ALLEN & OVERY

CRD VI – What EU branches of third country banks need to know

26 January 2024

The EU is harmonising the rules on the prudential supervision of EU branches of non-EU banks under CRD VI. The new EU-wide third country branch regime will introduce minimum requirements including capital and liquidity requirements, internal governance obligations and rules on outsourcing management. CRD VI will further establish a tiering system for third country branches based on the size and activities and a subsidiarisation power for systemic branches. Existing TCBs will need to apply for re-authorisation, unless they already meet the minimum requirements in CRD VI, in which case competent authorities may decide to grandfather their existing authorisation. Lastly, third country branches will also become subject to onerous reporting and record-keeping requirements.

Background

The European Commission proposed revisions to the Capital Requirements Directive (**CRD**) and Regulation (**CRR**) in October 2021, known as the '2021 Banking Package'. In December 2023 the final elements were politically agreed and endorsed by Council and Parliament. The text is subject to a final vote by Parliament before publication in the Official Journal.

Art. 21 c of CRD VI introduces a prohibition on the provision of cross-border banking services into the EU by a third country institution, coupled with harmonised minimum requirements for the regulation of branches of third country institutions.

In this note we give a high-level overview of the harmonised minimum requirements in CRD VI for the regulation of branches of third country institutions and the impact. We do not cover the implications for providing cross-border services by third country institutions into the EU which is discussed in a **separate briefing**.

Current state of play

EU law leaves the treatment of third country branches (**TCBs**) largely to national law requiring only that they be treated no more favourably than EU-bank branches.

This situation has led to a fragmented regulation of TCBs across the EU. In some Member States TCBs were regulated quite heavily while in some Member States there is sort of "light touch regulation" including intergovernmental agreements between the Member State and the third country for the treatment of TCBs and reliefs e.g. on the treatment of the endowment capital, liquidity waivers and large exposures. In light of this, the European Banking Authority (**EBA**) published a report on TCBs in June 2021, noting the disparity in local requirements and recommending harmonisation. This finding is now reflected in CRD VI.

(Re-)Authorisation of TCBs

CRD VI establishes that in order to provide core banking services (deposit-taking, lending, guarantees and commitments) in a Member State, third-country institutions must establish a branch and apply for authorisation. The requirement to seek authorisation is coupled with a set of minimum requirements that must be met by all TCBs in the EU.

The authorisation requirement will generally also apply to existing TCBs that have been fully licensed for some time, should they wish to continue to provide core banking services. There is a discretion for national competent authorities (**NCAs**) to grandfather such existing authorisations that have been granted 12 months or more before the application of CRD VI. For many TCBs that will apply if they are already subject to equivalent (or stricter) requirements. However, practically TCBs are required to conduct an in-depth assessment to identify if there are gaps that may mean they need to apply for re-authorisation and seek to understand the NCA's intended approach.

What are these minimum requirements?

Key requirements for authorisation will include:

(a) Authorised activities must be within the permitted activities contemplated by the home state licence of the applicant, i.e. the activities conducted by the TCB may no more than match those of the head institution;

(b) The authorisation must be limited to activities within the Member State where the TCB is established and expressly prohibit cross-border services into other Member States (except for intragroup funding transactions and transactions entered into via reverse solicitation);

(c) There must be no reasonable grounds to suspect that the TCB would be used to facilitate money laundering; and

(d) Compliance with minimum prudential requirements (for further detail see below paragraph 6 Ongoing requirements).

Categories of TCBs

In order to provide a degree of differentiation among TCBs and proportionality of requirements applicable to them, CRD VI establishes a classification system for TCBs based on their activities and size, and a subsidiarisation requirement for TCBs which are of systemic importance to protect financial stability (i.e. to require the establishment of a subsidiary instead of a TCB).

Class 1 and class 2 branches

TCBs would be classified into two classes:

(a) **Class 1**: TCBs that meet **at least one** of the following conditions:

- assets booked locally are EUR 5 billion or more in the preceding year;
- the branch has authorisation to take retail deposits locally and such deposits equal at least 5% of total liabilities or exceed EUR 50 million;

- the branch is not a ‘qualifying branch’ (see below).

(b) **Class 2**: The remainder will be designated as Class 2 branches.

Qualifying branches

CRD VI introduces a centralised equivalence assessment of the third country regulatory regime at EU level. TCBs with head offices in countries whose regulatory regimes have been assessed as “equivalent” by an implementing act of the Commission would be qualifying TCB, which would render them eligible for Class 2 for smaller TCBs and benefit from less stringent prudential requirements.

The equivalence assessment for qualifying branch status is unilateral, being initiated by the Commission. It seems possible that, as with other equivalence assessments provided for under EU financial services legislation, it could be used for “political”, as well as regulatory, purposes.

Subsidiarisation

CRD VI requires NCAs to have the power to require TCBs in their Member State to “subsidiarise”, i.e. to apply for a fully-fledged banking licence as a subsidiary.

NCAs are to be given that power in the following minimum cases:

(a) the TCB has been engaging in prohibited cross-border services;

(b) the TCB is considered as systemically important and poses significant risks to the financial stability in the EU or in the EU Member State where it is established;

(c) the aggregate amount of the assets of all TCBs in the Union which belong to the same third country group is equal to or higher than EUR 40 bn; or

(d) the amount of the TCB’s assets on their book in the Member State where it is established is equal to or higher than EUR 10bn.

It is important to note that before requiring a TCB to apply for authorisation as a subsidiary the NCA must conduct an assessment of systemic importance. That means merely reaching the thresholds in points (c) and (d) above will not suffice.

Additionally, the “subsidiarisation power” is designed as a measure of last resort. NCAs may only employ it after the NCA has either exhausted all other remedies in its supervisory toolbox or it can justify that these would be of no avail to address the risk. The powers that need to be applied first include the power to impose additional prudential requirements, require the TCB to restore its assets or business or to cease certain activities.

Ongoing requirements

CRD VI introduces a number of ongoing obligations for TCBs including minimum prudential requirements, internal governance obligations similar to credit institutions and a whole host of record-keeping and reporting obligations.

Minimum prudential requirements

Certain minimum prudential requirements are set for TCBs across the EU. These would have limited effect on many branches that are already subject to such rules under the national law of their host Member States.

Capital endowment requirements

The minimum capital endowment for each TCB would differ between Class 1 and Class 2 branches.

(a) Class 1 branches: minimum capital endowment of 2.5% of average liabilities over previous three years subject to a floor of at least EUR 10m. Eligible instruments include cash, cash equivalents and EU government or central bank securities.

(b) Class 2 branches: 0.5% of average liabilities over previous three years subject to a floor of at least EUR 5m.

Liquidity requirements

The liquidity coverage ratio (LCR) regime of CRR will apply to Class 1 TCBs. These would have to hold a reserve of high-quality liquid assets to cover outflows over a minimum 30 day period. This requirement could be waived for qualifying TCBs.

Internal governance

TCBs will have to appoint two managers of good repute and sufficient skill and knowledge in the Member State. They would also have to apply internal governance guidelines broadly mirroring the framework for banks, including remuneration and risk management.

Outsourcing management

There is a significant focus on outsourcing and back-to-back frameworks apparently influenced by Brexit. Nevertheless, outsourcing of critical/important functions to the headquarters would remain possible.

Booking requirements and record-keeping

TCBs would have to maintain a registry book to keep a comprehensive and precise record of all assets and liabilities booked or originated by the TCB in the respective Member State. TCBs would also be required to have policies on booking arrangements which provide a clear rationale for the booking arrangements and set out how those arrangements align with the TCB's business strategy.

EBA will develop Regulatory Technical Standards to further specify the requirements for booking arrangements and record-keeping by TCBs.

Reporting obligations

TCBs would be subject to a stringent set of harmonised reporting obligations, including information on their head undertaking. The EBA will develop common reporting templates for this purpose. Class 1 TCBs will have to submit reports at least biannually and Class 2 firms at least annually.

The reporting obligations will apply earlier than the rest of the TCB regime, i.e. immediately after expiration of the transposition period of 18 months (i.e. some time in Q3/Q4 2025).

The key information that would need to be reported includes:

- Assets and liabilities held on the TCB's books and assets and liabilities originated by the TCB;
- Confirmation of its own compliance with regulatory requirements and compliance of its head undertaking with third country requirements;
- Details of the head undertaking's business strategy in relation to the TCB, its recovery plans and impact on the TCB;
- The services provided by the head undertaking to EU clients on a reverse solicitation basis.

CRD VI only sets a "floor" of minimum requirements, and it remains open to Member States to regulate TCBs more strictly by applying the same requirements that apply to credit institutions in their jurisdiction. This represents the *status quo* in many jurisdictions. For TCBs in these jurisdictions most ongoing requirements will have a limited impact. In e.g. Germany that is generally the case, but reliefs are available e.g. on capital endowment, liquidity waivers and large exposure requirements. TCBs that benefit from such reliefs and waiver would also need to conduct a careful gap analysis with the CRD VI requirements.

Timeline

The application date of the new rules will depend on when the final text is published in the Official Journal (expected in spring 2024).

After publication there will be an 18-month transposition period for Member States to implement CRD VI via domestic legislation. This will be followed by a 12-month period of transitional relief for licensing applications before any restrictions on cross-border services apply.

Assuming the legislation is published in the Official Journal in spring of 2024, this would mean that the new licensing requirement would go live in autumn

2026. The reporting requirements will go live 12 months earlier.

What to do now?

Existing branches should ready themselves for application of the rules and will need to conduct a gap analysis between their current authorisation requirements and the minimum requirements prescribed by CRD VI. They will need to ascertain whether they need to apply for re-authorisation. Engaging with supervisors early to discuss whether a re-authorisation will be required would be the recommended course of action.

As indicated above, for TCBs in jurisdictions that already regulate TCBs rather strictly, most of the new minimum requirements will represent little to no change and many could expect their authorisations to be grandfathered. What will be a significant change will be the rather onerous reporting and record-keeping frameworks which include details on activities of the headquarters. These will likely deviate from what is currently reported. TCBs will need to make changes to their processes to ensure they correctly capture all the required information.

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