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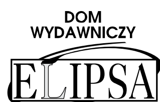

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Should supervisors allow capital waivers to be used within European cross-border banking groups?[1]

Abstract

A common theme in recent public European Union (EU) policy debates is improving integration of the EU financial sector. The suggestion is that the Euro area should be treated as if it were a single jurisdiction, across which banks should be able to centralise management of capital and liquidity. Financial fragmentation is said to trap capital and liquidity in local subsidiaries in Host countries which is suboptimal, hindering the cross-border provision of credit, and resulting in an inefficient economic allocation, with higher costs for customers, and lower profitability for the industry in the EU. The proposed policy involves measures to counteract ring-fencing of subsidiaries by Member States (MS), curtailing national options and discretions that limit the harmonization effects of the EU's Single Rulebook, and other regulations and supervisory practices that reduce banking groups' cross-border freedom. However, some of the national options affecting banks in the EU are still supported by MS as needed due to local risks, financial stability concerns.

Cross-border banking, often used as a yardstick to gauge the level of financial integration in the EU, can currently be realized in the EU in three basic forms: via subsidiaries, via passported branches or via cross-border provision of services. Among the solutions to fragmentation that many EU policy makers and governments focus on, at least in the Eurozone (EZ), are: completion of the Banking Union (BU), adopting regulations allowing capital, liquidity and MREL waivers in subsidiaries across borders, and the reduction of national options.

In November 2016, the European Commission (EC) proposed changes to Capital Requirements Regulation (CRR), Capital Requirements Directive IV (CRD IV) and Bank Resolution and Recovery Directive (BRRD) which would have allowed, under certain conditions (e.g.

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1 The article does not necessarily presents the opinions and position of PwC. The authors express appreciation for the comments received from colleagues in PwC network and from anonymous reviewers of the journal.

subject to guarantees), the application of capital, liquidity and MREL (Minimum Required Eligible Liabilities) waivers in the subsidiaries of EU banks operating in EU MS. These propositions faced strong opposition and were not ultimately adopted in the recently published CRR 2.0, CRD V and revised BRRD, due to lack of consensus among MS. But the arguments in favour of change have not disappeared.

In this paper, we start with a look at the current state of financial integration in Europe. We then examine the arguments for and against the use of waivers. Building on these arguments, we subsequently explain sensible preconditions that should be put in place – in addition to completing the BU – to allow the prudent use of such waivers. We also discuss alternatives to the use of waivers, based on expanding the use of branches and indicate incentives which can play a role in shaping the quality of cooperation between Home and Host supervisors.

Key words: capital and liquidity waivers, EU financial sector integration, SSM waiver, CRR 2.0, CRD V, BRRD, resolution, financial sector fragmentation, Home-Host supervisors, SRB, SSM, ECB

JEL: G18, G21,G28

Introduction

This paper examines the arguments for and against the use of waivers within European cross-border banking groups, and explains some sensible preconditions that should be put in place – in addition to completing the BU – to allow the prudent use of such waivers.

The debate over SSM waivers has become an important area of focus in the EU, as policymakers search for ways to improve economic growth via more efficient capital allocation across borders – using measures of financial integration to assess progress. So we start with a look at the data on financial integration and the most recent legislative efforts to address fragmentation, including by completing the Banking Union, as well as proposals for the use of capital waivers to enable more centralized pan-European banking. We then look at the arguments which have been deployed by both supporters and opponents of allowing, under waivers, the free flow of capital and liquidity within international banking groups in the EU..

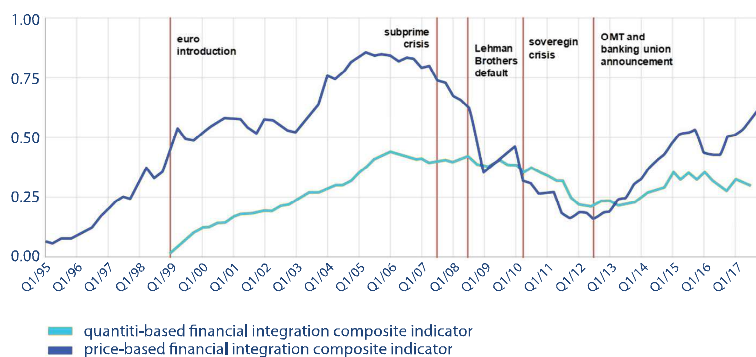
We note that alternatives to waivers are available – such as expanding the use of branches. We suggest that if future legislative efforts to enable capital waivers are to succeed, there needs to be more confidence in countries that primarily host cross-border banks, that tools and resources will be available in these host countries to ensure that a banking crisis could be managed smoothly.

Financial integration vs fragmentation – what does the data say?

Since financial fragmentation is one of the key concerns used to justify proposals circulating in the EU for centralization of capital and liquidity at group (parent bank) level under the concept of capital and liquidity waivers, we will look first at the level of fragmentation in EU and then ask whether the capital waiver is the right response to the issue.

The European Central Bank (ECB) uses two major indicators of financial integration (price-based and quantity-based), to assess the aggregated post-crisis integration. These indicators show improvement mostly in terms of ***price integration***, but not in ***quantity-based integration***. The ECB's price-based indicator illustrates clear increases during 2017 (see yellow line in the chart), after a correction in the period of 2015 to the end of 2016. But the quantity-based financial integration indicator has not improved much, and even decreased recently (blue line in the chart). The ECB explains the reduction as being a consequence of lower cross-border interbank lending. It says that its monetary policy has supported money market integration but that "injection of excess reserves – as expected – has reduced counterparties' needs to trade across borders within the euro area money market".

Figure 1. Price-based and quantity-based composite indicators of financial integration

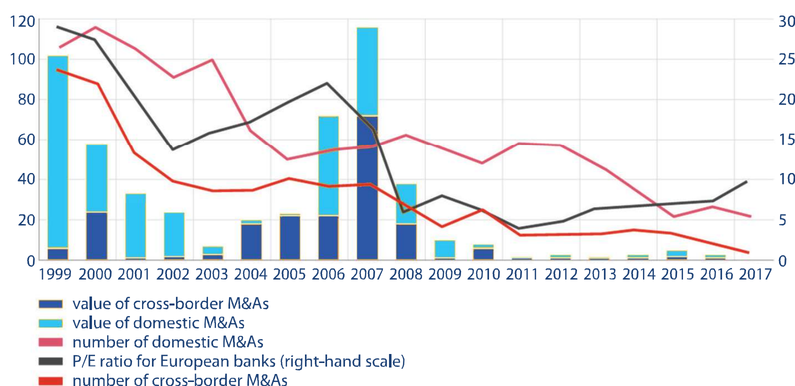


Source: Financial integration in Europe, ECB 2018; The price-based composite indicator aggregates ten indicators covering the period from the first quarter of 1995 to the quarter of 2017, while the quantity -based composite indicator aggregates five available from the first quarter of 1999 to the third quarter of 2017. The indicators are bounded between zero (full fragmentation) and one (full integration). Increases in the indicators signal greater financial integration.

Thus, the picture illustrates that prior to the financial crisis, integration was increasing steadily. But since the crisis the price and quantity-based indicators are both still below pre-crisis levels, and although price-based integration has been improving steadily since its post-crisis the quantity-based integration measures show no sign of increasing.

Another indicator of integration is cross-border merger and acquisition (M&A) activity. As illustrated in Figure 2, both the number and value of M&A activity are very low, only a fraction of their pre-crisis levels. These very low levels have been continuing for several years, since the financial crisis.

Figure 2. Bank M&A activity and bank valuations



(left-hand scale: number per year, € billions; right-hand scale: P/E ratio in multiples of earnings)

Source: Schmitz Martin, Tirpák Marcel (2017), Cross-border banking in the euro area since the crisis: what is driving the great retrenchment? Financial Stability Review, ECB 2017; M&A data cover the EU28. Values only include transactions for which data are available. The value spike in 2007 reflects one very large deal (the acquisition of ABN Amro by a consortium comprising Royal Bank of Scotland, Fortis and Santander).

There may be many reasons why cross-border M&As (a measure of financial integration) are so low in the EU. Among them are poor financial results translating (in connection with growing capital requirements) into low bank ROE levels, often below costs of capital[2], poor dividend payment track records in recent years (also due to increasing capital requirements), concerns about persistent low interest rates resulting from long lasting monetary policy impact on banks' profitability, prolonged issues in banks (high legacy Non-Performing Loans (NPLs), in some countries, Anti-Money Laundering(AML) issues and resulting fines and reputational damage, etc.), absence of sizeable enough targets (to achieve desired C/I and economies of scale), and lack of real expansion opportunities combined with the perceptions of uncertain net benefits. The existence of SSM waivers may not have much impact, if these other factors remain unresolved. Other factors such as rising banks' capital requirements or special taxes imposed on banks or transactions, growing costs related to new consumer protection in the financial sector might also play additional role.

[2] The detailed status of some aspects of the current Home-Host arrangements after final version of CRR 2.0 and CRD V and BRRD 2.0 is issued has been expressed in EC communique http://europa.eu/rapid/press-release_MEMO-19-2129_en.htm which clearly indicates that MREL will be required at subsidiary level.

One of the conclusions that was drawn after crisis was that the EU needs a more diversified banking system and to avoid too much bank concentration at national and cross-border levels. In that respect, M&A has the potential to impact financial stability as a factor leading to greater concentration of banking systems in the EU, even if emergence of even bigger EU banks would lead to EU banking champions better able to compete globally. Before the financial crisis of 2007–2009, M&A activity, as illustrated in the Figure 2, resulted in the emergence of several large, cross-border banks (e.g. Royal Bank of Scotland, Fortis), which proved difficult to handle in the crisis, and which ultimately required public bail-outs.

Proponents of cross-border M&As indicate that they would results in much greater economies of scale, better profitability and the emergence of stronger global EU banks (EU champions). They add that post-crisis measures substantially reduce the potential impact of the failure of such EU champions. These measures include: a strong SSM – independent of (at least direct) political pressures, much higher capital requirements for Global and Locally Systematically Important Banks (Total Loss-Absorbing Capacity/TLAC, systemic buffers), and – in some countries – implementing separation between investment banking and deposit taking (UK), and much greater scrutiny of the risk models for capital optimization.

With the decline in M&A activity, questions about the profitability of EU banks, and their growing capital requirements (sometimes driven locally – e.g. via local buffers or other capital add-ons), a new policy debate started in 2016 with the first draft of CRR 2.0. Many EU policy makers (both at EC, EEA and from some Member States) argued in support of capital, liquidity and MREL waivers for local subsidiaries of home country parent banks, saying that such wavers could be an important factor in overcoming financial fragmentation. However, other participants in the discussion indicated that alternative issues may play a role in the lower than expected level of cross-border integration, such as overbanking, legal and economic uncertainties (e.g. over insolvency or foreclosure regimes), and an unattractive fiscal environment. The lack of SSM waivers may not be the most important of such factors.

The benchmark given in many discussions about integration vs. fragmentation by both EU policy makers and some major EZ banks is the United States of America (US)[3], with its federal system, common institutions and agencies, underpinned by strong, popular political buy-in to the mutualisation of risk mitigation and support. But Europe, unlike the US[4], is still a union of sovereign Member States, whose common institutions and support mechanisms, even within the 19 EZ countries, are not endowed with the same level of popular, political commitment to extending support across borders. The project of centralising capital and liquidity in European banking groups, or making it moveable across such groups, will therefore need

[3] See for example EGOV Briefing ("Liquidation of Banks: Towards a FDIC for the banking Union").

[4] In the US there is also state level licensing and supervision process for certain segments of banks, mostly local banks, while the Federal Reserve, the Office of the Comptroller of the Currency and the FDIC play more nation-wide, federal roles.

a different system of controls and commitments. A solution to the fragmentation issue will need to be acceptable to both Home and Host MS, which means carefully planning how to withstand crises which can affect any banking system.

Legislative efforts to address financial fragmentation

As mentioned above, efforts to address fragmentation were part of the initial 2016 legislative proposals to amend the CRD IV [5]. In that first legislative proposal for an amended CRR (and BRRD in respect of MREL) some new solutions were tabled to help European cross-border banking groups, especially in the BU, to manage liquidity, capital and MREL in more efficient, centralised ways[6]. The idea was to allow management of capital, liquidity and MREL at the level of EU banking groups, so they could be allocated efficiently to the various parts of the group, instead of holding capital and liquidity at subsidiaries in EU Host countries. The idea was to give such the option of granting capital and liquidity waivers for cross-border banks to Competent Authorities. Nevertheless, the EC in its Explanatory Memorandum, recognized that even in the BU, there were concerns among the Host MS. The latter indicated that insufficient liquidity or capital at the level of subsidiaries might have adverse fiscal consequences for such host MS, in the event of problems. The Commission believed that these concerns were addressed in the CRR 2.0 (Nov 2016) proposal via safeguards requiring the parent to support the subsidiaries, and by guaranteeing the whole amount of the waived requirement, collateralized by at least half of the guaranteed amount. Nevertheless, the proposed safeguards did not convince enough MSs, and the provision was eventually deleted from final version of CRR 2.0.

Despite being deleted, the idea is still supported in principle by some MS and larger banking groups. They have suggested starting first with the BU countries, and so the approach is called an "SSM waiver", as it would be applied only to banks which are supervised commonly by the ECB (as a Single Supervision Mechanism/SSM).

[5] Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements and amending Regulation (EU) No 648/2012, Brussels 23.11.2019.

[6] See REPORT on the proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) No 575/2013 of June 28, 2018 – Preamble, Recital (56) stipulating that "In light of the strengthened group supervision resulting from the reinforcement of the prudential regulatory framework and the establishment of the Banking Union, it is desirable that institutions take ever more advantage of the benefits of the single market, including for ensuring an efficient management of capital and liquidity resources throughout the group. Therefore the possibility to waive the application of requirements on an individual level for subsidiaries or parents should be available to cross-border groups, provided there are adequate safeguards to ensure that sufficient capital and liquidity will be at the disposal of entities subject to the waiver. Where all the safeguards are met, it will be for the competent authority to decide whether to grant such waivers. Competent authorities' decisions should be duly justified." http://www.europarl.europa.eu/doceo/document/A-8-2018-0242_EN.pdf

To summarise, arguments in favor of capital and liquidity waivers for cross-border banks were/are:

- The BU should allow banks to benefit from the Single Market, including by ensuring efficient management of capital and liquidity resources across the group entities located in various MS of the Union
- The SSM has sufficiently strengthened group supervision in the BU, having a better knowledge and direct powers over group entities situated in different MS in BU
- To some extent the BU has already become a “single jurisdiction”, with a few important, common institutions (Single Resolution Board*SRB), ECB, Single Resolution Fund(SRF))
- Such an approach promotes risk-sharing and helps to create pan-European banks of a new type which can easily reallocate resources across EU jurisdictions, ensuring greater efficiency of capital, liquidity and operations in general
- Precedents for SSM waivers exist – under existing legislation (e.g. in CRR), competent authorities have the power to waive the application of requirements on an individual level for subsidiaries or parents within a single Member State or in part of a liquidity sub-group spread across several Member States. These waivers could also be made available, as an option, for competent authorities of the Member States outside the BU, subject to their explicit agreement
- Technological developments increasingly facilitate centralised management of capital and liquidity management in a group as well as cost cutting, optimizing processes and avoiding, for instance, ICAAP, ILAAP and other liquidity reports prepared on a local basis
- Greater centralisation could free up assets trapped in subsidiaries. France’s Minister of Finance, Bruno Le Maire[7] has suggested there are some €300bn of liquid assets inefficiently trapped in EZ subsidiaries of EZ banks that could be more efficiently deployed
- Capital and liquidity managed at group level would be more optimally allocated by parent banks to grow the EU economy, and more effectively deployed to deal with crisis scenarios, too. Managing efficiently financial resources within cross-border groups by moving capital and liquidity in optimal way would also contribute to mitigate the home bias in banks’ balance sheets through greater geographical diversification of banks’ exposures, including to sovereign debt
- Strengthening parent bank capital and liquidity would help to make regional EU banking champions truly global players, better able to compete with non-EU banks
- Such an approach allows banking groups in a crisis to move capital and liquidity where they are needed – potentially making the groups more resilient.

[7] In his speech during EUROFI conference in Budapest in April, 2019.

Concerns about change

Even though much support for integrated financial markets exists, a number of predominantly Host Member States and some international institutions have raised concerns about premature implementation of SSM waivers due to:

- Incompleteness of the BU (i.e. lack of a mutualised deposit guarantee scheme and/or fiscal backstop); for example, in EZ, the combination of centralised supervision (ECB) and resolution (SRB) authorities and national deposit insurance and liquidation (MS) might result in incoherent incentives for various authorities, and in extreme cases lead to local systemic disruptions (e.g. no resolution of a bank at EZ level which might mean liquidation at local level with negative consequences[8]); it should be remembered that before and during the recent financial crisis (2007–2009) it was no so much insufficient Home and Host supervisors cooperation as a problem but rather the lack of clear answer to the question of "who pays the bill ?" or ex-ante burden sharing arrangements which were not in place. These and other factors, contributed to often non-coordinated actions towards problem cross-border banks operating across EU. The question of paying the bill is a key challenge here.
- Waivers could radically change the hard-won, negotiated prudential framework for EU banks which was based on compromises among many EU MS around CRR and CRD, in which they have already sacrificed important 'national options.' Waivers introduce a new division of powers and responsibilities – an asymmetry in the position of Home and Host countries. In case of waivers, responsibility to a large extent stays with the Host country (i.e. via deposit insurance) while the powers (regarding capital, liquidity flows) and resolution options (closely related to the capital and liquidity) are shifted to the parent bank Home supervisors (in case of the largest EZ banks, to the ECB) and away from Host MS. It should be no surprise that Host MS suggest that before waivers are implemented, additional reform is needed, including harmonization of insolvency laws and a much stronger SRF with a fiscal backstop in place.
- Too much centralisation, including substantial or complete elimination of local capital, liquidity, and MREL might hamper separability and sales potential of parts of the business (e.g. local subsidiary in Host MS as a whole) during a resolution process; as separability is an underlying principle in case of the transfer

[8] An illustration of the divergences in approach to the collapse of Latvia's third-biggest bank – ABLV Bank (accused by US authorities of money laundering, breach of sanctions against North Korea, etc.). Following the decision by the European Central Bank to declare ABLV Bank, AS and its subsidiary ABLV Bank Luxembourg S.A. as 'failing or likely to fail', the Single Resolution Board (SRB) decided that resolution action by the SRB is not necessary as it is not in the public interest. As a consequence, the winding up of the bank took place under the law of Latvia. However, the request of Luxembourg's Commission de Surveillance du Secteur Financier (CSSF) to liquidate ABLV's Luxembourg branch was rejected by a Luxembourg court. ABLV said its Luxembourg branch had a strong financial standing, which was recognized by the court, and it would now look for new investors.(see: https://www.reuters.com/article/us-latvia-bank-luxembourg/court-rules-latvian-bank-ablv-may-keep-luxembourg-branch-idUSKCN1GM0HM and https://srb.europa.eu/en/node/495?mod=article_inline).

or asset sale as resolution tools then interdependencies so much present in centralized model might create a true roadblock to resolution[9].

- Some credible research shows that the "correlation between parent banks' and foreign subsidiaries' default risk is lower for subsidiaries that have a higher share of retail deposit funding and that are more independently managed from their parents." This is even more evidenced "for subsidiaries operating in countries that impose higher capital, reserve, provisioning, and disclosure requirements, and tougher restrictions on bank activities"[10].
- Lack of adequate safeguards for Host MS where systemically-important subsidiaries operate (local SIIs); in such cases Host MS would still supervise such subsidiaries (as they collect local deposits and often have minority listings on local exchanges, but no longer have capital or liquidity to guarantee safety of the local deposits in a crisis). This issue of Home-Host share of responsibilities and powers boils down to the fundamental question "who pays the final bill" in case of bank failure.[11]. The question becomes especially important where foreign banks have systemically-important local roles. The argument that "banks are international in life but national in death" is still raised and continues to carry importance.
- Insufficient safeguards for Host countries – the waivers as initially proposed in CRR 2., CRD V and BRRD draft law were not supported by adequate safeguards to allow subsidiaries in Host jurisdictions to apply them – i.e. legislative provisions to require banking groups to provide guarantees/obligations of support for subsidiaries did not (yet) provide legal certainty that they would function as needed in a crisis. Transferring capital or liquidity from a parent bank to subsidiary might not always be possible, if it jeopardizes the group's position. En-

[9] But these obstacles could be mitigated at least partially if a parent bank holds enough equity (to be used to rescue subsidiary with no legal impediments for transfer in Home MS) and debt issued by the subsidiaries. Such debt should rank lower to claims on the subsidiary by third parties. In case of resolution such debt is written down and converted into equity in order to recapitalize the subsidiary in case of need. In such a model, a parent bank should provide liquidity and access to key services and market infrastructures to its subsidiaries. For example, in the UK it is called intra group liquidity modification i.e. the legal obligation to support UK entity must be fulfilled in BAU and stress situation. On the other hand, we need to bear in mind fiduciary responsibility that boards and directors of individual legal entities are normally under. Such an obligation makes the boards to act solely in the interests of their shareholders and while the failure of a subsidiary would cause a parent company to lose its equity in the subsidiary (plus any other exposures), it is possible that during a financial stress, directors of an individual entity may determine that the financial costs of supporting another group entity would outweigh the reputational damage of allowing the other entity to fail. See for example the case of Croatian Rijecka Banka, where the parent bank – Bayerische Landesbank, having own problems, did not decide to support failing subsidiary and walked away (The Economist 12.02.2002, Rogue trader, rogue parent).

[10] see IMF Working Paper Research Department *"Foreign Bank Subsidiaries' Default Risk during the Global Crisis: What Factors Help Insulate Affiliates from their Parents?"* Prepared by Deniz Anginer, Eugenio Cerutti, and Maria Soledad Martinez Peria (2017).

[11] See for example: P. Bednarski, G. Bielicki, *Home and Host supervisors' relations from Host supervisors' perspective*, [in:] *Cross-border banking. Regulatory challenges*, ed. G. Caprio, D.D. Evanoff, G.G. Kaufmann, World Scientific (2007).

forceability of safeguards for Host MS is uncertain: legal effectiveness of strong guarantees from parent banks and the effectiveness and credibility of the Home MS deposit insurance schemes require further legal analysis[12].

- NPL problems in some banks are yet to be resolved – although efforts are underway to do so, and progress continues. Subsidiaries of groups with NPL problems elsewhere might be left with insufficient liquidity or capital in a crisis, which could then translate into a need for local fiscal support by the Host Member State.
- EU resolution authorities are still relatively new – their effectiveness and operational capability to deal with crisis remains (thankfully) untested. Some central bankers have posed a hypothetical scenario about what would have happened if, when Banco Popular (BP) failed in Spain, Santander Group had decided not to buy BP's Portuguese operations. If this had then put the Portuguese banking system into further crisis, the central bankers suggested there are questions about whether the SSM or the SRB would have sufficient tools or resources to work with the Portuguese central bank to deal effectively with it.
- The SRF, even at its ultimate capacity of €50–60bn, may not be enough to deal with a major systemic crisis. To support the SRF, the European Stability Mechanism (ESM) backstop to SRB might need to be used. Such a backstop as well as its application by SRF/SRB at an institution level, will be dependent on meeting several conditions (e.g. on macro-level reduction of NPLs, level of NPL provisioning, meeting MREL targets, on micro-level: compliance with BRRD, MREL, etc.) and on its early introduction (in 2021 or 2022)[13].
- The ECB is not a lender of last resort for banks in the euro area and the national central banks are still in charge of Emergency Liquidity Assistance (ELA). Therefore, there may still be barriers to the use of local subsidiary funds (capital and liquidity moveable in cross-border group), with central banks needing to fund deposit outflows in other jurisdictions. Clarification by the ECB about the availability or/and commitment of ELA in case of problems in subsidiaries would be helpful.

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[12] This is supported by some historical examples eg. from Iceland where after the Lehman Brothers collapse, all 3 internationally active Icelandic banks failed, and local deposit insurance fund was not able to reimburse depositors in failing banks and their foreign branches (incl. single passport branches in the UK and NL) for some years or the US Savings and Loans crisis (the 1988 failure of the First Republic Bank) which demonstrated weakness of similar intra-group guarantees; The Icesave case illustrates the fact that the ruling of international courts as regards obligations of the deposit guarantee schemes might be also less predictable as illustrated by EFTA Court judgement of 28 January 2013, Case E-16/11, EFTA Surveillance Authority, supported by the European Commission versus Iceland, link https://eftacourt.int/download/16-11-judgment/?wpdmdl=1260&masterkey=, see also, Iceland triumphs in Icesave court battle, Financial Times 2013, link Iceland triumphs in Icesave court battle.

[13] Current discussions in Eurogroup are reflected in the public documents such as https://www.consilium.europa.eu/en/press/press-releases/2018/12/04/eurogroup-report-to-leaders-on-emu-deepening/.The detailed status of some aspects of the current Home-Host arrangements after final version of CRR 2.0 and CRD V and BRRD 2.0 is issued has been expressed in EC communique http://europa.eu/rapid/press-release_MEMO-19-2129_en.htm which clearly indicates that MREL will be required at subsidiary level.

- The capacity of local deposit guarantee schemes (DGS) varies – resources are not yet sufficient in all countries, and the buildup of financial capacity needs to continue.
- Uncertain European economic growth prospects continue – which may also affect banks' standing. In such an environment, large transfers of capital and liquidity to parent banks or other entities in a cross-border group become a political, as much as a prudential issue. With subsidiary banks in most cases largely funded by local deposits that are also insured locally (and thus subject to local fiscal backstop in a crisis), local concerns cannot be easily dismissed.
- Local subsidiaries may have local stock exchange listing and minority shareholders, such as local pension funds and other institutional investors, who will be cautious about the use of SSM waivers.
- Depositors may not want to put money in banks with no capital even if the deposits are guaranteed under local DGS in Host country.
- The legal framework for cross-border insolvency of EU banks presents obstacles – today, local operations would be dealt with under each country's insolvency regime. Creditors in Host countries need confidence in equitable treatment.
- The International Monetary Fund (IMF) suggests that any changes to capital, liquidity or governance requirements should be mindful of financial stability in individual member states and be made gradually, to minimize the risk of unintended consequences. The concern about financial stability is particularly relevant for systemically important subsidiaries.
- The "Basel Committee Core Principles of Effective Banking Supervision (BCP)" set standards for supervisors, together with the criteria of their assessment[14], and are used by the IMF in its periodical Financial Sector Assessment Programs (FSAPs) in various countries. These typically suggest that banks (and by definition, bank subsidiaries in Host countries) should have adequate capital and liquidity[15].
- The IMF in the *Financial Sector Assessment Report for Belgium*, while addressing the question of capital and liquidity movable from subsidiaries to the group (in the context of EC CRR draft proposal of November 2016), stipulated in a broad terms that the question of liquidity and capital in subsidiaries could be approach in a more flexible way. IMF noted in the Report that "while the EC proposal [EC draft proposals CRR 2.0 and CRD 5 of 23, November 2016] is not inconsistent with the Basel standard, the quality of monitoring and supervisory intervention at the subsidiary level will be important to ensure that the EU supervisory framework meets these standards". The CRR allows national supervisors to waive the capital adequacy requirements on a solo basis for cases where the parent and subsidiaries are established in the same country.

[14] Core Principles Methodology, Basel Committee on Banking Supervision, 2006.

[15] Laws or regulations require all banks to calculate and consistently maintain a minimum capital adequacy ratio.

Expanding the debate

The debate over SSM waivers has been joined by the EBA and the SSM. In 2018 public speeches by the Chairs of both institutions (Andrea Enria and Daniel Nouy respectively) clearly supported such waivers, at least within the BU. Both defined integrated EU markets as markets where asset transfers or SSM waivers should take place. Truly European, integrated banking would happen when cross-border business could predominantly take the form of single passport branches or "quasi branches" i.e. subsidiaries which are not required to hold capital or liquidity, or are allowed to move capital, liquidity and MREL from subsidiary to the group (sister companies) or parent bank domiciled in BU (after being granted SSM waivers).

At a global level, the FSB is also increasingly concerned about trends in fragmentation of the global financial system. Its Chair, Randal Quarles, and Secretary General, Dietrich Domanski, have been speaking recently about fragmentation and the need for greater international cooperation and trust between bank regulators and supervisors.[16, 17]

Despite its directional support for capital and liquidity waivers, the SSM, in its ***Guide on options and discretions*** available in the Union law (for EZ countries) indicates as one of the conditions for Art. 7 (1) allowing waiver on capital requirements – that "there should be an evidence that the parent undertaking has guaranteed all the obligations of the subsidiary, by means, for example, of a copy of a signed guarantee or an extract from a public register certifying the existence of such guarantee or a declaration to such effect, which is reflected in the parent undertaking's articles of association or has been approved by the general meeting and reported in the annex to its consolidated financial statements. As an alternative to a guarantee, credit institutions can provide evidence that the risks in the subsidiary are negligible".

The debate has been actively followed and in some cases joined by policymakers, politicians, and the industry, itself. At the Eurofi conference in April 2019 in Bucharest, divisions between countries that are predominantly "exporters" of banking services and those which are "importers" of banking services (i.e. being Host jurisdictions with foreign banks holding a substantial share of local bank assets), were on clear display.

SSM waivers were promoted by governments, supervisors, central banks and leading banks from EZ countries which are home to large cross-border banks, and opposed by those from other Host countries where large cross-border banks hold significant shares of the market. For these Host countries, SSM waivers are

[16] Quarles Randal K., *Government of Union: Achieving Certainty in Cross-Border Finance – remarks at Financial Stability Board Workshop on Pre-Positioning*, Ring-Fencing, and Market Fragmentation Philadelphia, Pennsylvania, September 26, 2019, link: https://www.fsb.org/wp-content/uploads/S260919.pdf

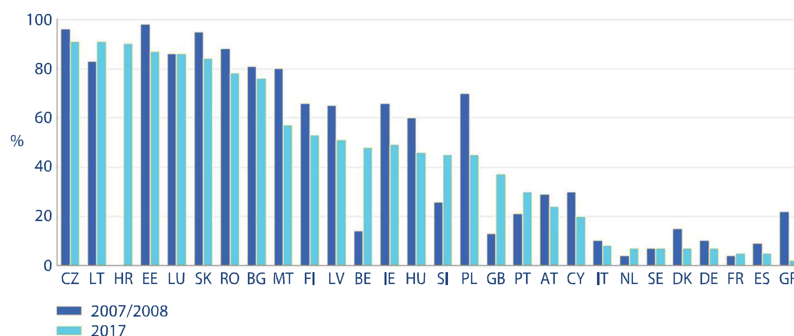
[17] Domanski D., *Three priorities for international regulatory and supervisory cooperation*, Financial Stability Board, remarks delivered at Eurofi conference, September 13, 2019, link: https://www.fsb.org/wp-content/uploads/S130919.pdf

considered a radical move that would transform existing large credit institutions operating in their territories, into quasi branches, still holding local licenses and subject to the local deposit guarantee system, but operating without local capital, liquidity and MREL. Therefore, it is not surprising that SSM waivers faced stiff resistance[18].

A senior European cross-border banker stated that the "solo approach is a contradiction of the BU and a retrenchment to national borders which affects growth in EU". And he presented arguments for waivers based on overcoming the suboptimal allocation of capital and liquidity, and providing for a greater supply of capital to European economies. But a central banker from a smaller Host country argued that foreign bank subsidiaries in his country should not be just left without capital and liquidity, and no other strong safeguards.

It is interesting to look at this discussion through the lens of ownership structure of banks in the countries active in the debate on SSM waivers and in general on the Home-Host themes. In many (if not all cases) the countries that raise objections and concerns to allow free movement of capital and liquidity from subsidiaries to parent bank or other entities in the same group (which would leave such subsidiary without capital and liquidity) are mostly countries with a dominant presence of foreign banks, mostly Belgium, Member States from Central, Eastern or Southern Europe (with foreign banks in many cases controlling close to 100% of the local banking markets), and the UK.

Figure 3: Foreign banks in EU Member States in 2008 and 2017
(% assets of banking systems in EU Member States controlled by foreign banks)



Source: ECB, PwC.

[18] J. Deslandes, C. Dias, M. Magnus, *Banking Union: What next?*, European Parliament, ECONOMIC GOVERNANCE SUPPORT UNIT (EGOV), Directorate-General for Internal Policies PE 634.374 (2019).

As a context for the analysis of the arguments raised above, it makes sense to note that currently in the EU, three groups of countries can be identified with respect to the foreign banks penetration:

- Countries with a high level of foreign banks (CZ, LT,HR, EE,LU, SK, RO, BG), most of them are new members of the EU from Central, Eastern and Southern European countries
- Countries with more balanced share of foreign and local banks – MT, FI,LV, BE, IE, HU, SI, PL and UK, a mixture of old and new MS
- Countries with low to very low presence of foreign banks – mostly old EU countries: PT, AT, CY, IT, NL, SE, DK, DE, FR, ES, GR.

The countries with low level of foreign banks dominate in the EU both in terms of their size and voting power in the EU institutions.

It is also worth noting that Belgium, UK, SI and PT experienced important increases, within the last 10 years, of the size of foreign vs. local banks in terms of total assets. At the same time, presence of foreign banks assets dropped visibly in Poland, MT, Greece, DK, ES and less in CY, IE, HU, DE.

The concerns of Host MS found also understanding in the ardent proponent of SSM waiver, the Chair of SSM, Andrea Enria who while at EBA, recognized that ring-fencing approaches of Host MS (such as increased capital and liquidity requirements, limits on intra-group cross-border transfers and dividend payouts) were means "to better safeguard the interests of local stakeholders – shareholders, creditors and depositors, as well as deposit insurers and taxpayers – mitigate spillovers and cross-border contagion and support credit supply at the national level".[19]

So where to from here?

Making progress from here surely means recognising that the use of waivers represents a significant change. As previously mentioned, the prevailing regulatory arrangement in the EU is based on "freedom of service provision" and "freedom of establishment," which allows banks to operate in Host jurisdictions via subsidiaries, via passported branches, or via direct provision of service from another EEA country.

The use of passported branches, in particular, warrants more consideration. Branches allow cross-border banks to operate in another EU jurisdiction without fragmenting capital and liquidity, and to achieve operational efficiencies, but with crisis responsibility resting clearly with the parent group, and its home state supervisors and resolution authorities. Without agreement to a shared European Deposit Insurance Scheme (EDIS), Home MS deposit insurance schemes bear responsibility for those depositors in the Host MS. The distribution of responsibilities and powers in such a framework is clear and well-established, though not without certain problems

[19] Enria Andrea, Fragmentation in banking markets: crisis legacy and the challenge of Brexit, September 2018.

in the past (e.g. the Icelandic banking crisis in 2008–2009). There is also a well-established regulatory regime for insolvency of a bank with single passport branches (Winding-up directive)[20]. In such a legal set up, there are no impediments to the free flow of liquidity across borders, and the deposit insurance responsibility framework is well established, too (usually the Home country Deposit Guarantee Scheme). But in the case of subsidiaries in Host countries, unless and until a system is designed to include workable crisis funding guarantees of subsidiaries by parent banking groups, clarity about crisis liquidity provision by the ECB for banking operations in Host MS states, and political commitment to a more-mutualised EDIS, it seems likely that MS which predominantly act as Hosts for banks, will continue to oppose change.

The steps to move the debate forward were raised in the report of the Chair of the High Level Working Group on EDIS, issued in June 2019. The report recognises the interests of Host supervisors that would need to be factored into "a new balance in the Home-Host equilibrium"[21] and it makes reference to the safeguards above and also adds formalisation of the parent support (introduction of legally certain and enforceable intra-group parent support mechanisms) as well as the governance of the SRB to assess whether appropriate safeguards are in place for Host Member States.

So if the full benefits of the Single Market are to be realised via waivers, and especially in the EZ, then the next, 2019-24 Commission should look again at these policies and measures, when it again revises the CRR to implement the remaining elements of the Basel III Accord (more commonly known as 'Basel IV').

At this juncture though, operating through single passport branches, represents the most realistic option for quick wins in cross-border integration of banking groups. 'Brachification' may not be achievable for all banking groups – e.g. where there are minority interests, or where large, systemic subsidiaries are listed on local stock exchanges. And certain issues also can emerge (see Annex 2) as described in literature[22]. But 'branchification' of many groups is surely feasible, and would provide a good test of the importance of the various factors which seem to contribute to fragmentation. Based on this evidence, further moves to allow SSM waivers could then be taken with confidence. It may be insightful to see whether the transformation into branches would boost cross-border lending, especially when large exposure regime is waved in case of passported branches[23].

Other policy initiatives to improve deposit guarantee schemes (DGS) – alternatives to a full EDIS – could also be considered, such as a more transparency and dynamic

[20] Some more research is needed: how this framework worked during the recent financial crisis in the case of Icelandic banks branches in UK, NL and other countries.

[21] Considerations of the further strengthening of the Banking Union, including a common deposit insurance scheme, June 2019, Report of the HLWG Chair.

[22] K. D'Hulster, *Cross Border Banking Supervision Incentive Conflicts in Supervisory Information Sharing between Home and Host Supervisors*, The World Bank, Policy Research Working Paper 5871 (2011).

[23] As the large exposure and other concentration limits are calculated at Headquarters level. Passported branch, as opposed to a local subsidiary, does not need to keep local capital and is not bound by the large exposure limits, all should allow for grater expansion of lending in Host country.

replenishment of the funding of national DGS. A regular buildup of resolution funds could play an important role too, in mitigating fears about transfers across borders in a crisis. These fears might have root in historical examples, such as the inability of the Iceland deposit insurance scheme to fulfill its obligations (resulting from membership in EEA and necessary compliance with EU directives, including DGS directive) towards foreign depositors of Icelandic banks during the last financial crisis (2008–2009)[24].

An approach promoting single passport branches, which are well grounded in the existing EU legislation and practice, could help push forward, at least at this stage, cross-border banking and a reduction in fragmentation within the EU. Some situations and scenarios will present opportunities for branch expansion which are more attractive than others – for Home and Host supervisors. One of the key factors contributing to the success of bank to branch transformation and then smooth cooperation between parent bank (Home) supervisor and branch supervisors is right the alignment of incentives. The alignment of incentives is not always easy and tensions may emerge between supervisors. In Annex 2, we assess a number of such scenarios, and summarise the prospects for transformation or establishment a branch instead of a subsidiary based on the likely incentives for smooth cooperation between Home and Host supervisors under such scenarios. A real life illustration of large banks transformation into branches in EU is the case of Nordea, which transformed its banks which were systemic institutions in Scandinavian countries into branches and then relocated the headquarters of the Nordea Group to Finland. Therefore, the whole groups is now subject to SSM and SRB supervision and resolution powers respectively. The transformation of a systemic bank into a branch has several macro- and micro-prudential as well as capital markets implications. This includes responsibility for ELA where the responsibility for providing ELA stays with the Bank of Finland, which will be expected to provide liquidity if requested by Nordea under the Nordic-Baltic central bank MoU from December 2016.[25]

In the context of the current rules, branch oversight puts the Home supervisor almost entirely in control of crisis situations. "Branchification" will be attractive to authorities where the financial stability interests and incentives between the Home and Host countries are aligned and both countries share a strong interest in

[24] This was closely related to aggressive lending of major Iceland banks, weak supervision in the years preceding the crisis, and the eventual collapse on the Icelandic DGS. These events had tangible effects on some EU countries with Iceland not paying its deposit insurance obligations for several years.

[25] In September 2017, the Board of Directors of Nordea Bank AB (Nordea) decided to move the parent company to Finland and thereby to the European Union's (EU's) banking union. This decision was preceded by the earlier decision to convert Nordea's subsidiaries in Finland, Denmark and Norway into branches of Swedish Nordea. This transformation into a branch structure entered into force on 1 January 2017. As a consequence of the transformation the responsibility for supervision, resolution and deposit guarantee is moved to Home country, which means that ECB/the Single Supervisory Mechanism and Single Resolution Board in addition to Finish Deposit Guarantee Scheme have the main responsibility for Nordea as a result of the transformation. For discussion of micro- and macro-prudential aspects see : *Statement of opinion with regard to Nordea Bank AB's application for permission to implement merger plans,* Finansinspektionen, July 4, 2018, link: https://www.riksbank.se/globalassets/media/remisser/riksbankens-remissvar/engelska/2018/statement-of-opinion-with-regard-to-nordea-bank-abs-application-for-permission-to-implement-merger-plans.pdf

effective supervision, including commitment of adequate resources, including from a Home country DGS and Resolution Authority, to deal with a bank in crisis[26].

But divergences of Home and Host country interests can arise, for example, when local businesses are of systemic importance to a Host country, but considered marginal to the overall group and/or where the home country DGS is poorly funded, and both supervisors and DGS lack resources to deal with a wider crisis. Where the interests of Home and Host supervisors and resolution authorities diverge, there is a greater possibility of tensions emerging which can affect the functioning of such branches.

Conclusion

The debate over SSM waivers, allowing banking groups to move capital, liquidity and MREL freely across borders within the EZ, is polarised between Member States which are largely Home and Host countries. The crucial test for such policies is to consider what would happen in a crisis situation, how authorities in largely Host countries can be assured that the deposits in banks are safe, local financial stability not endangered, the local companies have steady access to credit, and that they will have the tools and resources to deal with any crisis.

This is an important debate, which underpins the structure and efficiency of the highly regulated financial services industry in Europe. To approach existing fragmentation from a largely political perspective – seeking to unlock the perceived potential of cross-border banking in a Single Market in order to symbolise progress towards a more integrated Europe – might carry unintended financial stability risks to predominantly Host Member States.

To ensure these risks are properly understood, more examination of themes such as a cross-border insolvency regime for foreign bank subsidiaries operating in the EU, the quality and conditionality of support guarantees from parent banks, and how the crisis tools and resources of the SRB and the ECB may be deployed, needs to take place to ensure cross-border failures will be managed smoothly.

As we have identified, a quick win strategy for deepening European financial integration and achieving many of the same benefits of capital waivers would be to facilitate greater use of single passport branches which already benefit from stable, transparent, and predictable (after incorporating lessons learnt from recent financial crises) regulatory frameworks. There are a number of cases where the interests of Home and Host MS align, and this will be feasible (see Annex 2 for details). A road map with sequencing of further measures, bringing together other related policies such as the Capital Market Union, would be a useful direction for the new EC to take, as it begins its new mandate in 2019.

[26] K. D'Hulster, *Cross Border Banking Supervision Incentive Conflicts in Supervisory Information Sharing between Home and Host Supervisors*, The World Bank, Policy Research Working Paper 5871 (2011).

Annex 1. Cross-border operation of EEA banks: key features of the forms available

Form of cross-border operations	General legal basis	Detailed legal basis	Licensing	Supervision	Regulation
Subsidiary	Freedom of establishment – art. 49 of TFEU*	CRD IV (art. 33 and other)	License issued by Host Member State (MS), ECB in a EZ MS	Host MS supervisor leads; coordination with Home supervisor (via colleges)	EU prudential framework for banks (e.g. directly applicable EU regulations such as CRR, locally transposed EU directives) and local laws and guidelines; all prudential norms (capital, liquidity, MREL, large exposure, etc.) on Host country level; local & group prudential reporting
Single passport branch	Freedom of establishment – art. 49 of TFEU*	CRD IV (art. 17, 33–38, 40–41 and other)	No license. Notification only needed from Home to Host MS	Home MS supervisor leads and Host MS relies Home MS to supervise and enforce the conditions for authorisation or approval. Host MS might carry out on-site inspections. Home supervisor and Host coordinate their activities, esp. for *significant branches*+	EU prudential framework for banks applies, as well as Home MS prudential requirements. Host MS local requirements limited to “general good”** considerations (e.g. financial consumer protection) No prudential numerical norms at branch level (no capital, liquidity, MREL requirements, no large exposure limits); limited host country reporting – mostly statistics (monetary policy and payment) for host central bank

Form of cross-border operations	General legal basis	Detailed legal basis	Licensing	Supervision	Regulation
Cross-border provision of services	Freedom of services – art. 56 of TFEU*	CRD IV (art. 33, art. 39)	Notification from Home to Host MS	Home MS supervisor leads and Host MS relies Home MS to supervise and enforce the conditions for authorisation or approval. No reporting, no prudential norms in Host MS.	EU prudential framework for banks as applicable in Home MS only applies. Host MS local requirements limited to "general good"** considerations (e.g. financial consumer protection on cross-border business)

* Treaty on the Functioning of the European Union (TFEU); + Art. 51 and 158 CRD IV defines "significant branch" using one of 3 criteria: a) representing 2% share in the Host country deposits or b) likely having important impact in case of closure on systemic liquidity and the payment, clearing and settlement systems, c) significant size and the importance of the branch in terms of number of clients within the context of the banking or financial system.

** "General good" consideration usually cover professional rules to protect the recipient of services, protection of workers and consumers, preservation of the good reputation of the national financial services sector, fraud prevention, social order, intellectual property protection, preservation of national historical and artistic heritage, cohesion of the tax system or road safety.

Annex 2: "Branchification" scenarios and assessment of the potential for smooth Home-Host cooperation after transformation of subsidiaries into branches in Host countries

Type of branch business and significance of a branch in Home and Host country	Home country perspective*	Host country perspective**	Potential for smooth cooperation between home and host: conversion of a subsidiary into a branch or branch notification and supervision of a branch as a consequence of convergent or divergent of interests of home and host	Comments
Non-material for Home MS, non-material for Host MS *Type of business*: small or medium scale wholesale business, no open position trading, no or small scale of deposit taking (mostly from corporates)	Low risk Low allocation of resources (supervision, resolution) No or limited risk to Home DGS	Low risk Low allocation of resources (supervision) due to low impact on local markets No risk to Host DGS as deposits insured in Home DGS	High	Interest of Home and Host mostly aligned, no triggers to disputes

* In case of banks directly supervised by SSM, the Home supervisor is ECB.

** In case of smaller MS (such as Baltic countries, Malta, Cyprus) operating as Host countries, their assessment of risk and negative impact of the potential cross-border turbulences might be more cautious than in the case of larger and economically strong countries. Host MS in such cases would look also into the capacity and strength of parent bank, Home country' DGS.

Annex 2 – cobtinued

Type of branch business and significance of a branch in Home and Host country	Home country perspective*	Host country perspective**	Potential for smooth cooperation between home and host: conversion of a subsidiary into a branch or branch notification and supervision of a branch as a consequence of convergent or divergent of interests of home and host	Comments
Non-material for Home MS, medium to high material for Host MS *Type of business:* Wholesale business, no deposit taking, important player on the local market (e.g. market maker in Host country in financial instruments such as derivatives, contributor to local benchmarks such as interest rates, fulfilling critical (systemic) function in Host financial system)	Low risk Low allocation of resources (supervision, resolution) No risk to Home DGS	Low to medium risk Medium allocation of resources (supervision) due to impact on markets (local interbank, capital markets, critical functions) Low to medium financial (systemic) stability risk to Host No risk to Host DGS but potential risk to financial stability if the bank performs poorly and have impact on the market; Host might look to the capacity of parent bank	Medium	Interest of Home and Host, only partially aligned, some triggers to disputes if Home does not supervise sufficiently the branch and branch de-stabilizes local markets through mis-selling of financial products or other activities

* In case of banks directly supervised by SSM, the Home supervisor is ECB.

** In case of smaller MS (such as Baltic countries, Malta, Cyprus) operating as Host countries, their assessment of risk and negative impact of the potential cross-border turbulences might be more cautious than in the case of larger and economically strong countries. Host MS in such cases would look also into the capacity and strength of parent bank, Home country' DGS.

Annex 2 – cobtinued

Type of branch business and significance of a branch in Home and Host country	Home country perspective*	Host country perspective**	Potential for smooth cooperation between home and host: conversion of a subsidiary into a branch or branch notification and supervision of a branch as a consequence of convergent or divergent of interests of home and host	Comments
Non-material for Home MS, low to medium material for Host MS *Type of business:* Low to medium scale of corporate, SME, micro business, incl. modest deposit taking locally	Low risk Low allocation of resources (supervision, resolution) Limited risk to Home DGS; in case of smaller countries with limited resources in DGS and insufficient quality of supervision, aggressive growth of deposits in branch might create potential burden for Home DGS and questions from Host authorities	Low risk Low allocation of resources due to low impact on local markets (supervision); mostly "general good" considerations, fair sales and trading practices, AML, etc. No risk to Host DGS but Host authorities might look to the capacity of parent bank and the strength of Home country DGS in case of a problems	Medium	Interest of Home and Host generally aligned, no major triggers to disputes but potential issues with aggressive lending and growing local deposit taking, especially when the potential for regulatory arbitrage between Home and Host countries, as Home requirements less restrictive than Host, triggering unlevel playing field (and raise to the bottom questions) and other issues

* In case of banks directly supervised by SSM, the Home supervisor is ECB.

** In case of smaller MS (such as Baltic countries, Malta, Cyprus) operating as Host countries, their assessment of risk and negative impact of the potential cross-border turbulences might be more cautious than in the case of larger and economically strong countries. Host MS in such cases would look also into the capacity and strength of parent bank, Home country' DGS.

Annex 2 – cobtinued

Type of branch business and significance of a branch in Home and Host country	Home country perspective*	Host country perspective**	Potential for smooth cooperation between home and host: conversion of a subsidiary into a branch or branch notification and supervision of a branch as a consequence of convergent or divergent of interests of home and host	Comments
Material for Home MS, Material for Host MS *Type of business*: large wholesale/trading business as assessed from Home and Host perspective, important role in Host market (e.g. market making in financial instruments, contributor to benchmarks, limited or no deposit taking (if any, wholesale, large corporate deposits)	High risk*** Moderate to high allocation of resources (supervision, resolution) Limited risk to Home DGS	High risk*** Medium to high allocation of resources (supervision of some aspects due to market impact) No risk to Host DGS but potential negative impact on the market and financial stability implications; Host might look to the capacity of parent bank to support branch liquidity and help to limit negative impact on the local market	High	Interest of Home and Host generally aligned, no triggers to disputes as both Home and Host interested in soundness of the branch and Home more likely to allocate sufficient resources for branch supervision; if a subsidiary bank is systemic in Host country there still might be some resistance on the part of Host to transforming it into single passport branch

* In case of banks directly supervised by SSM, the Home supervisor is ECB.

** In case of smaller MS (such as Baltic countries, Malta, Cyprus) operating as Host countries, their assessment of risk and negative impact of the potential cross-border turbulences might be more cautious than in the case of larger and economically strong countries. Host MS in such cases would look also into the capacity and strength of parent bank, Home country' DGS.

*** This rough risk level assessment focus only on inherent risk and does not consider quality of risk management and mitigating measures applied.

Annex 2 – cobtinued

Type of branch business and significance of a branch in Home and Host country	Home country perspective*	Host country perspective**	Potential for smooth cooperation between home and host: conversion of a subsidiary into a branch or branch notification and supervision of a branch as a consequence of convergent or divergent of interests of home and host	Comments
Non-material for Home MS, Material for Host MS <u>*Type of business:*</u> Large deposit taking from retail clients – market share of deposits of 2% or more, also corporates, SME and micro-firms deposits, active role in the local markets, medium to large wholesale business and trading (back-to-back), impact on the market	Low risk Low allocation of resources (supervision, resolution) Modest risk to Home DGS in case of problems in the branch	High risk Medium to high allocation of resources (supervision of some aspects due to market impact and consumer protection) No risk to Host DGS if the Home DGS well funded; Host might look to the capacity of parent bank, quality of Home supervision, and the strength of Home country DGS	Medium	Interest of Home and Host partially misaligned, potential disputes if Home does not supervise effectively the branch and branch de-stabilizes local markets, or Home DGS poorly funded; if a subsidiary bank is systemic in Host country there still might be some resistance on the part of Host to transforming it into single passport branch

* In case of banks directly supervised by SSM, the Home supervisor is ECB.

** In case of smaller MS (such as Baltic countries, Malta, Cyprus) operating as Host countries, their assessment of risk and negative impact of the potential cross-border turbulences might be more cautious than in the case of larger and economically strong countries. Host MS in such cases would look also into the capacity and strength of parent bank, Home country' DGS.

Annex 2 – cobtinued

Type of branch business and significance of a branch in Home and Host country	Home country perspective*	Host country perspective**	Potential for smooth cooperation between home and host: conversion of a subsidiary into a branch or branch notification and supervision of a branch as a consequence of convergent or divergent of interests of home and host	Comments
Non-material for Home MS, non-material for Host MS (but important from consumer protection point of view) *Type of business*: *providing investment services, limited or no deposit taking*	Low risk Low allocation of resources (supervision, resolution); potential reputation and lawsuit risks in case of misseling of financial products; No or limited risk to Home DGS	Low to medium risk, mostly resulting from sales or broking of financial instruments to non-professional investors (potential issues with MiFID II, MiFIR, local consumer protection laws)	Medium to High	Interest of Home and Host partially misaligned, potential disputes if Home does not supervise effectively the branch in the area of financial instruments sale or broking to non-professionals (an area under regulated in EU laws), the manner of branch resolving consumers' complaints, especially when supervision over investment activities of the branch may be outside Home legal mandate, interest,and capacity

* In case of banks directly supervised by SSM, the Home supervisor is ECB.

** In case of smaller MS (such as Baltic countries, Malta, Cyprus) operating as Host countries, their assessment of risk and negative impact of the potential cross-border turbulences might be more cautious than in the case of larger and economically strong countries. Host MS in such cases would look also into the capacity and strength of parent bank, Home country' DGS.

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