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Committee on Economic and Monetary Affairs, European Parliament

Economic and Financial Affairs, Council of the European Union

Financial Stability, Financial Services and Capital Markets Union, European Commission

Proposals Regarding the EU Banking Reform
(Proposed IPU Requirements)

Japanese Bankers Association

We, the Japanese Bankers Association ("JBA"), are a banking industry group in Japan which is comprised of 138 domestic banks and 51 foreign banks operating in Japan.

We submitted "Comments on the Proposed Reforms to EU Banking Rules"[1] on April 24, 2017 in response to a comprehensive package of reforms to EU Banking Rules, comprising of proposed amendments to the Capital Requirements Regulation ("CRR"), the Capital Requirements Directive ("CRD") and the Bank Recovery and Resolution Directive ("BRRD"), which was published by the European Commission (the "Commission") on November 23, 2016.

Of the issues described in the comment letter noted above, we would like to request additional considerations and modifications of provisions pertaining to the proposal on the intermediate parent undertaking ("IPU") which will be a significant issue for Japanese banks.

[General comments]

From our standpoint, it is unclear whether the EC's proposal to require third country financial groups to establish an IPU (per Article 21b of the proposed amendments to CRD) is an optimal measure in order to achieve the stated objectives,

1 See the following site for JBA's previous comment letter ("Comments on the Proposed Reforms to EU Banking Rules" (2017/4/24)):
https://www.zenginkyo.or.jp/fileadmin/res/en/news/news170424.pdf

including the improvement of resolvability and strengthening of supervision for third country financial groups. Given the size of operations and business models of Japanese banks in the EU, the benefits of establishing an IPU would not necessarily outweigh the costs associated with the organizational restructuring a bank would have to go through, and therefore, we would like to request additional considerations and modifications of provisions to the EC's proposal.

- ✓ In the proposal, the Commission states that the establishment of an IPU is necessary in order to improve the resolvability of third country financial groups, however the Commission did not provide a concrete explanation about the mechanism behind how it could enhance resolvability.
- ✓ Given the profile, size and simplicity of Japanese banks' business in the EU, there could be cases where the banking group in the EU consolidated under an IPU may neither be directly supervised by the European Central Bank ("ECB") nor be subject to the resolution planning by the Single Resolution Board ("SRB") even if an IPU were to be established. Assuming that's the case, the establishment of an IPU would not lead to the strengthening of supervision and enhancement of resolvability especially in a case IPU and its operating subsidiaries are located in different EU member states.

In this context, we take the same view as a statement made by the Council of the European Union in its presidency progress report (para. 172) of June 16[2], pointing out "the lack of a cost/benefit assessment and the necessity of further discussions" with respect to the EC's IPU proposal.

If third country financial groups are required to establish an IPU, some banks may be forced to concentrate their assets and human resources in a specific EU member state, which may widen regional disparities within the EU. Therefore, the cost/benefit assessment should also take into account such possible adverse effects on third country financial groups and the EU itself.

We support and agree with the policy objectives of appropriately supervising third country financial groups that have a significant presence in the EU and improving their resolvability in order to prevent adverse effects on the global financial system.

We believe that additional consideration and modification of proposed texts are necessary by taking into account of points 1 to 4 described in [**Specific comments**] to

2 http://data.consilium.europa.eu/doc/document/ST-9484-2017-REV-1/en/pdf

ensure that the proposal meets its objectives appropriately. Furthermore, to develop the understanding of relevant parties and facilitate more practical discussions going forward, clarification of provisions would be needed as described in [**Other technical modifications**].

[Specific comments]

1. Obligations for global systemically important institutions ("G-SIFIs") to establish an IPU

The profile, size and complexity of operations within the EU vary across third country financial groups. Therefore, the principle of proportionality should be applied even to G-SIFIs.

Article 21b (3) of the proposed amendments to CRD requires the establishment of an IPU to all G-SIIs (G-SIFIs) having multiple subsidiary institutions in the EU without exception. This provision should be modified to apply the principle of proportionality, for example, as follows: "A G-SIFI is required to establish an IPU only if, as a result of consolidating its subsidiary institutions under the IPU, the IPU is deemed to be a significant institution as defined under the Single Supervisory Mechanism ("SSM") Regulation and becomes subject to ECB's direct supervision and the Single Resolution Board ("SRB") becomes the resolution authority."

- ✓ There could be a case where direct supervision by the ECB and resolution planning by the SRB will not be necessary since, even if an IPU is established, the IPU is neither deemed as a material sub-group defined in the TLAC Term Sheet developed by the Financial Stability Board ("FSB") nor a significant institution defined in Article 6(4) of the SSM Regulation (in fact, it is the likely scenario for Japanese banking groups). In such a case, respective competent EU member state authorities will presumably be responsible for supervision/resolution. If so, the establishment of an IPU would not necessarily lead to the strengthening of supervision and improvement of resolvability especially in a case where an IPU and its operating subsidiaries are located in different EU member states.
- ✓ Despite costs incurred for organizational restructuring, if the establishment of an IPU does not give significant benefits in the context of the strengthening of supervision and improvement of resolvability, it is an unreasonable requirement and entails a risk of undermining the Japanese banking groups' existing global governance framework which is in place aligned to business

line (i.e. commercial banking, trust banking and securities business).

2. Treatment of branches

Branches of third country financial institutions ("third country branches") are subject to home authorities' regulations and supervision, which are based on international standards, including the Basel Accords.

Therefore, we strongly support the Commission's proposal to not consolidate third country branches under an IPU and believe it unnecessary to modify the provision pertaining to the treatment of branches.

- ✓ Requiring third country branches to be consolidated under an IPU indicates that EU authorities consider the home authorities' regulation/supervision based on international standards, including the Basel Accords, insufficient and therefore, impose their own regulation/supervision on third country branches. This means that the sovereignty of home authorities to regulate and supervise third country branches will be reassigned to EU authorities. However we do not view regulation/supervision by our home authorities insufficient. We note that Japanese authorities do not impose their regulation/supervision on foreign financial institution's branches operating in Japan. And even in the U.S., it is not required to group branches of foreign financial institutions under the U.S. Intermediate Holding Company ("IHC").
- ✓ If non-EU (i.e. third country) financial groups are obliged to consolidate EU branches under an IPU while EU financial groups are not subject to the corresponding requirements in non-EU jurisdictions, this will create an unlevel playing field in terms of global competition and reciprocity between non-EU financial groups and EU financial groups will be undermined. We are concerned that such a situation may transform the EU financial market to an unfair, protectionist and closed market.
- ✓ If third country branches in the EU are consolidated under an IPU, the large exposures limit will be reduced significantly as the underlying capital base will become smaller. As a result, third country financial institutions will not be able to provide needed credit in the EU and third country financial groups will be forced to change their terms and conditions of existing loans, including the amount. This will have a negative impact on customer's funding activities, including EU companies, and ultimately, the EU economy as well.
- ✓ Traditionally, major Japanese banks operate in the EU in the form of branch. If third country branches were to be consolidated under an IPU, Japanese banks

would not only have to change the legal form of branches but also would have to restructure their loan portfolios to comply with the large exposure limit.

- ✓ Furthermore, other jurisdictions might require third country branches to be consolidated under a locally-incorporated company and to be subject to their local regulation/supervision, as a retaliation measure against the IPU requirement in the EU. This will lead to legislative fragmentation across jurisdictions, which will undermine global competition and possibly increase financial costs for end-users.
- ✓ Some officials of relevant EU institutions have publicly stated that it is necessary to consolidate branches under an IPU. However, since there are many corresponding issues as discussed above, we strongly disagree with such a view.

3. The UK's exit from the EU

While discussions of the proposed reforms to EU Banking Rules are expected to be held in parallel with Brexit negotiations, it is not appropriate to subject UK entities to the IPU requirement given that the UK's exit from the EU is anticipated.

In order to clarify that only those subsidiaries existing within the EU, not including the UK, will be subject to the IPU requirement, we suggest that the Commission specifies in the proposed amendments to the CRR or CRD that the cut-off date to determine subsidiaries to be consolidated under an IPU is set on or after April 1, 2019, given Brexit is scheduled in the previous month.

Furthermore, an adequate period of time for preparation should be provided between the cut-off date of determining subsidiaries to be consolidated under an IPU and the due date of establishing the IPU, in order to allow thorough considerations for its operations and structures, and carrying out necessary procedures for its establishment.

- ✓ Setting the cut-off date for determining subsidiaries to be consolidated under an IPU at a date before Brexit would theoretically mean that third country financial groups would have to temporarily consolidate UK entities under an IPU and then to remove them from that parent once the UK exits from the EU.
- ✓ Such organizational changes are not meaningful at all and would even impose significant operational burdens and risks on third country financial groups. This is also a significant burden for relevant supervisory/resolution authorities.
- ✓ Third country financial groups should be provided with a necessary preparation period to allow for considerations of a group-based operational / governance

structure and process for the IPU establishment (at minimum 12 months after the cut-off date, and at least 36 months after the legislation is posted on the official journal and takes effect). Otherwise, relevant parties will face confusion and third country financial groups will not be able to complete group restructuring in time, because they will be forced to simultaneously work on Brexit planning and the IPU establishment, under very unclear and uncertain environment.

4. Relating to the resolution strategy

(1) Ensuring consistency in the cross-border resolution process and coordination among relevant authorities

In order to develop an orderly cross-border resolution process of G-SIFIs, coordination among relevant authorities is essential because their resolution strategies within the EU should be consistent with the home authority's global resolution plan/strategy.

We therefore propose that the proposed amendments to BRRD or CRD to specify the process where the SRB or the resolution authority of each EU member state (hereinafter referred to as "EU resolution authority") coordinates with the home authority of a third country financial group, to consult and confirm that the establishment of an IPU does not impede the execution of the third country financial group's global resolution by the home authority and is consistent with the home authority's resolution plan/strategy.

- ✓ In the Key Attributes, the Financial Stability Board ("FSB") requires coordination among relevant authorities in cross-border resolution.
- ✓ The Commission explains that the objective of the establishment of an IPU is to improve the resolvability of third country financial groups. To achieve this objective, coordination between the EU resolution authority and the home authority should be ensured.

(2) Respecting the international agreement on internal TLAC/MREL

We support the policy goal of the Commission's proposal, i.e. to implement the FSB's TLAC requirement into the MREL requirement within the EU and ensure consistency with international standards.

Article 92b of the proposed amendments to CRR that imposes the MREL requirement only on material subsidiaries is consistent with the international standard. However, the proposed amendments to CRR do not provide specific guidance on the process for determining the necessity and specific requirements for internal TLAC/MREL.

Therefore, we request the Commission to insert the proposed amendments to CRR or BRRD in line with the FSB's international standard: "When designating an IPU or its subsidiaries as a material subsidiary, the EU resolution authority should provide the rationale and consult with the home authority on the necessity and specific requirements for internal TLAC/MREL (i.e. the amount and terms)."

- ✓ To align with the FSB's international standard, the application of the MREL requirements to an IPU (i.e. the amount and terms) should be determined through consultation between the home and the EU resolution authority.
- ✓ If the EU authority applies the MREL requirements at its discretion without consulting with the home authority, this will undermine the international agreements/standards and also lead to fragmentation of resolution strategy, making optimal allocation of the group loss-absorbing capacity difficult.
- ✓ We note the objective of MREL is to maintain critical functions and enable orderly resolution process without imposing any burden on taxpayers by securing loss-absorbing and recapitalization capacity of financial groups in times of resolution. Requiring third country financial groups with no material critical functions within the EU to consolidate their EU subsidiaries under an IPU, followed by the designation as a material subsidiary and applying the internal TLAC/MREL requirements to such groups would mistake the means for the end and would not be appropriate per se.

[Other technical modifications]

To develop the understanding of relevant parties and facilitate more practical discussions going forward, clarification of provisions would be necessary as described hereunder.

1. Definition of subsidiaries to be grouped under an IPU

We propose to clarify Article 21b (or in the recital of the CRD) of the proposed amendments to CRD that "institution" for purposes of the IPU requirement include credit institutions and investment firms in accordance with the definition under the CRD (i.e. institutions holding a license for banking or securities businesses), and that nonbanks and other financial institutions that do not have a license for banking or securities businesses are out of scope from the IPU requirement.

2. Ownership requirement of subsidiaries grouped under an IPU

We propose to modify Article 21b of the proposed amendments to CRD that subsidiaries consolidated under an IPU do not necessarily have to be a wholly-owned subsidiary of the IPU.

- ✓ The Commission's proposal uses a term 'subsidiary,' clearly indicating that an IPU is required to own a majority stake of subsidiaries consolidated under it. It is however uncertain whether the IPU needs to own 100% stake of such subsidiaries.
- ✓ A group structure varies across financial institutions. In order to optimize governance structure within the group, an ownership structure needs to be flexibly determined.
- ✓ Requiring an IPU to wholly own its subsidiary will undermine the flexibility of an investment strategy. Investments in the EU by third country financial groups may be reduced if they will not be able to execute less-than-100% strategic investments in banks and securities companies within the EU.

3. Scope of a third country group

We propose to modify Article 21b of the proposed amendments to CRD to clarify that the term "third country group" used in the article means the consolidated group of the parent company.

- ✓ Under the current proposed article, it is unclear if an entity in which the ultimate parent owns a minority interest (i.e. the entity is not within the scope of the parent's consolidation) is out of the scope of the "third country group."
- ✓ To consolidate an EU subsidiary of a company which is not within the scope of the parent's consolidation and to subject the EU subsidiary to a consolidated supervision is not reasonable and is highly impracticable.

Furthermore, with respect to an EU subsidiary of the company which is consolidated but not wholly owned by the parent company, we request that Article 21b of the proposed amendments to CRD explicitly allows the exclusion of EU subsidiaries from the scope of the IPU requirement if the supervisory authority provides explicit consent.

- ✓ Consolidating EU subsidiaries of non-wholly owned entity under an IPU would be difficult or even impossible, due to complex procedures and negotiation with other shareholders, especially in the case where the company is publicly traded.