liquidity in EU financial markets.

Furthermore, the Commission's proposals with regard to third country branch capital and liquidity requirements do not seem to take into account the long-standing principle of home country consolidated supervision, but rather seem to promote a principle of localised supervision and regulation, separate from what has been agreed at the international level through the Financial Stability Board and Basel Committee on Banking Supervision. We urge the Commission to revise the prudential requirements to avoid any unnecessary duplication in the context of a single legal entity's regulatory capital and liquidity requirements.

Restrictions on cross-border business

The current drafting of article 21c would be a significant change to the manner in which foreign banking institutions are currently allowed to provide certain services in the EU. At present, not all banking and markets activities require a physical presence in the EU to conduct specified activities within individual Member State jurisdictions. Rather, the national regimes for the provision of cross-border services without a physical presence govern market access where certain conditions are met. These regimes have been long-established and allow for a wider provision of services to customers in jurisdictions that may not benefit from the local provision of such activities. This has helped boost liquidity flows and the availability and price competitiveness of product offerings within jurisdictions while also allowing financial institutions to maintain efficiencies in terms of skills, risk management and financial resources.

Requiring institutions to establish a physical presence for the provision of any kind of banking services and market activity or to operate strictly upon the basis of reverse solicitation would bring significant change to the

[1] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021PC0663&from=EN

current regime, and potentially lead to severe consequences for the continued provision of services by foreign banking institutions. The current drafting would lead to a series of impracticalities that would be difficult to overcome. For example, it is not practical for third country institutions to establish a branch in every Member State in order to provide services to more remote or less developed markets within the EU on a sustainable basis. This would unnecessarily limit liquidity and clients' options within those jurisdictions, with likely adverse consequences for competition that would be to the detriment of EU-based corporates and entrepreneurs, including fewer options for raising finance, managing risk and making cross-border payments and investments. Requiring institutions to operate on a reverse solicitation basis would, like requiring a physical presence, not deliver the same level of competition or market breadth as existing cross-border arrangements.

Restricting cross-border EU market access for third country banks via the introduction of a branch requirement could put EU clients at a competitive disadvantage, with consequent downsides for the European economy and potential barriers to international trade. The financial stability concerns that the Commission cites in its explanatory memorandum can be addressed in a less intrusive manner. Existing bilateral market access agreements between EU Member States and third countries prove that national competent authorities (NCAs) can guarantee financial stability through their important role in licensing, supervising and monitoring third country bank activities in their territory without requiring banks to have a physical presence. Non-EU banks that operate under such national regimes in individual Member States (eg, Germany) must complete authorisation procedures with the competent authorities before starting cross-border activities. Once authorised, such non-EU banks must adhere to local investor protection standards which are determined by respective EU Member State law. We therefore encourage EU legislators to remove the branch requirement and aim for minimum common standards that ensure continued cross-border market access based on sound supervisory, licensing and investor protection principles.

TCBs – Intragroup Funding

Wholesale and universal banks operating in the EU, as well as multiple jurisdictions globally, require the ability to access funding and liquidity from their parent entity and to move that liquidity freely throughout the group, to where it is needed to service customers.

In addition to subsidiaries, third-country banking entities use TCBs to facilitate cross-border intragroup funding to other branches and subsidiaries in the EU and elsewhere, which enables the provision of a broad range of banking services to clients across the EU.

The branch structure allows banks to utilise the group balance sheet to support larger transactions by deploying capital and liquidity in a more rapid fashion and allowing EU corporates to be able to access the global balance sheets of non-EU banks.

As currently drafted, the proposals in Article 48cwould significantly increase the cost of capital for third-country banks, ultimately leading to a reduction in lending capacity from third-country banks, which would have a long-term negative effect on the provision of finance in the EU. Article 48c would restrict the activity of TCBs to the Member State in which they are established and impact their ability to interact with other entities of the same third-country banking group, restricting the role of TCBs to undertake intra-group financing and access capital and liquidity from the parent entity. Furthermore, Article 48j specifies that the 'interconnectedness' of a TCB's activities will be taken into account as a 'systemic importance indicator' – this will likely result in TCBs restricting their operations to avoid possible subsidiarisation, leading to a reduction in lending capacity in the EU.

The ability for TCBs to conduct intragroup funding activities brings significant benefits for EU clients and for financial stability. However, the €30bn threshold set for systemic TCBs does not differentiate between intragroup funding and other banking funding activities. A simple balance sheet threshold is not an accurate representation of the systemic risk, if any, posed by a TCB. More consideration should be given to which activities pose the most risk, rather than the sum of all activities as a whole. As such, we would argue that group funding activities by third-country banks from Capital Requirements Regulation (CRR) equivalent jurisdictions should be excluded from any threshold, as they are subject to consolidated capital requirements at the group level.

Local liquidity requirements for TCBs

Given the importance of being able to move liquidity freely between jurisdictions through a branch network, we have concerns regarding the proposed provisions that would impose localised liquidity requirements at the branch level in addition to the local capital requirement that is also being proposed. Firstly, a standalone liquidity requirement for a TCB does not recognise that it is in fact part of the same legal entity as the parent bank and therefore the consolidated group liquidity position already takes account of the branch 'balance sheet'. Furthermore, the requirement as drafted is lacking in proportionality given that TCBs often hold fully funded transactions that do not require additional liquidity support. At a minimum, any liquidity requirement should exclude fully funded transactions from the liquidity calculation.

We are also concerned with the proposed requirement to maintain additional liquidity resources in an escrow account with an EU bank. Such a requirement would i) mean that such assets are not available to meet short-term liquidity needs and ii) create an unnecessary interdependence risk between banks. Finally, we are concerned that a requirement for localised liquidity in one of the world's major financial markets will set a poor precedent for other jurisdictions, especially if there is no provision for deference to home country regulations. If other jurisdictions were to follow suit with their own localised financial requirements this would result in significant liquidity resource duplication which undermines the business case for branches, and ultimately, cross-border banking. It should be noted that both EU and non-EU headquartered banks have extensive overseas branch networks, so any global trend to trap or fragment liquidity could have significant consequences for overall financial stability and the provision of cross-border banking.

Given the concerns outlined above, we recommend the liquidity provisions be revisited and amended to more carefully take into account home country liquidity requirements, the business model and actual risks that are being run locally as well as the practicalities of being able to access any local liquidity in an unhindered manner. Where the home country liquidity requirements are equivalent to the Basel standards, banks headquartered in such jurisdictions should be exempt from EU branch liquidity requirements under the principles of deference and substituted compliance.

Our institutions remain highly invested in, and committed to, the EU. The EU is a valuable and important market for global banking groups. The growth and stability of financial services in the EU is vital to ensuring the stability of the global financial system. We are keen to work with policymakers to find collective policy solutions that underpin stable, long-term financing for European business and economic growth in the region.

Yours sincerely,

American Chamber of Commerce to the European Union (AmCham EU)
Bank Policy Institute (BPI)
Japanese Bankers Association (JBA)
Swiss Finance Council

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