February 14, 2022

Directorate-General for Financial
Stability, Financial Services and Capital
Markets Union
European Commission
1049 Bruxelles/Brussels
Belgium

Japanese Bankers Association

JBA comments on provisions in the draft EU Capital Requirements Directive VI ("CRD VI") regarding cross-border business and third country branches

Dear Sir/Madam,

The Japanese Bankers Association[1] (JBA) welcomes the opportunity to provide feedback on the European Commission's draft Capital Requirements Directive VI ("CRD VI"[2]). In this letter, we set out to respond to the proposed changes to the supervision of third country branches (TCBs) in the EU and to the proposed changes to the cross-border provision of banking services by third country undertakings.

1. General comments

The JBA supports the European Commission's efforts towards further harmonising supervisory powers and tools across EU Member States, as this will bring enhanced transparency and strengthen supervision across the EU banking landscape. Notwithstanding our general support for the objectives of the Commission's proposals in CRD VI (the Proposals), **we do have several significant concerns regarding the provisions of the Proposals in relation to cross-border business and TCBs,** which are highlighted herein. These provisions must be balanced with the objectives of bringing benefits for corporations and financial institutions through improved market access, choice and reduced friction in financial services within the EU. As currently drafted, however, we believe there will be significant adverse impact on the ability of TCBs to provide services to EU clients, leading to a reduction in choice for European businesses and a reduction in liquidity in EU financial markets.

[1] The Japanese Bankers Association is the leading trade association for banks, bank holding companies and bankers associations in Japan. As of February 14, 2022, the JBA has 114 Full Members (banks), 3 Bank Holding Company Members (bank holding companies), 77 Associate Members (banks & bank holding companies), 58 Special Members (regionally-based bankers associations) and one Sub-Associate Member for a total of 253 members.

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

Japanese banks are highly invested in and committed to the EU, helping to finance the European economy by providing EU clients with various kinds of financial service through TCBs in certain EU Member States. **We urge the European Commission to consider the critical contribution which the Japanese TCBs make to the European economy, and to strike the right balance between EU policy objectives**.

2. Role of Japanese banks in the EU

Japan is one of the EU's largest trade partners, and this partnership will further expand as a result of the EU-Japan Economic Partnership Agreement. **Through its support for Japanese and EU businesses, the Japanese banking sector not only facilitates trade flows between the EU and Japan but also with the rest of the world**. This enhances competition and brings diversity of funding sources, which, in turn, gives the EU businesses access to deep pools of global capital and liquidity.

Japanese banks are deeply integrated in the Single Market and by the nature of their businesses, provide long-term sources of finance for not only European clients but also for European infrastructure projects that has remained stable through changing market cycles. **Many of these activities rely on integrated solutions, including liquidity provision and other services, provided by the Japanese banking groups for the EU as a whole and through TCBs** in certain EU Member States. TCBs allow global banks to utilise their group balance sheet, which brings benefits for financial stability by virtue of being subject to global prudential requirements[3]. Examples include global credit facilities, large syndications, project finance, global trade finance, global risk management facilities, as well as support for the individual operations of clients on the ground in multiple EU Member States.

It seems unclear how such financial services could continue to be provided under the Proposals without either establishing branches in each Member State or significantly expanding the remit of an existing subsidiary or converting TCBs to subsidiaries, **which may not be viable from a cost perspective and is an inefficient use of capital as it does not enable Japanese banks to benefit from economies of scale through their global balance sheet**. We reiterate the need for the European Commission to consider before finalising the Proposals the critical contribution that Japanese TCBs make to the European economy.

3. Issues with the TCB Proposals

In general, the Proposals would lead to an increase in capital, liquidity and reporting requirements, but also an increase in counterparty and liquidity risks, and subsequently the cost of capital. Ultimately this will cause a reduction in lending capacity for Japanese banks looking to serve their existing and potential EU clients. This reduced economic activity would negatively affect the European economy and the Single Market as well as the

[3] Japan's Basel Framework is assessed as being compliant with the global standards agreed by the Basel Committee through BCBS's Regulatory Consistency Assessment Programme (RCAP). Japan is the only jurisdiction that deemed "compliant" among major financial markets.

ability of Japanese banks to fully support important EU policy objectives, such as the move towards sustainable finance and helping rebuild a post-COVID-19 Europe.

Based on the economic arguments set out herein, **it is essential that the regulatory and supervisory proposals for TCBs should be subject to a thorough impact assessment to achieve a proportionate regulatory treatment that enables business to continue**, a point acknowledged recently by the EBA[4]. Furthermore, the impact assessment should carefully consider the possible negative effects on funding for European and Japanese clients operating in the EU, on infrastructure, and on other investments.

We draw your attention to the following most pertinent points in the Proposals concerning TCBs for which the JBA requests further consideration.

i. Assuring visibility over TCBs

We agree that it is of critical importance that both the national competent authorities and EU-wide authorities have appropriate visibility over TCBs. In this context, the Proposals do not give adequate consideration to the existing framework of Supervisory Colleges and Crisis Management Groups, which is the well-established mechanism for cooperation between home and host authorities. In addition, TCBs are required to report the recovery plans covering the TCB to their competent authorities[5], which would have improved visibility over the TCB and its head undertaking. If the EU has concerns about TCBs' activities within the EU, **this should, in the first instance, be addressed by engaging with the home authority through the said cooperation mechanism, and in a close liaison between the national competent authorities and EU-wide authorities. If this proves insufficient, the primary option to be considered should be how the framework itself can be empowered to address the emerging risks, as opposed to introducing additional host requirements by way of new and/or additional regulations**.

In short, **the EU's concern for visibility over the TCBs should be addressed not by the proposed regulations that potentially could cause drastic change with consequential impact on the EU economy, but by steady efforts to improve existing home-host supervisory cooperation and closer communication between the national competent authorities and EU-wide authorities**.

ii. Ability to conduct cross-border business

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[4] REPORT TO THE EUROPEAN PARLIAMENT, THE COUNCIL AND THE COMMISSION ON THE TREATMENT OF INCOMING THIRD COUNTRY BRANCHES UNDER THE NATIONAL LAW OF MEMBER STATES, IN ACCORDANCE WITH ARTICLE 21b (10) OF DIRECTIVE 2013/36/EU, JUNE 2021.

[5] This requirement is stipulated in Article 47 of DIRECTIVE (EU) 2019/878 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 20 May 2019 (CRD5).

In the first place, the choice between serving clients via branches and/or subsidiaries should be the choice of individual institutions depending on their business model. Global regulators have long held that both branch and subsidiary structures have certain features that make them suitable for cross-border banking business[6]. The choice of entity is largely dependent on the business model and type of activity they undertake. In each case, the chosen entity is of course subject to the respective supervisory approvals. As the EBA mapping exercise indicates, nearly all non-EU banks operating in the EU do so via branches rather than subsidiaries. This is no different to the preference of EU banks operating in Japan. All EU-headquartered banks operating in Japan are engaged in banking business through branches.

There are currently cases where the national competent authorities permit certain "cross-border" activities to be conducted with clients in their Member States. Article 48c 3 (d) and Article 21c would, if implemented, override existing Member State regimes with a much-restricted regime, which would lead to a severe reduction in the choice of financial service providers for EU businesses. This reduction in choice and competition could reduce the quality of service and increase costs for EU businesses. In addition, a comprehensive impact assessment has not been conducted based on the restrictions imposed on cross-border business.

Furthermore, in certain circumstances, the restrictions on cross-border business would have a disproportionate impact on many peripheral EU Member States, who may no longer be served at all by TCBs. The EBA mapping exercise of TCBs indicated that only 17 Member States host TCBs and 6 of those only have one TCB within their borders. **To avoid such a disproportionate impact, it is important that TCBs are allowed to continue to conduct cross-border transactions into other EU Member States**.

The Proposals also bring uncertainty for cross-border transactions out of the EU. Furthermore, the Proposals may prevent EU corporations from setting up subsidiaries or expanding their overseas business to access funding in other jurisdictions. **If the EU is to strengthen its position as an open and international financial market, cross-border transactions should be allowed for TCBs not only within the EU, but also outside of the EU to the extent that this is permitted by the national competent authorities**.

It is our understanding that the main purpose of the Proposals is to bring about a common supervisory framework for TCBs in the EU, while still maintaining the openness of the EU financial market and encouraging third country banks to provide banking services into, out of and within the EU. If this is indeed the intention of the Proposals, **competent authorities should not be restricted to having the power to grant rights for TCBs to operate cross-border into other EU Member States and indeed outside the EU**. This could then be assessed against compliance with capital requirements as outlined in Article 48e. We see this as consistent with the aims of the EU's Capital Markets Union project and a logical and fair step towards further harmonisation across EU Member States.

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[6] Basel Committee on Banking Supervision "PRINCIPLES FOR THE SUPERVISION OF BANKS' FOREIGN ESTABLISHMENTS", May 1983 (https://www.bis.org/publ/bcbsc312.pdf), and "The Supervision of Cross-Border Banking", October 1996 (https://www.bis.org/publ/bcbs27.pdf)

iii. Importance of intra-group funding and interconnected activities

The ability for third country banking groups to transact with their own branches, subsidiaries or affiliates established in the EU is a critical factor in how global banks operating across regions manage their intra-group funding and risk management. However, the Proposals do not differentiate between intra-group funding and other external transactions in all aspects of the requirements[7], and therefore the Proposals could create unnecessary inefficiencies for global banks, including additional funding costs and the uneven challenge to expand local funding sources if a TCB cannot rely on intra-group funding. **We would argue that intra-group funding from/to CRR equivalent jurisdictions should be excluded from any threshold in order not to create any unnecessary liquidity concerns**. It should also be noted that the Japanese regulator, JFSA, does not impose such regulatory restrictions on European banks' branches in Japan, thus not allowing Japanese banks to compete on a level playing field.

Regarding intra-group funding, the branch structure and ability to access the group balance sheet enables banking groups to conduct funding activities more efficiently in wider global wholesale markets, rather than raising the necessary funds in each local market. This facilitates economies of scale and enables the TCB to utilise the credit standings and published credit ratings of the bank. We are not of the view that the use of TCBs and group balance sheets provides any unfair advantage for third country banks; rather, this provides funding to businesses that would not otherwise be available. The ability to utilise the group balance sheet through the branch also permits the bank to support clients with larger transactions. This in turn boosts economic growth and has a positive impact on financial stability through additional liquidity in EU markets. **We believe that the Proposals should be amended to ensure that intra-group funding activities by TCBs can continue**.

If the Proposals were to be implemented in their current form, there is also a concern associated with Article 48j and its required assessment of whether a TCB is of systemic importance for the EU and the Member State where it is established, by reference to the "interconnected activities" of a TCB with other TCBs and subsidiaries of the same group in the EU. Ultimately, this could prohibitively hinder the ability of a TCB to provide services in the EU, if all those activities are unconditionally deemed to be interconnected with branches or subsidiaries of the same group in other Member States. **We would urge that the definition of the term "interconnected activities" be appropriately narrowed down to cover only those activities entailing systemic risk**.

[7] For example, cross-border inter-group funding into, out of and within the EU and the €30bn threshold for subsidiarisation requirements.

iv. Reauthorisation of existing businesses

Reauthorisation takes up considerable time and resources from banks and their supervisory authorities alike. Using the EBA's data[8] on total assets as a proxy for authorisations, the analysis indicates that 86% of these reauthorisations would fall to supervisory authorities in Belgium, France, Germany and Luxembourg.

The reauthorisation process would raise significant uncertainty in the immediate term. On the assumption that the Proposals would require all TCBs currently operating in the EU to be reauthorised within 12 months from when CRD VI is transposed by EU Member States, existing TCBs could be forced to cease operation if their applications are still pending at the end of the 12-month adaptation period, which would pose considerable business continuity risks. This could affect the certainty and ability of global banks to serve their EU clients from TCBs once the deadline for reauthorisation approaches, disrupting the business-as-usual of supervisory authorities and banks.

To minimise disruption, **transitional arrangements should be put in place to allow supervisory authorities sufficient time to conduct their assessments and TCBs sufficient time to implement any new requirements, including, where necessary, through the grandfathering of existing authorisations to ensure the TCBs can continue to operate.**

Furthermore, it would seem unevenly disproportionate to require unconditionally all TCBs to obtain authorisations again from the ground up. Instead, **it would make more sense for them to only have to obtain any further authorisations in excess of those required by the applicable EU Member State, so as to meet the future minimum EU standards**.

v. Forced subsidiarisation

The Proposals stipulate that a competent authority may require a TCB to subsidiarise or take other actions such as restructuring their activities to fall below the relevant €30bn threshold. **We would urge competent authorities to consult in detail with the respective banks about which activities could and should be conducted safely and securely by their TCB(s) before thresholds are applied and subsidiarisation is required**. As an example, subsidiaries are generally unsuitable for providing large transactions and global financial services/products and the management of intra-group funding due to capital constraints. Therefore, third country banks would still require the use of TCBs to maintain their business model.

[8] REPORT TO THE EUROPEAN PARLIAMENT, THE COUNCIL AND THE COMMISSION ON THE TREATMENT OF INCOMING THIRD COUNTRY BRANCHES UNDER THE NATIONAL LAW OF MEMBER STATES, IN ACCORDANCE WITH ARTICLE 21b (10) OF DIRECTIVE 2013/36/EU, JUNE 2021.

Using a threshold merely focusing on the total asset value does not necessarily represent systemic risk, if any, posed by a TCB. **We would argue that competent authorities should be given the power to make a supervisory judgement on whether a TCB should have systemic importance, and it should be made clear that the requirement of subsidiarisation is intended as a final resort**, given the extent of supervisory and regulatory measures available prior to a requirement to subsidiarise. **Again, we reiterate our view that, at the very least, intra-group funding from/to CRR equivalent jurisdictions should be excluded from any threshold**, as this is subject to rigorous capital requirements at group level. Japan is one of the jurisdictions that are recognised as being "compliant" with the global standards agreed by the Basel Committee through BCBS's Regulatory Consistency Assessment Programme (RCAP)[9].

The timeframe to comply with a regulatory requirement to subsidiarise or restructure should be proportionate with the action being undertaken. In the event of a requirement to subsidiarise, the proposed 3-month grace period in Article 48k (6) is insufficient to allow banks to make necessary changes to legal structures. **We would argue that the grace period should be agreed on a flexible basis with the regulator, commensurate with the degree and nature of the systemic risk posed by the TCB as well as its planned actions to reduce any systemic risk**.

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We thank the Commission for the opportunity to comment on the draft CRD VI package and hope to form a structured dialogue between regulators and the industry to explore the economic consequences of the Proposals and possible solutions.

Yours faithfully,

Japanese Bankers Association

[9] https://www.bis.org/bcbs/implementation/rcap_jurisdictional.htm