

Transforming bank prudential regulation – Issue 2 of 3

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On 23 November 2016 the European Commission published proposed amendments to the Capital Requirements Regulation and Directive, the Bank Recovery and Resolution Directive, and the Single Resolution Mechanism Regulation.

The Commission's stated aims include seeking to increase the resilience of EU institutions and enhance financial stability; measures to improve banks' lending capacity to support the EU economy; and measures to further facilitate the role of banks in achieving deeper and more liquid EU capital markets to support the creation of a Capital Markets Union.

Importantly the Commission is proposing to require third country banking groups that have significant European businesses to establish and obtain authorisation for an intermediate EU holding company. This proposal in particular demonstrates a move away from international harmonisation and mutual recognition of bank prudential standards in favour of greater regional fragmentation and ring fencing. It does not foresee these amendments going live before Summer 2019 at the soonest. However, here we lay out some areas to consider

This is the second client alert of three on this topic and focuses on the entirely new Commission proposals for the establishment of European financial holding companies and the implications for banks.

Read the first instalment [here](#).

Financial Holding Companies (CRD arts 21ab)

Where a banking group includes an EU established financial holding company¹ or a mixed financial holding company² it will be necessary to be authorised, and if necessary, comply with the consolidated financial requirements imposed under Capital Requirements Regulation (CRR). This implies that newly established European financial holding companies will have to comply with own funds, large exposures and the leverage ratio requirements on the basis of the consolidated position of the group.

¹ 'Financial holding company' means a financial institution the subsidiaries of which are exclusively or mainly institutions [banks and investment firms] or financial institutions at least one of such subsidiaries being an institution and which is not a mixed financial holding company -art 4(1)(20) of CRR

² mixed financial holding company means a parent undertaking, other than a regulated entity, which together with its subsidiaries, at least one of which is a regulated entity which has its head office in the Community, and other entities, constitutes a financial conglomerate art 2 of Directive 2002/87/EC

Third country banking groups (CRD art 21b)

The Commission is proposing to require third country banking groups that have assets in the EU totalling €30bn, or where the third country group is a Non-EU G-SII³, to establish an intermediate EU established parent undertaking that is authorised either as a credit institution, or as a financial holding company, or mixed financial holding company. The €30bn figure captures both affiliate assets and assets in branches.

This represents a very significant development which if carried through to the final legislation will have a significant impact for banking groups headquartered outside the EU that have businesses located in the EU including US banks and, potentially, UK banks post Brexit.

One implication of the proposal is that it will allow EU regulators to insist on the maintenance of localised (i.e. “trapped”) EU capital held at the level of the EU intermediate holding company that will be authorised and subject to supervision by EU regulators.

Although the details of the capitalisation requirements are yet to be fleshed out, the changes to the consolidation requirements appear to confirm that the intermediate financial holding company or mixed holding company of a third country banking group will need to satisfy own funds, large exposures and leverage ratio requirements on the basis of the consolidated position of the EU group.

Resolution at EU holding company level

The proposals for new EU holding companies also have implications for resolution authorities as it will enable resolution to be undertaken at the EU holding company level (the co-called ‘single point of entry’ model of resolution – see below). This is similar to the foreign bank holding company requirements in the U.S.

Implications for banks

- Where EU banking groups include financial holding companies or a mixed financial holding company then they should consider the potential impact of having to secure authorisation for such entities under proposed article 21a of the Capital Requirements Directive (CRD) and the application of consolidated prudential requirements to such entities.
- EU Banking groups affected by the proposal may wish to consider whether it would be beneficial to restructure the group.
- Non-EU banking groups should consider whether they satisfy the size criteria that would require the establishment of an EU holding company.
- Affected non-EU banking groups should consider the potential impact of having to establish and have authorised an EU intermediate holding company and possible ways to restructure or re-organise business to avoid the requirement.
- Non-EU banking groups that are required to carry out their retail and wholesale businesses in Europe through separate ring-fenced operations may wish to bring to the attention of the Commission the potential impossibility of complying with the requirement to establish a single European holding company.

³ non-EU global systemically important institution' (non-EU G-SII) means global systemically important banking groups or banks (G-SIBs) that are not G-SIIs and that are included in the list of G-SIBs published by the Financial Stability Board, as regularly updated –art 4(1)(133)

As a reminder, a link to our first client alert that covered:

- Leverage Ratio
- Own Funds and Liquidity requirements
- large exposures
- the Commission's approach to 'proportionality' and
- the treatment of SME exposures
- powers to exempt entities from CRD and CRR

can be found here:

<http://www.whitecase.com/publications/alert/transforming-bank-prudential-regulation-issue-1-3>

Links to the Commission's proposals can be found here:

http://ec.europa.eu/finance/bank/docs/regcapital/crr-crd-review/161123-proposal-amending-directive_en.pdf

http://ec.europa.eu/finance/bank/docs/regcapital/crr-crd-review/161123-proposal-amending-regulation_en.pdf

http://ec.europa.eu/finance/bank/docs/crisis-management/161123-proposal-directive-unsecured-debt-instruments_en.pdf

http://ec.europa.eu/finance/bank/docs/crisis-management/161123-proposal-directive-recapitalisation-capacity_en.pdf

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