



EBA/Op/2017/12

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12 October 2017

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# Opinion of the European Banking Authority on issues related to the departure of the United Kingdom from the European Union

## Introduction and legal basis

1. The European Banking Authority's (EBA's) competence to deliver an opinion is based on Articles 29(1)(a) and 34(1) of Regulation (EU) No 1093/2010<sup>1</sup> ('EBA Regulation'). Article 29(1)(a) mandates the EBA to play an active role in building a common Union supervisory culture and consistent supervisory practices and approaches throughout the Union including by providing opinions to competent authorities, while Article 34(1) empowers the EBA to provide opinions to the European Parliament, the Council and the Commission on all issues related to its area of competence, including on issues within the EBA's competence arising in the context of the UK's withdrawal from the European Union.
2. In accordance with Article 14(5) on the Rules of Procedure of the Board of Supervisors,<sup>2</sup> the Board of Supervisors has adopted this opinion.
3. This opinion is addressed to:
  - competent authorities as defined in point (2) of Article 4(2) of the EBA Regulation, including the European Central Bank with regard to matters relating to the tasks conferred on it by Regulation (EU) No 1024/2013 and to the Single Resolution Board, established by Regulation (EU) No 806/2014.<sup>3</sup> The opinion is also addressed to the national competent authorities ('NCAs') of the EEA-EFTA States Norway, Liechtenstein and Iceland as per the EEA Agreement, and
  - the European Commission.

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<sup>1</sup> Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

<sup>2</sup> Decision adopting the Rules of Procedure of the EBA Board of Supervisors of 27 November 2014 (EBA/DC/2011/01 Rev4).

<sup>3</sup> Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).

## The background

4. On 29 March 2017, the United Kingdom (UK) notified the European Council of its intention to withdraw from the European Union (EU) pursuant to Article 50 of the Treaty on European Union. The withdrawal will take place on the date of entry into force of a withdrawal agreement or, failing that, two years after the notification, on 30 March 2019.<sup>4</sup>
5. The UK's decision to withdraw from the EU includes the UK leaving the European Single Market.<sup>5</sup> Several UK-based financial services firms provide services in other Member States of the EU. These firms may seek to retain access to the EU market following the departure of the UK, either by using establishments that are already present in the remaining Member States ('EU27') or by seeking the authorisation or approval of new establishments in the EU27.
6. The EBA has decided to issue this opinion in response to this unprecedented situation, to provide guidance on supervisory expectations and to address regulatory and supervisory arbitrage risks that arise as a result of increased requests from entities seeking to relocate to the EU27 within a relatively short period of time. The aims of this opinion are to provide practical recommendations<sup>6</sup> to credit institutions, investment firms and other financial services firms, and EU competent authorities, and to highlight to the Commission areas of the legislative framework which could be updated to respond to challenges posed by the exit of the UK.
7. With respect to recommendations to authorities, this opinion aims to foster further convergence and consistency of authorisation and supervision processes across Member States by setting out guidance on the appropriate supervisory approach to take to issues arising in the context of the withdrawal of the UK from the EU ('Brexit'). It aims to provide pragmatic guidance to EU authorities dealing with these issues, and to provide certainty and transparency to market participants. Legal certainty is particularly important in these circumstances, and requests from UK institutions to relocate to an EU27 jurisdiction will be treated in accordance with the existing European legal frameworks.
8. For the most part, these recommendations are focused on the (c. 18-month) period prior to the departure of the UK from the EU. During this period, EU rules continue to apply to UK institutions. From March 2019 onwards, firms and competent authorities should be cognisant of the preparatory measures to take depending on the likely future status of the UK after Brexit and in particular if the UK become a third country for the purposes of EU law. Where recommendations relate to the period after Brexit, these are flagged clearly.

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<sup>4</sup> Article 50 also allows the European Council, in agreement with the Member States, to extend this period.

<sup>5</sup> See: HM Government, The United Kingdom's exit from and new partnership with the European Union, February 2017.

<sup>6</sup> Any reference to the term 'recommendation' in this opinion should not be considered to be a reference to an EBA Recommendation issued under Article 16(1) of the EBA Regulation – rather, the term is to be construed as bearing its normal meaning.

9. This opinion assumes that after Brexit becomes effective the UK will be a third country for the purposes of the application of the relevant EU legal framework. However, this opinion is without prejudice to any specific arrangements that may be reached between the UK and the EU or, where applicable, existing national rules relating to market access, or the effect of any equivalence decision adopted by the Commission or competent authorities in accordance with the European regulatory framework. Given the uncertainty inherent in the process, some aspects of this opinion may become more or less relevant depending on the evolution of discussions between the EU and UK.
10. With respect to recommendations to the Commission, the EBA notes that the EU legislative framework already provides for prudential, conduct of business and resolution rules, including rules relating to third country institutions operating within the EU. The framework also sets out rules regarding interaction with third country authorities. However, in practice the degree of economic and financial integration between the UK and the Member States remaining after Brexit will be significantly greater than with any other third country. The existing third country framework was not designed with such an integrated third country in mind. Therefore, the EBA has identified in this opinion areas of the framework concerning interactions with third countries which would benefit from a legislative update in the light of the challenges posed by Brexit, also having regard to their potential impact on other third countries.
11. Cooperation and coordination between supervisors, as well as between supervisors and resolution authorities,<sup>7</sup> are crucial. In the first instance, this cooperation should be evident amongst EU authorities dealing with the reorganisation of institutions in the EU in response to Brexit. In addition, cooperation and coordination between EU27 authorities and UK authorities remains vital in future in the light of likely continuing financial interlinkages between the two jurisdictions. The EBA aims to foster regulatory and supervisory cooperation and coordination both at present between EU authorities, and with respect to the future relationship with UK authorities.
12. This opinion addresses a number of areas of relevance for competent authorities, namely the authorisations process, equivalence access for the provision of investment services (whether directly or by establishment), internal model approvals, internal governance and risk management – in particular when it comes to outsourcing and risk transfers using back-to-back or intragroup operations – and resolution and deposit guarantee scheme issues. In each area, key principles have been identified, followed by a number of more detailed technical recommendations, having regard to the legal framework. The detailed analysis supporting the recommendations in each of these areas is set out in a report that is appended to this opinion.

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<sup>7</sup> In this opinion, and in the report appended to it, the term ‘resolution authority’ should be construed in line with point 18 of Article 2(1) of the Bank Recovery and Resolution Directive (BRRD), Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2011/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council.

13. Irrespective of their addressee or subject area, the recommendations set out in this opinion are focused on a number of key principles:

- i. the European legal and regulatory framework is to be applied in a consistent and harmonious manner throughout the EU, and competition on regulatory or supervisory standards should be avoided;
- ii. competent authorities should avoid imposing an unnecessary regulatory burden on firms, while at the same time regulatory standards which have always applied should be maintained; and
- iii. cooperation and coordination between supervisors, as well as between supervisors and resolution authorities, is important both now and in the future.

14. This opinion is in line with the European Parliament resolution<sup>8</sup> and the European Council guidelines.<sup>9</sup> Where relevant, this opinion takes into account and complements the opinions issued by the European Securities and Markets Authority (ESMA)<sup>10</sup> and the European Insurance and Occupational Pensions Authority.<sup>11</sup> This opinion does not prejudice any future opinions or other convergence tools issued by the EBA, in particular in response to changes in the negotiating or legal environment prior to Brexit.

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<sup>8</sup> European Parliament resolution of 5 April 2017 on negotiations with the United Kingdom following its notification that it intends to withdraw from the European Union (2017/2593(RSP)).

<sup>9</sup> European Council guidelines of 29 April following the United Kingdom's notification under Article 50 TEU (EUCO XT 20004/17).

<sup>10</sup> See: <https://www.esma.europa.eu/press-news/esma-news/esma-issues-principles-supervisory-approach-relocations-uk> and <https://www.esma.europa.eu/press-news/esma-news/esma-issues-sector-specific-principles-relocations-uk-eu27>.

<sup>11</sup> See: <https://eiopa.europa.eu/Pages/News/EIOPA-issues-principles-on-supervisory-approach-to-the-relocations-from-the-United-Kingdom-.aspx>.

## I. Authorisations

### Key principles:

- i. Existing authorisation standards should not be lowered.
- ii. Competent authorities should ensure that all applications for authorisation, registration, admission<sup>12</sup> or variation of permission, and notifications regarding branches, are subject to existing procedures and standards, without any derogations or exemptions, and continue to ensure that applications are subject to rigorous assessment against the relevant requirements.
- iii. Competent authorities should assess carefully the adequacy of the relocating firms' structure and governance. Applications should contain sufficient information on their business structure and programme and a clear explanation of the choices taken in terms of substance of the incoming entity (no 'empty shells').
- iv. The provision of MiFID<sup>13</sup> investment services in the Union should be subject to adequate prudential supervision and oversight. For institutions established in the Union, this should entail an updated prudential framework in line with the EBA's Opinion on investment firms in response to the European Commission's Call for Advice of 13 June 2016. The ECB should be the competent authority for Class 1 investment firms (indicatively those which are systemic or exposed to the same types of risks as credit institutions, but which should be definitively specified in legislation) established in the Banking Union. Investment services provided by third country investment firms should also be subject to adequate prudential rules and oversight.
- v. The regulatory burden on firms should be kept to a minimum through the use of existing information held by the competent authorities and cooperation between supervisors.

15. In general, it is the EBA's opinion that:

- Competent authorities should articulate clearly to potential applicants supervisory expectations regarding the application and assessment process.
- Competent authorities should apply existing authorisation, registration or admission standards without any derogations or exemptions and should not rely on mere

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<sup>12</sup> The Mortgage Credit Directive uses a concept of 'admission' rather than authorisation.

<sup>13</sup> The Markets in Financial Instruments Directive, Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC.

confirmations or previous or existing authorisation decisions granted by another competent authority.

- Competent authorities should assess if firms have provided in their applications a clear explanation of the factors supporting their choice of jurisdiction, in particular demonstrating how it is related to their business structure and programme, so that competent authorities can verify that the firms have not chosen a jurisdiction for the purposes of evading stricter standards in force in the Member State in which they carry out or intend to carry out the greater part of their activities. The request to provide such information should be consistent with the obligations that exist in relevant legislation.
- Competent authorities should cooperate in the consideration of applications and seek information as appropriate from one another, for example in relation to the shareholders and members of an applicant, in order to facilitate the efficient progress of the consideration of applications for authorisation.
- Competent authorities should share information with one another, and with resolution authorities (where relevant in accordance with procedures agreed between competent authorities and resolution authorities), on a timely basis in the course of the consideration of applications for authorisation or branch notifications.
- Competent authorities should assess if, as part of their application, firms that are obliged entities under Directive (EU) 2015/849 have ensured that their systems and controls in place are compliant with the anti-money laundering and countering the financing of terrorism (AML/CFT) requirements in that Member State.

## A. Credit institutions

16. In particular, it is the EBA's opinion that:

- Competent authorities should have regard to the EBA's draft regulatory technical standards (RTS) and implementing technical standards (ITS) on the information to be provided for the authorisation of credit institutions<sup>14</sup> regarding the information to be presented in applications and the format of that information.
- Competent authorities should evaluate if firms have supported their applications with information pertaining to all requirements for authorisation.<sup>15</sup> In evaluating the completeness of the applications, competent authorities should take into account the information that need not be provided because it is already in their possession or because it relates to activities the applicant does not propose to carry out.

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<sup>14</sup> See: <http://www.eba.europa.eu/-/eba-publishes-final-standards-specifying-information-requirements-for-the-authorisation-of-credit-institutions>. The RTS and ITS were submitted by the EBA to the Commission on 14 July 2017. As at the date of this opinion, the RTS and ITS have not been adopted by the Commission, and therefore are not in force. Until such time as they are adopted, the RTS and ITS can be regarded as a useful reference point for competent authorities and firms in considering the information appropriate to support an application for authorisation.

<sup>15</sup> *Ibid.*

- Competent authorities should assess carefully if the application file contains sufficient information to assess whether or not the envisaged structure is commensurate to the size, nature and complexity of the activities (no ‘empty shells’).
- Competent authorities should have regard to the questions set out in the annex to the report appended to this opinion when considering applications for authorisation.
- Competent authorities should seek from any credit institution looking to obtain, where applicable, a variation of permission any information necessary to verify the continued compliance of the institution with the requirements for authorisation.
- In accordance with procedures agreed between competent authorities and resolution authorities, competent authorities and resolution authorities should engage with each other at an early stage during the authorisation process to seek views on how the firm might be treated from a resolution perspective, including any likely impediments to resolvability.
- The Commission should adopt at the earliest possible opportunity the draft RTS and ITS on the information to be provided for the authorisation of credit institutions.

## **B. Branches of credit institutions**

17. In particular, it is the EBA’s opinion that:

- competent authorities should clarify to credit institutions their supervisory expectations regarding the notification and assessment process relating to branch establishment and the variation of branch activities;
- competent authorities should consider if firms have articulated clearly their business intentions and organisational structure related to the programme of activities and risk management to the competent authority of the Member State of incorporation of the head office; and
- competent authorities should assess if, when opting for the establishment of a branch, UK institutions have considered the fact that EU branches will after Brexit become, in the absence of an agreement to the contrary, branches of third country entities subject to the relevant provisions governing these entities pursuant to EU legislation and national legislation in the Member States concerned.

## **C. Investment firms**

18. It is the EBA’s opinion that:

- With respect to the prudential supervision of investment firms:

- a. Competent authorities should refer to the opinion issued by ESMA on investment firms<sup>16</sup> when assessing the authorisation applications of investment firms.
  - b. Competent authorities should consider the systemic implications of investment firms seeking authorisation, and, where the investment firm is granted authorisation, authorities should ensure that all the relevant requirements in the CRD<sup>17</sup> and MiFID/MiFIR<sup>18</sup> are satisfied.
  - c. The Commission should consider proposing that Class 1 investment firms (indicatively, Class 1 investment firms are those which are of systemic importance, or which are exposed to the same types of risks as credit institutions, but they should be definitively specified in legislation) established within the Banking Union be supervised by the ECB, to ensure equivalent prudential supervision to credit institutions. The identification of these investment firms should be in line with the recommendations provided by the EBA on so-called Class 1 firms in its work<sup>19</sup> on investment firms.
- With respect to access to the EU market for investment services offered by investment firms established in a third country:
    - a. The Commission should consider ensuring that, when investment firms are established in third countries, they be subject to appropriate conditions for access to the single market including a robust assessment of the equivalence of the prudential standards applicable to them. The current MiFID/MiFIR equivalence regime is suboptimal in this regard, since the prudential standards against which such an equivalence assessment would take place are only the limited ones in MiFID/MiFIR and the CRD, and not those in the CRR,<sup>20</sup> which should ground the framework and any related equivalence assessments. In any case, the EBA should be consulted for advice to support the Commission decisions on the equivalence of third countries' prudential frameworks.

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<sup>16</sup> See: [https://www.esma.europa.eu/sites/default/files/library/esma35-43-762\\_opinion\\_to\\_support\\_supervisory\\_convergence\\_in\\_the\\_area\\_of\\_investment\\_firms\\_in\\_the\\_context\\_of\\_the\\_united\\_kingdom\\_withdrawing\\_from\\_the\\_european\\_union.pdf](https://www.esma.europa.eu/sites/default/files/library/esma35-43-762_opinion_to_support_supervisory_convergence_in_the_area_of_investment_firms_in_the_context_of_the_united_kingdom_withdrawing_from_the_european_union.pdf).

<sup>17</sup> The Capital Requirements Directive, Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

<sup>18</sup> The Markets in Financial Instruments Regulation, Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012.

<sup>19</sup> See <https://www.eba.europa.eu/documents/10180/1639033/Opinion+of+the+European+Banking+Authority+on+the+First+Part+of+the+Call+for+Advice+on+Investment+Firms+%28EBA-Op-2016-16%29.pdf> and <https://www.eba.europa.eu/documents/10180/1976637/EBA+Advice+on+New+Prudential+Framework+on+Investment+Firms+%28EBA-Op-2017-11%29.pdf>.

<sup>20</sup> The Capital requirement Regulation, Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.



- b. The Commission should consider, as part of its wider deliberations about the prudential rules for investment firms in the EU, the manner in which third country investment firms should be able to access the EU market. In particular, investment services should be provided by only those third country firms (whether directly or via establishment) that are subject to prudential standards as complete and robust as those applicable to EU firms. The EBA in this regard stands ready to provide further advice or assessments.

## **D. Payment institutions and electronic money institutions**

19. In particular, it is the EBA's opinion that:

- Competent authorities should develop plans to ensure they can cope adequately and in a timely manner with the increased workload that will arise from the implementation of PSD2 overlapping with Brexit.
- Competent authorities should assess if firms have included in their applications a clear explanation of the objective factors supporting the choice of jurisdiction, to facilitate the assessment by the competent authorities of whether or not the requirements under Article 11(3) of the PSD2<sup>21</sup> for payment institutions ('PIs') and e-money institutions ('EMIs') are met. The request for such information should be consistent with existing obligations in both Directives when firms seek to be authorised in a Member State.

## **E. Credit intermediaries and non-credit institutions admitted under the MCD**

20. In particular, it is the EBA's opinion that:

- EU27 competent authorities within the meaning of Article 5 of the MCD<sup>22</sup> should ascertain the number and identity of UK-based credit intermediaries providing services via passporting, or established, in their territories.
- Competent authorities should assess if credit intermediaries have included in their applications a clear explanation of the objective factors supporting the choice of jurisdiction, to facilitate the assessment by competent authorities within the meaning of Article 5 of the MCD of whether or not firms comply with the requirement under Article 29(5) of the MCD. The request for such information should be consistent with existing obligations contained in the MCD when firms seek 'admission' in a Member State.

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<sup>21</sup> The Payment Services Directive 2, Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC.

<sup>22</sup> The Mortgage Credit Directive, Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010.

## F. AML/CFT

21. In particular, it is the EBA's opinion that:

- competent authorities should develop plans to ensure they can cope adequately and in a timely manner with the increased workload that is likely to arise from AML/CFT assessments of newly authorised institutions; and
- competent authorities should note that firms previously authorised in the UK should not automatically assume that they comply with AML/CFT rules in another Member State.

## II. Internal models

### Key principles:

- i. The existing EU legal framework for model approvals should be applied in full, and, where model approvals or changes are sought, the CRR assessment process should be applied.
- ii. Permission to use internal models which is based on existing decisions will continue to apply in the EU27 Member States after Brexit. Assessments will need to be made of whether or not a group's new circumstances have affected its use of a model and therefore whether or not there is a material change or extension.
- iii. Institutions which do not yet have the relevant model permissions should apply for new permissions or model extensions to use the internal models in the EU27 Member States.
- iv. When considering applications, EU27 competent authorities can rely on assessments made by UK competent authorities where the assessment was for a similar rating system in the same class of exposures. In such cases, EU27 competent authorities should subsequently review the approval as part of the ongoing review, as set out under Article 101 CRD.
- v. UK and EU27 competent authorities should closely cooperate and exchange all necessary information for the purposes of the assessment and approval of the model applications.

22. In particular, it is the EBA's opinion that:

- For the purposes of acting on an individual basis, and also for the purposes of working together in the context of the joint decision process, competent authorities should ensure that their assessment of internal models or of changes and extensions is made subject to

the Union legislation, including without limitation to the provisions of the CRR/CRD as well as to the provisions of the Regulations on Model Changes and Extensions,<sup>23</sup> the EBA Model Validation Standards,<sup>24</sup> the Regulations on Supervisory Colleges<sup>25</sup> and the Regulation on Model Joint Decisions.<sup>26</sup>

- Competent authorities should work together, as provided for in the Union legislation, to replace, as appropriate and in a timely fashion, previous permissions, thereby achieving legal certainty and continuity of supervisory action for banks and groups across the Union. Competent authorities should, when assessing applications for the use of internal models, changes or extensions acting alone or on joint decisions, have regard, where relevant, to those previous permissions, in particular where these were granted on the basis of the CRR/CRD regime for the same exposures and portfolios.
- To assess whether or not the requirement of prior experience to use the internal model is met (i.e. length of use tests and time series/experience test), competent authorities should have regard to the exposures and portfolios covered by that model: permission may be granted, including when the applicant institution has not been the one using the model, provided that the institution using the model and the applicant institution belong to the same group of institutions, in particular where that use was approved under a previous permission.
- EU27 and UK competent authorities should closely cooperate and share relevant information on the assessments of internal models. Information to be exchanged should also include any terms and conditions to which the existing permissions are subject.

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<sup>23</sup> Commission Delegated Regulation (EU) No 529/2014 of 12 March 2014 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for assessing the materiality of extensions and changes of the Internal Ratings Based Approach and the Advanced Measurement Approach (OJ L 148/36); Commission Delegated Regulation (EU) 2014/942 of 4 March 2015 amending Delegated Regulation (EU) No 529/2014 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council as regards regulatory technical standards for assessing the materiality of extensions and changes of internal approaches when calculating own funds requirements for market risk (OJ L 154/1).

<sup>24</sup> Draft RTS on the specification of the assessment methodology for competent authorities regarding the compliance of an institutions with the requirements to use the IRB Approach in accordance with Articles 144(2), 173(3) and 180(3)(b) of Regulation (EU) No 575/2013; Draft RTS on the specification of the assessment methodology for competent authorities regarding the compliance of an institutions with the requirements to use the internal models for market risk and assessment of significant share under points (b) and (c) of Article 363(4) of Regulation (EU) No 575/2013; Draft RTS on the specification of the assessment methodology under which competent authorities permit institutions to use the Advanced Measurement Approaches (AMA) for operational risk in accordance with Article 312 of Regulation (EU) 575/2013.

<sup>25</sup> Commission Delegated Regulation (EU) 2016/98 (Commission Delegated Regulation (EU) 2016/98 of 16 October 2015 supplementing Directive 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards for specifying the general conditions for the functioning of colleges of supervisors (OJ L21/2)) and Commission Implementing Regulation (EU) 2016/99 (Commission Delegated Regulation (EU) 2016/99 of 16 October 2015 laying down implementing technical standards with regard to determining the operational functioning of the colleges of supervisors according to Directive 2013/36/EU of the European Parliament and of the Council (OJ L 21/21)).

<sup>26</sup> Commission Implementing Regulation (EU) 2016/100 of 16 October 2015 laying down implementing technical standards specifying the joint decision process with regard to the application for certain prudential permissions pursuant to Regulation (EU) No 575/2013 of the European Parliament and of the Council (OJ L21/45).

- Competent authorities should require that institutions established in the Union, including parent undertakings and EU intermediate parent undertakings, where relevant, should apply for permissions to use, change or extend internal models in accordance with the Union legislation. The applicants should coordinate with their respective consolidating supervisors and host competent authorities and provide all information necessary with regard to previous permissions obtained for the same exposures and portfolios.
- Nevertheless, there will be scenarios in which these applications are unlikely to be processed before the institution needs a decision. In this regard, competent authorities should note the principles set out in the IRB assessment methodology which make explicit a mechanism under which competent authorities may take account of assessments carried out by other competent authorities, including the UK competent authority;<sup>27</sup> this mechanism is particularly well suited at a time when significant pressure exists on EU competent authorities to consider a significant number of models. This therefore allows for a convergent and practical solution to streamline the supervisory burden on common grounds, in the exceptional circumstances to which Brexit gives rise for competent authorities.
- This practical solution should be limited to cases where existing model approvals have been granted by the UK competent authorities and the scope and content of the approvals match the portfolios that will exist in the new/expanded entity. In such cases, a schedule should be established by competent authorities to conduct a review having regard to the requirements set out in Article 101 CRD. Competent authorities should consider making public the conditions in which they will take such an exceptional approach, with a view to ensuring that applications are made in a timely manner.<sup>27</sup> By placing greater reliance on the assessment made by the UK competent authorities, the burden on institutions and EU27 competent authorities can be significantly reduced.
- Competent authorities should prioritise the review of the more critical cases using a risk-based approach by looking at the materiality of the assets in scope of the models, any indicators of potential issues regarding the use of the internal models, and the extent to which previous assessments have taken place.
- Competent authorities should notify the EBA of their aggregate model validation planning in relation to the UK's withdrawal from the EU.
- Competent authorities should have regard to the steps to be taken in different model approval scenarios as set out in the report appended to this opinion.
- In the broader context of credit risk, the impact on own funds calculations based on credit assessments of external credit assessment institutions (ECAIs) located in the UK needs to

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<sup>27</sup> Specifically, see Article 2(5) of the IRB Assessment Methodology, as published on 21 July 2016 at <https://www.eba.europa.eu/documents/10180/1525916/Final+Draft+RTS+on+Assessment+Methodology+for+IRB.pdf/e8373cbc-cc4b-4dd9-83b5-93c9657a39f0>.

be explored further. ECAIs are defined as credit rating agencies (CRAs) registered or certified by ESMA, which is the single direct supervisor of CRAs. Registration status requires physical presence in the Union as a prerequisite. Their ratings could still be used for regulatory purposes in the EU27 through certification or endorsement arrangements, subject to a number of conditions.

### III. Internal governance, outsourcing, risk transfers and ‘empty shell’ companies

**Key principles:**

- i. Competent authorities should assess whether or not institutions have sound and effective governance and that the members of the management body are suitable.
- ii. Competent authorities should not allow institutions to outsource activities to such an extent that they operate as ‘empty shell’ companies, and all institutions should have the substance to identify and manage the risks they generate.
- iii. Risk management is an important function of credit institutions and investment firms which goes hand in hand with the extension of business. Local risk management needs to be commensurate to the business extended. With respect to outsourcing, institutions should be able to monitor and manage the outsourcing arrangements, and ensure that authorities have full access to all information they need to fulfil their supervisory function.
- iv. EU27 authorities should have regard to the likelihood that after Brexit the UK will be a third country and thus activities outsourced to institutions in the UK prior to Brexit should be assessed with regard to the ability of the institution to adapt to this possible scenario.
- v. Institutions engaging in back-to-back or intragroup operations to transfer risk to another entity should have adequate resources to identify and fully manage their counterparty credit risk, and any material risks that they have transferred in the event of the failure of their counterparty.

23. In particular, it is the EBA’s opinion that:

- Competent authorities should assess whether or not institutions have sound and effective governance. Competent authorities should supervise, in particular, whether or not the management body effectively performs its function in the Member State of establishment and should assess:

- a. the suitability of members of the management body upon appointment and on an ongoing basis;
  - b. that the number of members of the management body is adequate, and its composition is appropriate; and
  - c. that members of the management body commit sufficient time to perform their functions in order to cover all the necessary subjects in depth, in particular to consider risk issues, and that appropriate access is granted to information on the risk situation of the institution.
- Competent authorities should assess whether or not institutions monitor and manage any outsourced activity and in particular those related to critical or important operational services.
  - Competent authorities should ensure that there are no obstacles which may prevent the effective exercise of their supervisory functions, in particular when institutions enter into and manage outsourcing agreements that are undertaken outside the EU/EEA (or, in the case of the UK, that will be undertaken outside the EU/EEA after Brexit). In this case, the outsourcing institution should be responsible for ensuring that the competent authority can access information as necessary to perform its duties, including its right to demand documents and audits, and its inspection rights.
  - Competent authorities should require that the outsourcing institutions have established access to relevant data held by the outsourcing service provider and the right for the competent authority to conduct onsite inspections at an outsourcing service provider's premises, including access to data held by providers established in the UK after Brexit.
  - Competent authorities should assess whether or not, in the context of a consolidated calculation of own funds (where the UK parent is the consolidating entity including, inter alia, EU27 subsidiaries), transparency with respect to the risks considered at solo and/or sub-consolidated levels is maintained after Brexit.
  - Competent authorities and institutions should monitor any relevant developments in UK law that could have implications for netting agreements (e.g. where counterparties or involved branches move away from the UK, or where in the future different law will govern the individual transactions or the contracts/agreements necessary to effect the netting agreement).
  - Competent authorities should be satisfied that banks have sufficient capabilities in place to supervise outsourced activities and ensure that all material local risks are identified and managed, including the risk posed by outsourcing risk management activities.

- Competent authorities should ensure that entities generating material credit counterparty risk have the ability to identify and manage that risk in the entity generating it.
- Competent authorities as part of the Supervisory Review and Evaluation Process (SREP) should assess institutions' concentration risk and its management and controls, including whether concentration risk is adequately covered with capital, and based on such assessment may impose additional supervisory measures, including additional own funds requirements for concentration risk and/or governance and control deficiencies. They should also assess, as part of the SREP, that intragroup transactions in over-the-counter (OTC) derivatives are subject to appropriate centralised risk evaluation, measurement and control procedures and that the potential exemptions from clearing and margining obligations are compliant with all the legal requirements and granted in a consistent way.
- Competent authorities should pay special attention to large exposures or concentration risk to some counterparties, as it may result from systematic back-to-back operations and the exposure to large counterparty credit risk. They should also pay special attention to intragroup large exposures waivers.
- With respect to market risk and credit risk, after Brexit, EU27 entities may use back-to-back transactions or intragroup transactions to transfer a part of the risks to a non-EU/EEA entity according to current legislation, in which case competent authorities should adhere to the following recommendations:
  - a. The EU27 entity must not operate as an 'empty shell', but have appropriate governance and risk management arrangements in place to be able to take on identification and management of the risks that it has generated, and that in the event of a crisis, it could rapidly deploy scaled up risk management arrangements.
  - b. The market activity hedged via back-to-back transactions or the credit exposure re-financed or secured via intragroup transactions is not large enough to threaten the continuity of the EU27 entity in the event of the failure of the institution to which the risks have been transferred. This requires that the EU27 entity has enough capital above the Pillar 1 minimum requirement (i.e. stemming from Pillar 2 requirements that arise as part of SREP), as well as in-house risk management and operational capabilities, to be able to cover for the material risks stemming from the unhedged portfolio, manage it actively and, if needed, unwind the positions in an orderly way.
  - c. To the extent that the transfer of market risk relates to volumes of transactions that are significant having regard to the size of the local market, enhanced supervisory cooperation must be put in place with the supervisor of the entity to which the risk is transferred, to ensure that the host supervisor has sufficient access to information to be able to monitor the management of the

transferred market risk on an ongoing and continuous basis. In the absence of such enhanced supervisory cooperation, the competent authority should take steps to limit or prevent the transfer of significant market risk.

#### IV. Resolution and deposit guarantee schemes

**Key principles:**

- i. Changes arising from Brexit should be factored into resolution authorities' resolution planning.
- ii. Institutions and authorities need to assess their stock and issuance plans for instruments used to meet the minimum requirement for own funds and eligible liabilities (MREL) in the light of Brexit, and in particular their reliance on instruments issued under English law.
- iii. Deposit Guarantee Schemes (DGSs) should be prepared to ensure that EU27 depositors maintain their protection after Brexit, by assessing (where relevant) the equivalence of the UK's deposit protection regime at the date of Brexit, and should consider putting in place cooperation arrangements with the UK DGS after Brexit.

24. In particular, it is the EBA's opinion that:

- With respect to resolution planning, resolution authorities should:<sup>28</sup>
  - a. adjust their analysis having regard to the plans put in place by institutions to respond to Brexit;
  - b. consider the extent to which institutions rely on access to financial market infrastructures located in the UK, and assess any impact on the continuity of access to such infrastructures;

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<sup>28</sup> Once the UK leaves the EU, arrangements for resolution planning for entities based in the UK should be subject to the same standard as for any other third country, in the absence of an agreement to the contrary. The timing of actions to be taken by resolution authorities is somewhat dependent on the actions taken by the institutions to restructure themselves, as well as the existing structure and resolution plans of the banks concerned (e.g. multiple point of entry (MPE) banks with a presence in the UK may be less inclined to restructure). Some institutions may take no such actions, in which case no additional consideration is required by resolution authorities. Other institutions may take immediate actions, in which case resolution authorities should be prepared to assess these actions and adjust their resolution planning accordingly. Article 10(6) BRRD requires resolution plans to be reviewed and updated at least annually, and 'after any material changes to the legal or organisational structure of the institution ... that could have a material effect on the effectiveness of the plan or otherwise necessitates a revision of the resolution plan.'



- c. consider the implications for operational continuity, and in particular the extent to which institutions rely on critical shared services provided by UK-based entities;
- d. consider any contracts or service level agreements with entities based in the UK and the extent to which they could be continued in circumstances where the UK is a third country;
- e. assess the extent to which institutions are reliant on data systems and information technology infrastructure based in the UK and ensure that appropriate safeguards are in place to maintain and preserve access to this data or infrastructure;
- f. consider any other change to the organisation or structure of institutions arising from their reaction to Brexit that may create an impediment to the resolvability of those institutions;
- g. engage with the competent authority to discuss how (expected changes in) the resolution planning needs for institutions in response to Brexit may interact with supervisory decisions taken or to be taken when granting approvals/licensing to new firms to be set up after Brexit;
- h. for existing entities, to the extent that any substantive impediments to the resolvability of institutions are identified arising from the above analysis, use their powers to remove those impediments to resolvability in line with the BRRD,<sup>29</sup> including consulting the competent authority;<sup>30</sup>
- i. for newly authorised entities, engage with the competent authority during the authorisation process regarding potential impediments to the resolvability of the applicant;<sup>31</sup>
- j. revise the resolution plans of institutions, as appropriate, where they intend to rely on some or all of their statutory powers with respect to a contract governed by UK law, or assets or liabilities located in the UK; and

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<sup>29</sup> The Bank Recovery and Resolution Directive, Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council.

<sup>30</sup> Articles 15-18 BRRD.

<sup>31</sup> In particular, it would be important for the supervisor to understand how the resolution authorities' views to resolvability of the proposed new/enlarged entities may (1) affect the business plans submitted by the institution to the competent authority as part of the licensing process and/or (2) interact with planned or foreseen supervisory decisions in relation to the licensing procedure (e.g. decisions with respect to waivers, outsourcing, booking models, etc.).

- k. consider if they need to re-evaluate their resolution strategy in respect of that institution, or utilise their powers to remove impediments to resolvability in accordance with Article 17 BRRD, such as requiring changes to legal or operational structures (Article 17(5)(g) BRRD), or otherwise mitigate the risk that the use of their powers will not automatically be recognised by the UK courts, for instance through requiring the inclusion of resolution action recognition clauses in contracts governed by English law.
- With respect to the determination of MREL and the assessment of the eligibility of liabilities to be included in the amount of MREL,<sup>32</sup> resolution authorities should:
    - a. Assess the approach to be taken by institutions to ensure that newly issued instruments can be subject to the write-down and conversion powers of EU resolution authorities. Institutions that wish to issue new MREL-eligible instruments under English law should at a minimum include clauses<sup>33,34</sup> in the relevant contracts recognising the eligibility of those instruments to be subject to the write-down and conversion powers of EU resolution authorities. As an alternative to issuing such instruments under English law, institutions may issue the instruments under EU27 law given the enhanced legal certainty this would entail.
    - b. Assess the extent to which institutions' existing stock of MREL-eligible liabilities are governed by English law. Unless resolution authorities can be otherwise satisfied that their powers would be given effect in respect of English law contracts, for instance through statutory recognition of their resolution actions by the UK, they should engage with the institutions concerned to replace or renegotiate these contracts (insofar as appropriate and proportionate) to include bail-in recognition clauses where a material proportion of an institution's existing MREL-eligible liabilities are issued under English law, having regard to the duration of the contracts in question.

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<sup>32</sup> Once the UK leaves the EU, English law instruments should be treated no differently from any other non-EU instruments, in the absence of an agreement to the contrary; the recommendations made in this opinion relate to the period up until the UK leaves, since at present English law instruments are EU law instruments, but they will become instruments issued under non-EU law after the UK's departure.

<sup>33</sup> A failure to include such clauses could result in the de-recognition of instruments issued under English law for MREL purposes once the UK becomes a third country. This could result in a breach by institutions of their MREL requirements, or a longer time horizon before they meet their MREL requirements, in either instance threatening the resolvability of those institutions.

<sup>34</sup> Articles 45(5) and 55 BRRD. See also Articles 42-44 of Commission Delegated Regulation (EU) 2016/1075 of 23 March 2016 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges.

- c. Aim to ensure that non-MREL liabilities issued under English law that might be subject to bail-in as part of the resolution action for an institution can also credibly be written down or converted through the inclusion of recognition clauses, unless they can be otherwise satisfied that their resolution powers would be given effect in respect of English law contracts.
- Resolution authorities should be ready to collect contributions to resolution financing arrangements after Brexit from branches of UK institutions established in the EU27, once such institutions become third country branches.
  - Resolution authorities should actively explore the options for engagement with UK central counterparty (CCP) resolution authorities after Brexit.
  - DGS designated authorities<sup>35</sup> should:
    - a. Ensure that they have appropriate processes and procedures in place to assist in or carry out, as relevant, any equivalence assessment<sup>36</sup> confirming the equivalence of protection provided by the UK DGS after Brexit.
    - b. After Brexit, consider requiring that any branches of UK institutions operating in their Member State become members of a local DGS and that such institutions adhere to the requirements of Article 15 DGSD, in the event that the protection is not deemed to be equivalent.
    - c. After Brexit, consider putting in place appropriate cooperation arrangements with the UK designated authority to secure the effective protection of depositors at branches of UK institutions established in the EU27, to the extent that the protection provided by the UK DGS is deemed to be equivalent.
    - d. After Brexit, engage with the UK designated authority to clarify which DGS will be responsible for the protection of depositors at branches of EU institutions based in the UK. Appropriate measures should be put in place to protect such depositors depending on the agreement between the UK designated authority and EU DGSs in this regard.
    - e. After Brexit, ensure that institutions provide depositors with all relevant information for them to be able to identify the DGS of which those institutions are members.

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<sup>35</sup> In this section, and in the corresponding section of the report appended to this opinion, the term 'designated authority' should be construed in line with point 18 of Article 2(1) of the Deposit Guarantee Scheme Directive (DGSD), Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes.

<sup>36</sup> Within the meaning of Article 15 DGSD.

## Monitoring by the EBA

25. Authorisation and supervision of, and potential enforcement against, supervised undertakings are a competence of the competent authorities.

26. The EBA will monitor developments, including by surveying relocation intentions, and assessing notifications received from competent authorities, applying a risk-based approach and using information collected from Members. The EBA will assess the extent to which the recommendations in this opinion have been adhered to, with a view to completing a progress report on this before the end of 2018. In addition, the EBA will conduct its analysis and make use of its powers and oversight tools to support supervisory convergence through bilateral engagements with the supervisory and resolution authorities, providing opinions and initiating investigations of possible breaches of Union law as the need arises.

This opinion will be published on the EBA's website.

Done at London, 12 October 2017

Andrea Enria

Chairperson

For the Board of Supervisors

# Report

## I. Authorisations

1. In order to support the functioning of the internal market for banking, mortgage lending, investment and payment and e-money services, it is necessary to have transparent, predictable and harmonised supervisory processes in relation to the granting of authorisations.
2. It is known that a number of firms established in the UK and currently operating in the EU are investigating so-called 'relocation' options to retain access to the internal market after the UK's withdrawal from the EU. In a number of cases, firms may seek to retain access by establishing an entity in an EU Member State, as either a branch or a subsidiary. Different processes apply to each. For new subsidiaries, authorisation, registration<sup>37</sup> or admission<sup>38</sup> by a competent authority under the relevant legislation is required. For new branches, the legislation sets out the manner in which the home and host authorities in the Member States should deal with notifications.
3. In the period before the UK's withdrawal has taken effect, it is of common interest for competent authorities in the EU to take steps to minimise disruption to the provision of banking and other financial services and therefore to facilitate the continuity of business. Nevertheless, the need to minimise disruption and facilitate continuity should not come at the expense of a full and thorough licensing process, conducted in line with the existing requirements, as recalled in this report. Relying on common and sound policies will help serve this purpose.
4. The current framework for authorisation, admission or registration does not achieve full harmonisation in this area, so there is a large variety of rules and procedures in Member States. In these circumstances, this opinion aims to achieve greater harmonisation in the application of the existing principles, and to avoid any relaxation of existing principles or practices in response to Brexit.
5. Irrespective of the type of authorisation, admission, registration or change sought or notification made, a number of principles of general application are set out in this report. This report also contains relevant analysis of the specific technical recommendations made in respect of the different types of authorisation, change or notification.

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<sup>37</sup> The Payment Services Directive, Directive (EU) 2015/2366 of 25 November 2015 on payment services providers, distinguishes between providers that must be authorised and those that need to be registered.

<sup>38</sup> 'Admission' is the term used in the MCD.

## A. Credit institutions

6. Depending on the operating structures already in place, relocation may involve firms:
  - a. seeking authorisation of new credit institutions<sup>39</sup> in the EU for the purposes of establishing a new presence or converting an existing branch to a subsidiary;
  - b. changing/expanding the activities undertaken by existing credit institutions in the EU, which may, in certain Member States, involve the variation of permission.<sup>40</sup>
7. Some relocation decisions may not be taken by firms until after the UK has withdrawn from the EU, in which case, unless any alternative provision is agreed between the UK and the EU27, the UK will be regarded as a third country, relations with which will be governed in accordance with Articles 47 and 48 of Directive 2013/36/EU (the CRD).
8. In other cases, and most probably, firms may seek the relevant new authorisations or, as appropriate in relevant Member States, variations of existing licences before the UK's withdrawal from the EU, in which case any such UK-based firms/banking groups shall be treated in accordance with existing EU law.
9. This section of the report reflects separately on the cases described in paragraph 6(a) and (b) and the application of Union law in the period before the UK's withdrawal has taken effect.

### A. Authorisation of credit institutions

10. In order to establish a new subsidiary as a credit institution in the EU27 (including cases in which a UK-based credit institution is looking to convert an existing branch in another Member State into a subsidiary), it is necessary to obtain authorisation from the relevant competent authority<sup>41</sup> (Article 8(1) CRD).<sup>42</sup> This involves preparing an application for authorisation to be considered by the competent authority.

### The application

11. All applications are required to be assessed rigorously against the requirements for authorisation specified in the CRD as transposed into national law. Additional

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<sup>39</sup> Credit institutions are defined in point (1) of Article 4(1) of Regulation (EU) 575/2013 (the CRR).

<sup>40</sup> An entity authorised as a credit institution in a Member State is able to carry out in other Member States the activities referred to in Annex I to the CRD (the activities subject to mutual recognition) by establishing branches or by the provision of services on a cross-border basis. Entities established in third countries do not have the power to carry out these activities on a cross-border basis in the EU.

<sup>41</sup> The relevant competent authority is the competent authority in the jurisdiction in which the subsidiary is to be established. In the case of jurisdictions participating in the Banking Union, the procedure for granting or a changing a banking licence is one of the 'common procedures', meaning that both the national competent authority and the ECB (as the SSM) are involved, albeit the ECB is responsible for taking the final decision.

<sup>42</sup> Member States are required to prohibit persons or undertakings that are not credit institutions from carrying out the business of taking deposits or other repayable funds from the public (except as permitted pursuant to Article 9(2) CRD).

requirements specified under national law have been notified to the EBA in accordance with Article 8(1) CRD by Croatia.

12. The EU requirements for authorisation are set out in Articles 10, 12, 13 and 14 CRD. The requirements relate to the following aspects: (a) programme of operations and structural organisation;<sup>43</sup> (b) initial capital; (c) effective direction of the business and place of the head office (see further below); and (d) shareholders and members.
13. In order for the competent authority to carry out the necessary assessments and verifications of the aforementioned requirements, as transposed into national law, applications should cover all requirements and be supported by a substantial amount of information evidencing the capacity of the applicant to comply with the requirements; mere confirmations are insufficient.
14. At the date of this report, the EBA's draft RTS and ITS on the information to be provided for the authorisation of credit institutions<sup>44</sup> have not been adopted as EU regulation (they were submitted to the European Commission on 14 July 2017). Pending adoption, competent authorities and firms may have regard to the RTS/ITS, and use them as a point of reference regarding the information to be presented in applications and the format in which that information should be provided.<sup>45</sup>
15. Dispensations or facilitating provisions regarding the information to be presented in applications are envisaged in the RTS (see Article 2(3)), namely where already held by the competent authority, including where obtained from another competent authority, or where the information is relevant to activities that the applicant will not be carrying out. In particular, competent authorities will take into account information already in their possession (e.g. in relation to existing branch operations, or where obtained from the UK authorities (see further below)). In such cases the competent authorities may, on a case-by-case basis, inform firms that the same information need not be provided in the application and, in this sense, elements of the application may be regarded as abridged.

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<sup>43</sup> This shall include matters such as the geographical distribution of activities, target markets, likely business and regulatory risk factors, organisational structure and internal control functions and framework, outlines of key policies and plans, and operational readiness (e.g. outsourcing arrangements, systems and controls, payments infrastructure in line with the applicable law on payment services ([https://ec.europa.eu/info/business-economy-euro/banking-and-finance/consumer-finance-and-payments/payment-services\\_en](https://ec.europa.eu/info/business-economy-euro/banking-and-finance/consumer-finance-and-payments/payment-services_en)) etc.

<sup>44</sup> See: <http://www.eba.europa.eu/-/eba-publishes-final-standards-specifying-information-requirements-for-the-authorisation-of-credit-institutions>. The EBA's draft RTS on the information to be included in an application for authorisation (pursuant to the mandate prescribed in Article 8(2) CRD) are intended to standardise the information to be presented in an application for authorisation as a credit institution. In so doing, the RTS are intended to mitigate the risk of divergent practices by listing and gathering the required information to enable the competent authorities to make decisions on applications for authorisation. The RTS and ITS were submitted by the EBA to the Commission on 14 July 2017. At the time of writing, the RTS and ITS have not been adopted by the Commission, and therefore are not in force. Until such time as they are adopted, the RTS and ITS can be regarded as a useful reference point for competent authorities and firms in considering the information appropriate to support an application for authorisation.

<sup>45</sup> The RTS set out the information necessary in order for a competent authority to assess applicants against the requirements for authorisation specified in EU law; information needed for ongoing supervision is not dealt with in the RTS.

### **The assessment process**

16. In order for authorisation to be granted, the competent authority must determine that all requirements for authorisation are satisfied by the applicant (see paragraphs 12 and 13).
  17. EU law does not provide a basis for any reliance on previous or existing authorisation decisions granted by an authority in another Member State or a third country, for instance by mutual recognition. Rather it supports the best use of existing information where information is exchanged between the competent authorities. This will come into play to feed the application file.
  18. Therefore, competent authorities should reach their own decisions about whether to grant or refuse authorisation, taking account of all relevant information, including as obtained from the applicant and from other competent authorities.
  19. In accordance with Article 16(1) CRD, competent authorities are required to consult the competent authorities of another Member State (hence the UK authorities, in cases where UK institutions seek to establish a new group company in another Member State) where the applicant is:
    - a. a subsidiary of a credit institution authorised in that other Member State;
    - b. a subsidiary of the parent undertaking of a credit institution authorised in that other Member State; or
    - c. controlled by the same natural or legal persons as those who control a credit institution authorised in that other Member State.
  20. The competent authorities will also consult the competent authorities responsible for the supervision of insurance undertakings or investment firms where the applicant is:
    - a. a subsidiary of an insurance undertaking or investment firm authorised in the EU;
    - b. a subsidiary of the parent undertaking of an insurance undertaking or investment firm authorised in the EU; or
    - c. controlled by the same natural or legal persons as those who control an insurance undertaking or investment firm in the EU (Article 16(2) CRD).
  21. In the cases described in paragraphs 19 and 20, the competent authorities are required to:
    - a. consult their counterparts when assessing the suitability of the shareholders or members (see further Articles 14 and 22-27 CRD);
    - b. consult their counterparts when assessing the reputation and experience of members of the management body involved in the management of another entity of the same group; and
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- c. exchange information regarding the suitability of shareholders or members and the reputation and experience of members of the management body which is of relevance for the granting of an authorisation and for the ongoing assessment of compliance with operating conditions (Article 16(3) CRD).
22. In addition, the competent authorities may agree to seek from one another information about other matters relevant to the assessment of the application, in order to enhance as much as possible the efficiency of the assessment process by leveraging information already in the supervisory domain.
23. In view of the requirements under EU law described in paragraph 21, the competent authorities may agree not to require applicants to provide the information on matters relating to controlling shareholders of a kind described in that paragraph (and any other information also requested from, and supplied by, the other competent authorities) where feasible and appropriate in order to minimise the burdens on applicants when preparing their applications. Applicant firms remain responsible for the completeness and accuracy of the information provided.
24. Consistent with the obligations on competent authorities to cooperate with trust and full mutual respect (Article 6(a) CRD), the authorities will endeavour to supply the information requested on a timely basis, acknowledging the resource constraints to which the authorities may be subject.
25. Where they are possible, these exchanges of information will help competent authorities receiving applications to make the best use of the information, and help minimise the amount of information required to be presented in applications, in order to facilitate the most efficient and timely assessment of applications.
26. Authorisation will be refused where a competent authority determines that:
  - a. an applicant does not meet all requirements for authorisation set out in the CRD and, in accordance with Article 8(1) CRD, any additional requirements specified under national law;
  - b. pursuant to an assessment in accordance with Article 14(3) CRD, competent authorities are liable to be prevented from exercising effectively their supervisory functions by the close links between an applicant and other natural or legal persons (recital (17) CRD); or
  - c. in the light of factors such as the content of the activities programme, the geographical distribution of activities or the activities actually carried out, the competent authority determines that an applicant has chosen a jurisdiction for the purposes of evading stricter standards in another Member State (recital (16) and Article 13 CRD).

#### **Timeline for authorisation decisions**

27. Pursuant to Article 15 CRD, where a competent authority refuses authorisation it shall notify the applicant of the decision and of its reasons within six months of receipt of the application or, where the application is incomplete, within six months of the receipt of the complete information required for the decision. In any event, a decision to grant or refuse authorisation shall be taken within 12 months of the receipt of the application.
28. In terms of an assessment of the completeness of the information to be presented in the application, Article 2(1) of the ITS on information to be provided in the context of an application for the authorisation of a credit institution specifies that an application shall be determined to be complete where the applicant has provided an application containing all information needed by the competent authority to assess the application (i.e. the information as set out in the RTS and any additional explanations or supplementary information required by the competent authority in accordance with Article 2(4) of the RTS).
29. Accordingly, to be sure of being treated under existing provisions in the EU and therefore benefiting from current legal certainty, firms wishing to relocate and acquire or change (an existing) licence should make sure their complete application files are remitted before the end of March 2018.<sup>46</sup> It is also a joint interest of the competent authorities and the applicant credit institutions to anticipate this deadline in order to smooth the flow of work.

#### **Updates to the EU Credit Institutions Register**

30. Competent authorities are required to notify the EBA of every authorisation of a credit institution granted pursuant to Article 8 CRD and of every withdrawal of authorisation (Article 20(1) and (5) CRD) in order that the EBA can maintain on its website a list of the names of all credit institutions authorised in the EU (Article 20(2) CRD) (the Credit Institutions Register).<sup>47</sup>
31. The EBA has recently enhanced its processes for such notifications to be operated in a more efficient and flexible manner. In particular, competent authorities are using an integrated eGate process.<sup>48</sup> The Credit Institutions Register is to be kept updated periodically by competent authorities. In general it is recommended that this is done every two months, but this can be done in near-real time.
32. Likewise, information on decisions to grant authorisation of a credit institution with an initial capital less than the amount required in Article 12(1) CRD, refusals regarding the

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<sup>46</sup> This date flows from the time limit imposed by Article 15 CRD.

<sup>47</sup> See: <http://www.eba.europa.eu/risk-analysis-and-data/credit-institutions-register>.

<sup>48</sup> EBA eGate is an IT tool designed to provide an environment to allow the collection, storage and display of different notifications that are reported by several data providers, including competent authorities, to the EBA. The ultimate objective is to include most, if not all, the notifications to the EBA required pursuant to Level 1 and Level 2 texts in eGate (e.g. in relation to authorisations and sanctions imposed in relation to credit institutions).

establishment of branches (Article 37 CRD) and decisions on authorisations in relation to branches of credit institutions having their head office in a third country (Article 47(2) CRD) will be published by the EBA to enhance transparency.

**B. Changes in the activity of existing credit institutions and the potential need for variations of existing licences**

33. In some cases relocations of business due to the UK's withdrawal from the EU may involve moving business to an existing subsidiary already authorised as a credit institution in one of the other Member States. In all cases it is necessary to ensure that the credit institutions concerned continue to comply with the requirements for authorisation (Articles 8 and 10-14 CRD), which must be satisfied on an ongoing basis.
34. In particular, the competent authorities will need to assess that the structural organisation remains adequate or is sufficiently adapted to the satisfaction of the competent authority to take account of the new business to be undertaken by the credit institution and to ensure that the arrangements, processes and mechanisms are proportionate to the nature, scale and complexity of the risks (Article 74(2) CRD) (see further below).
35. The EU framework does not expressly contemplate that competent authorities may grant authorisations subject to limitations or restrictions.<sup>49</sup> However, such practices are common.
36. Accordingly, firms seeking to implement organisational changes as a result of Brexit in relation to credit institutions established in the Member States may need to seek approval from the relevant competent authority, in accordance with national law, for variations of the licence in order to change/expand the activities of the credit institution concerned.
37. In determining whether or not to vary any limitations or restrictions attached to an existing authorisation, competent authorities must ensure that the requirements for authorisation continue to be satisfied by the credit institution concerned and should seek from the credit institution concerned any information necessary to verify its continued compliance with the requirements.
38. Furthermore, limitations or other restrictions must not be used by competent authorities as a means of circumventing or delaying the need for applicants to comply fully with the requirements for authorisation in order to carry out the activities of a credit institution.

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<sup>49</sup> Limitations may relate, for example, to the value or volume of business to be carried out by the entity concerned.

## **B. Branches of credit institutions**

39. Until such time as the UK's withdrawal from the EU takes effect, UK credit institutions have the same right to establish and maintain branches in the EU27 as any other EU credit institutions and vice versa.

### **A. Establishment of a branch**

40. In accordance with Article 35(2) CRD, credit institutions wishing to establish a branch in another Member State are required to notify to the home authority:

- a. the Member State within the territory of which the branch is to be established (i.e. the host Member State);
- b. the programme of operations setting out, inter alia, the types of business envisaged and the structural organisation of the branch;
- c. the address in the host Member State from which documents may be obtained; and
- d. the names of those responsible for the management of the branch.

41. Unless the competent authority of the home Member State has reasons to doubt the administrative structure or financial situation of the credit institution, taking into account the activities envisaged and all relevant EU requirements (e.g. on internal governance), the authority shall transmit to the competent authority of the host Member State information in accordance with the EBA RTS and ITS on passport notifications<sup>50</sup> in order that the host authority may prepare for supervision (Article 35(3) CRD). A refusal to do so shall be notified to the credit institution, the Commission and the EBA (Articles 35(4) and 37 CRD).

42. Ongoing supervision and cooperation between the competent authorities shall be carried out in accordance with Articles 40-45 and 50-52 CRD. Information exchanges between the home and host authorities are governed by the RTS and ITS on the information that competent authorities of home and host Member States supply to one another.<sup>51</sup>

### **B. Variation of the activities of a branch**

43. Any variations in the programme of operations of, and activities carried out by, branches of credit institutions (e.g. to run off existing business or to transfer business to an existing branch of another credit institution in the group) are required to be notified to the competent authorities of the home and host Member States (Article 36(3) CRD).

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<sup>50</sup> See: <https://www.eba.europa.eu/regulation-and-policy/passporting-and-supervision-of-branches/draft-technical-standards-on-passport-notifications>.

<sup>51</sup> See: <http://www.eba.europa.eu/regulation-and-policy/passporting-and-supervision-of-branches/draft-technical-standards-on-information-exchange-between-home-and-host-competent-authorities>.

44. Based on the information received, the competent authorities of the home and host Member States shall take a decision and may impose conditions relating to the change of business (Articles 35(3) and 36(3) CRD).
45. In accordance with Article 50 CRD, the competent authorities of the Member States concerned are required to cooperate closely and share information<sup>52</sup> to facilitate the examination of the conditions for the establishment of branches and ongoing supervision.

### **C. Branches of third country institutions**

46. For those UK credit institutions who seek to establish or maintain branches in the EU after the UK's withdrawal from the EU, the third country regime would apply (unless some alternative provision is agreed between the EU and the UK as part of the withdrawal negotiations) under Articles 47 and 48 CRD.<sup>53</sup>
47. To establish a branch, a third country credit institution must seek authorisation from the competent authority in the Member State concerned. In general, authorisation assessments are carried out in accordance with national law. However, branches of third country credit institutions must not be subject to more favourable treatment than credit institutions having their head office in the EU (Article 47(1) CRD). Accordingly, EU law requires competent authorities to assess compliance of third country applicants against the requirements specified in EU law, for instance relating to participation in schemes to protect depositors<sup>54</sup> and governance arrangements.<sup>55</sup>
48. Proposals to vary branch operations should be notified to the competent authorities in accordance with the procedures applicable to branches of EU credit institutions.

## **C. Investment firms**

### **A. Regulation and supervision of investment firms**

49. Investment firms operate under MiFID authorisations rather than CRD authorisations. Certain large investment firms are currently based in the UK, and they may seek to

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<sup>52</sup> See <http://www.eba.europa.eu/regulation-and-policy/passporting-and-supervision-of-branches/draft-technical-standards-on-information-exchange-between-home-and-host-competent-authorities>.

<sup>53</sup> Entities established in third countries do not have the power to carry out the activities set out in Annex I to the CRD (the activities subject to mutual recognition) on a cross-border basis in the EU. Therefore, for third country firms to provide these services in the EU it is necessary to establish a subsidiary or branch. Branch activities are confined to the jurisdiction in which the branch is based. It is not possible for branches to 'passport' their services into another Member State or to provide their services on a cross-border basis.

<sup>54</sup> Article 10 of Directive 2014/49/EU on deposit guarantee schemes (the DGSD) requires Member States to check that branches established in their territory of credit institutions having their head office outside the Union have protection equivalent to that prescribed in the DGSD.

<sup>55</sup> Article 74(1) CRD requires institutions to have robust governance arrangements, which include a clear organisation structure with well-defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks they are or might be exposed to, adequate internal control mechanisms, including sound administration and accounting procedures, and remuneration policies and practices that are consistent with and promote sound and effective risk management.

relocate some of their activities to the EU27 under a new or existing MiFID-licensed entity. Other institutions may also seek to establish themselves in the EU27 using new or existing MiFID-licensed entities, rather than as banks under the CRD.

50. It is important that all such institutions be subject to appropriate authorisation standards and adequate supervision. Various provisions of the CRD also apply to institutions licensed as investment firms under MiFID. In addition, authorities should also be cognisant of firms which will become systemic in the host jurisdiction. Class 1 investment firms (indicatively those which are of systemic importance or which are exposed to the same types of risks as credit institutions, but which should be definitively specified in legislation) should be subject to oversight and comparison with banks.
51. The current prudential framework for investment firms is not always adequately calibrated to deal with the different types of entity operating under a MiFID licence. In response to the Call for Advice received by the European Commission on 13 June 2016 on investment firms, the EBA has issued an opinion on a new prudential framework for investment firms.<sup>56</sup> The EBA opinion on the new prudential framework includes principles and detailed specifications on a broad range of aspects, including (a) the categorisation of investment firms by size and complexity; (b) the design and calibration of capital and liquidity requirements; (c) the applicability of the CRD and CRR remuneration requirements and corporate governance rules to investment firms distinguishing between the proposed investment firm classes; and (d) the suitability of the proposed prudential regime for certain specialised firms.
52. UK institutions wishing to relocate to the EU27 could:
  - a. obtain an authorisation when seeking to establish a new investment firm<sup>57</sup> in the EU27 (including cases in which a UK-based investment firm is looking to convert an existing branch into a subsidiary); or
  - b. submit a request for the extension of an authorisation when seeking to extend the business undertaken by existing investment firms in the EU27 to additional investment services or activities or ancillary services not foreseen at the time of initial authorisation (Articles 5 and 6 MiFID I/MiFID II).
53. The competent authority shall grant an authorisation only when it is satisfied that the applicant complies with all the requirements specified in the MiFID framework,<sup>58</sup> taking into account ESMA guidance.<sup>59</sup>

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See: <https://www.eba.europa.eu/documents/10180/1976637/EBA+Advice+on+New+Prudential+Framework+on+Investment+Firms+%28EBA-Op-2017-11%29.pdf>.

<sup>57</sup> Investment firm are defined in point (1) of Article 4(1) of Directive (EU) 39/2004 (MiFID I) and point (1) of Article 4(1) of Directive (EU) 65/2014 (MiFID II).

54. In order to allow the smooth application of prudential requirements under CRR/CRD,<sup>60</sup> competent authorities should assess the systemic importance of the investment firms seeking authorisation. Where the investment firm is granted authorisation, authorities should ensure that all the requirements in the CRD and MiFID/MiFIR are satisfied.
55. The identity of the supervisor of Class 1 investment firms (indicatively those which are of systemic importance or which are exposed to the same types of risks as credit institutions, but which should be definitively specified in legislation) is also important – see, for instance, the UK’s ‘designated firms regime’.<sup>61</sup> The merits of making the credit institution supervisor also the competent authority responsible for the prudential supervision of Class 1 investment firms are that:
- a. it allows comparability between institutions exposed to similar types of risks;
  - b. it ensures that the type of licence sought by an institution cannot be used as a way to choose the identity of its competent authority; and
  - c. it allows consistency in the prudential supervision of these entities.
56. Class 1 investment firms (indicatively those which are of systemic importance or are exposed to the same types of risks as credit institutions, but which should be definitively specified in legislation) established within the Banking Union should be supervised by the ECB, in strict cooperation with market authorities, to ensure equivalent prudential supervision to credit institutions.

## **B. Equivalence access under MiFID II/MiFIR**

57. Issues around equivalence are potentially broad and far-reaching in the context of the UK leaving the EU. Equivalence already exists as a means by which third country financial services firms can access the EU market in certain cases. In addition, current equivalence provisions could serve as a blueprint for future access arrangements depending on negotiations between the EU27 and the UK. At this stage of the process, the priority issue identified in the context of equivalence relates to its use as a mechanism for third country institutions to provide investment services into the EU under MiFID II/MiFIR.

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<sup>58</sup> The ‘MiFID Framework’ shall consist of the Directive 2004/39/EC (MiFID I), Directive 2014/65/EU (MiFID II) and Regulation (EU) No 600/2014 (MiFIR).

<sup>59</sup> ESMA opinion on general principles to support supervisory convergence in light of the United Kingdom withdrawing from the European Union, May 2017 (ESMA42-110-43), ESMA opinion to support supervisory convergence in the area of investment firms in the context of the United Kingdom withdrawing from the European Union (ESMA35-43-762) and ESMA opinion to support supervisory convergence in the area of secondary markets in the context of the United Kingdom withdrawing from the European Union (ESMA70-154-270).

<sup>60</sup> In response to the Commission’s Call for Advice for the purposes of the report on the prudential requirements applicable to investment firms, the EBA is designing a new prudential framework for investment firms. The EBA has issued an opinion (EBA-Op-2016-16) recommending that investment firms that are identified as G-SII or O-SII in accordance with the current regulatory framework should be subject to the full CRR and CRD and that the suitability of the O-SII guidelines for the purpose of identifying those investment firms should be revised after the new prudential framework for investment firms is completed.

<sup>61</sup> See: <http://www.bankofengland.co.uk/publications/Documents/other/prd/designationofinvestmentfirms.pdf>.



58. The scope of equivalence in areas outside traditional banking services is significantly broader than that allowed in the CRR/CRD and there are a number of situations where the recognition of equivalence results in access to the Single Market.<sup>62</sup>
59. Of particular relevance for the implications on the banking sector is the framework envisaged by the new MiFID II/MiFIR applicable after January 2018. This provides for access to the single market by a passport for third country branches of investment firms, with or without the establishment of an institution in the EU.
60. To this extent, the issue of third country branches is a relevant one because these entities provide a way for third country groups to access the EU market, while they are authorised, regulated and supervised nationally. A distinction should be made between investment services provided to retail clients and to professional clients and eligible counterparties.
61. With regard to the provision of investment services to retail clients,<sup>63</sup> third country branches do not have financial services passports and can operate only within the Member State where they are established; thus the risk assumed by a Member State in granting one access to its market is, in theory, borne by that Member State.
62. However, starting from January 2018, under MiFIR provisions<sup>64</sup> third country branches of investment firms and credit institutions may access the whole Union by acquiring a passport on the basis of certain equivalence conditions, and thereby provide investment services or perform investment activities to serve professional clients or eligible counterparties across the Union. To this extent, a number of UK investment firms currently operate on the basis of a MiFID authorisation rather than being subject to CRD authorisation (see above).
63. In addition to this, a third country firm (including credit institutions providing investment services or performing investment activities) may enter the Union, just to serve professional clients or eligible counterparties, on certain equivalence conditions without establishing a presence via a branch in the first place. MiFIR provisions envisage that a third country firm may supply investment services without the establishment of a branch if it is registered in the register of third country firms kept by ESMA. In turn, ESMA shall register a third country firm that has applied for such registration if the following conditions are met:

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<sup>62</sup> For instance, with regard to market infrastructure, EMIR provisions maintain that a CCP from a third country recognised as equivalent can provide its services to EU clients. In such a case, the EU supervisors rely on a third country supervisor to conduct supervision.

<sup>63</sup> Article 39(1) and (2) of MiFID II.

<sup>64</sup> Article 46 of the MiFIR.



- a) there is an equivalence decision by the Commission in place, focusing on compliance with prudential and conduct requirements (equivalent to those in the MiFIR, MiFID and CRD, but not the CRR);
  - b) the firm is authorised in the jurisdiction where its head office is established to provide the services and activities in the EU and it is subject to effective supervision and enforcement; and
  - c) ESMA has cooperation agreements with the third country regulator.
64. The provisions of MiFIR essentially enable cross-border investment services in the Union by third country firms. In turn, this could imply that investment firms may opt to access the EU market under MiFID/MiFIR without an equivalence assessment of the capital/liquidity regime included in the CRR. Access on such terms is suboptimal from a prudential perspective. Thus, MiFID II/MiFIR equivalence provisions become very relevant for (cross-border) investment services.

#### **D. Payment institutions and electronic money institutions**

65. In the absence of an agreement between the UK and the EU, following Brexit and in order for a UK payment or electronic money institution to provide services in the EU27 after Brexit, the institution would need to be established and authorised in any of the EU27 Member States. Exempted (sometimes known as ‘small’) PIs and EMIs do not have passporting rights. Unlike for credit institutions, there is no explicit regime for third country branches. UK institutions can provide payment services via a branch after Brexit (third country branch) only if they are a credit institutions or EMI, in accordance with Article 1(1) of PSD2.

##### **A. Current regulatory framework under PSD1**

66. Payment Services Directive 1 (PSD1), which applies *mutatis mutandis* to EMIs with regard to authorisation as highlighted in Article 3(1) the Electronic Money Directive (EMD), contains a number of requirements with regard to authorisation.
67. Firstly, PSD1, currently applicable, and PSD2, which will apply from January 2018, state that a competent authority shall authorise only an institution that is established in its Member State. In the context of Brexit and institutions wishing to relocate to the EU27, establishment may be particularly important. Secondly the competent authority shall ‘scrutinise’ the application (Article 10 PSD1). Article 10 PSD1 also states that the authority shall ensure that the institution has ‘robust governance arrangements’ and a ‘clear organisational structure’ including ‘effective procedures to identify, manage, monitor and report the risks to which it is or might be exposed’, as well as having ‘internal control mechanisms’ in place. Management should also be ‘sound and prudent’.

68. Article 5 PSD1 also defines a number of documents that should accompany an application, including a business plan, evidence of initial capital required and a description of internal controls and governance arrangements.
69. Provided that the information and evidence submitted comply with the requirements and the overall assessment is 'favourable', the authorisation should be granted. If the competent authority is not satisfied about 'the suitability of the shareholders or members that have qualifying holdings' the authorisation shall not be granted. Finally, the authorisation shall be granted only if close links (including in a third country) 'do not prevent the effective exercise of the supervisory functions' of the competent authority.
70. PSD1 does not, however, define the detailed documents that should be submitted to the competent authority in order to comply with Article 5 PSD1.
71. The high-level rules detailed below suggest that national competent authorities may have a certain degree of flexibility, and that differences may exist in the ways in which they currently treat and process applications from PIs and EMIs, which may result in divergences of view and different applications of PSD1 by competent authorities. This may lead to a risk of a race to the bottom whereby UK-authorised institutions 'shop' for the least demanding competent authorities in the EU27.
72. However, given the limited period from now until the application date of PSD2 on 13 January 2018, and the likely additional workload for relevant competent authorities (see below), the EBA is of the view that any fact-finding exercise to understand potential differences between competent authorities under PSD1 would be disproportionate and unwarranted. However, the EBA encourages national authorities to consider the implications of the upcoming changes brought about by PSD2 and the EBA guidelines on authorisation ahead of the application date in January 2018.

#### **B. Changes brought about by PSD2**

73. The situation highlighted in the previous section will change somewhat under the revised Payment Services Directive (PSD2), which entered into force on 13 January 2016 and will apply from 13 January 2018. While the requirements mentioned above have been replicated in PSD2, PSD2 additionally sets out information requirements for authorisation as a PI and for registration as an account information services provider. The Directive provided a mandate to the EBA to develop Guidelines with regard to the authorisation of PIs and EMIs. On 11 July 2017, the EBA published the final Guidelines,<sup>65</sup> which will also apply from 13 January 2018.
74. The Guidelines specify the detailed documentation that applicants are required to submit to national competent authorities for the purpose of authorisation or registration.

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<sup>65</sup> See: <https://www.eba.europa.eu/-/eba-publishes-final-guidelines-on-authorisation-and-registration-under-psd2>.

75. An additional requirement for authorisation has also been included in PSD2, namely that when PIs or EMIs provide new types of payment services for which they do not hold client funds, i.e. account information and payment initiation services, they shall hold a professional indemnity insurance or similar guarantee. EBA guidelines<sup>66</sup> published in July 2017 define the way in which competent authorities shall stipulate the minimum monetary amount of this insurance.
76. Compared with PSD1, PSD2 somewhat reduces the flexibility of competent authorities in granting authorisations, and therefore potential risks of divergence between them and of a risk of a race to the bottom in the context of Brexit are reduced.
77. The EBA also notes an important change under PSD2. Article 11(3) newly requires, in addition to the other requirements to have its head office as a registered office in the Member State, that the payment service provider (PSP) ‘shall carry out at least part of its payment service business there also’. This applies to both PIs and EMIs. In the context of Brexit and institutions wishing to relocate to the EU27, this is particularly relevant and the EBA encourages national authorities to consider the implications of these upcoming changes ahead of the application date in January 2018.
78. Institutions wishing to relocate from the UK to the EU27 should include in their applications a clear explanation of the objective factors supporting the choice of jurisdiction, to enable competent authorities to assess whether or not the requirement under Article 11(3) PSD2 and Article 9 EMD, akin to the ‘real seat’ for credit institutions, has been satisfied. This should be in accordance with existing obligations and requirements under PSD2 and the EMD.

### **C. Implementing PSD2 and the transitional period**

79. The EBA notes that, in the context of the implementation of PSD2, competent authorities will need to reassess, in a relatively short period of time, all existing authorisations granted before 13 July 2018 in order to see if they comply with PSD2. During that same period, competent authorities will need to assess the application of new types of institutions that are being brought under the regulatory framework by PSD2, namely account information and payment initiation service providers.
80. Article 109(2) PSD2 provides the ability for NCAs to ‘automatically grant authorisation [...] if the competent authorities already have evidence that the requirements laid down in Articles 5 and 11 are complied with’. Article 109 cannot be used for relocation purposes. EU competent authorities – other than the UK competent authority – would not be able to apply this automatic authorisation to a UK-authorized institution seeking authorisation in its Member State during that period. Before Brexit takes effect, Article 109 applies to UK institutions just as it does to all other EU27 institutions.

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<sup>66</sup> See: <https://www.eba.europa.eu/-/eba-publishes-final-guidelines-on-professional-indemnity-insurance-under-psd2>.

81. In addition, and in the context of the general implementation and supervision of PSD2, the EBA is planning payment supervision work to support cooperation and convergence, including in the area of authorisation. This could include the EBA reaching out to a number of competent authorities in the context of re-authorisation during the transitional period between January and July 2018 if and where appropriate.

#### **D. Increase of workload**

82. The EBA is concerned that implementing the changes triggered by PSD2 itself and the 12 mandates developed by the EBA in support of PSD2 will have considerable implications for the workload of national authorities. In particular, in the area of authorisations, competent authorities have to:

- authorise or register new types of PSPs which PSD2 has brought under its scope (payment initiation service providers and account information service providers) within the three-month timeline as defined in PSD2;
- review and re-authorise existing PIs and EMIs that had been authorised before January 2018 by 13 July 2018 (Member States may provide for PIs and EMIs to be automatically granted authorisation if the competent authorities already have evidence that PSD2 requirements are complied with); and
- review and assess the documents that applicant PIs and EMIs are required to submit under the EBA guidelines published in July 2017 on the information to be provided for the authorisation of PIs and EMIs and for the registration of account information service providers.

83. Processing the application of any UK firm potentially wishing to relocate in any of the EU27 countries as a result of Brexit would further increase that workload.

#### **E. Credit intermediaries and non-credit institutions admitted under the MCD**

84. Under the MCD, credit intermediaries and non-credit institutions are subject not to authorisation but to 'admission'. They shall be admitted to carry out credit intermediation and credit activities within the EU, except for non-credit institutions in Member States where such activities are not permitted.

85. The date for Member States to transpose the MCD into national law was 21 March 2016. Before that date, there were no European rules, meaning that non-credit institutions or credit intermediaries (apart from those carrying out credit intermediation under a CRD passport) would not have been able to passport their services out, or establish themselves, in another Member State. The rules were implemented in the UK on 21 March 2016, and the EBA understands that 12 credit intermediaries admitted under the MCD have made at least one passporting notification (although not all of these

passports may be active). Any potential relocation plan for those 12 credit intermediaries is unlikely to have a significant impact on the EU27.

86. The EBA notes that, for both creditors that are not credit institutions and credit intermediaries admitted under the MCD, competent authorities<sup>67</sup> are required to enter their names in a register, including, for credit intermediaries, the obligation to specify the Member States in which the credit intermediary conducts business. The EBA expects that competent authorities should ascertain the number and identity of any UK-based credit intermediaries and non-credit institutions providing services in their territories and to report any issues to the EBA.
87. The MCD requires competent authorities to ensure that any credit intermediary applying for admission meets a number of requirements defined under Article 29 of the MCD. Those include the requirement for members of the board to be of good repute, the requirement to hold professional indemnity insurance, and the requirement for their staff and executive members to have the appropriate level of knowledge and competence in relation to credit agreements. The credit intermediary shall have its head office in the country or ‘actually carry on its main business’ in the Member State.
88. For creditors admitted under the MCD, and provided that they are admitted under the law of the Member State where they wish to relocate, the MCD simply stipulates that applicants should be ‘subject to an adequate admission process’.
89. Rules governing the admission of non-credit institutions and credit intermediaries, and in particular the former, are limited, which suggests that competent authorities have a certain degree of flexibility, and divergences and differences may exist in the way in which they currently treat and process applications, which may result in divergences of view and different applications by competent authorities.
90. Article 29(5) MCD also requires a credit intermediary that does not have a registered office to have its ‘head office in the Member State in which it actually carries on its main business’. The EBA recommends that credit intermediaries that are located in the UK and may wish to relocate to the EU27 ensure that their application includes a clear explanation of the objective factors supporting the choice of jurisdiction, to enable competent authorities to assess whether or not this requirement is met.

## **F. AML/CFT considerations**

91. In June 2017, the Commission published a report on ‘the assessment of the risks of money laundering and terrorist financing affecting the internal market and relating to cross-border activities’ (the ‘Supranational Risk Assessment’ or SNRA).<sup>68</sup> The SNRA

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<sup>67</sup> Throughout this section, references to ‘competent authorities’ should be construed as meaning ‘competent authority’ within the meaning of Article 5 of the MCD.

<sup>68</sup> See: [http://ec.europa.eu/newsroom/just/item-detail.cfm?item\\_id=81272](http://ec.europa.eu/newsroom/just/item-detail.cfm?item_id=81272).

assesses the risk of money laundering (ML) and terrorist financing (TF) in various financial services sectors.

92. In the context of Brexit and the expected relocation of UK-based firms into other Member States, the implications of this assessment are twofold:

- Competent authorities will have to check whether or not firms hitherto authorised in the UK have in place AML/CFT systems and controls to comply with Directive (EU) 2015/849 as transposed into national law by their Member State. This is because Directive (EU) 2015/849 is a minimum harmonisation directive, which is territorial in its application; compliance of formerly UK-based firms with the new home Member State's AML/CFT regime cannot therefore be assumed.
- Article 48(6)(c) of Directive (EU) 2015/849 requires competent authorities to base the frequency and intensity of their supervisory efforts on the ML/TF risk profile of obliged entities, among others.<sup>69</sup> This means that any relocation of firms whose ML/TF risk exposure is classified as high in the SNRA will require a concomitant increase in specialist supervisory resources to ensure that the AML/CFT supervision of those firms is adequate. Should the relocation of firms in the light of Brexit result in the concentration of a large number of high-risk firms in a small number of Member States, the competent authorities in those Member States have to ensure they are equipped to absorb what could be a considerable strain on AML/CFT supervisory resources.

93. Furthermore, although this is not directly linked to the SNRA's findings, where firms relocating from the UK wish to maintain a presence in the UK, NCAs will have to check whether or not the firms' AML/CFT policies and procedures adequately address the risk associated with the group providing financial services in a third country.

## II. Internal models

94. The change of status of the UK due to Brexit may result in the relocation of UK-based institutions to the EU27. This change of status will affect existing permissions to use internal models and may result in a number of new applications for new models and/or model changes or extensions within a relatively short period, as a number of cross-border financial institutions that are considering the establishment of new credit institutions in the EU27 currently hold permissions for the use of internal models in line with Articles 143(1), 151(4) and (9), 283, 312(2) and 363 CRR.

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<sup>69</sup> See also the ESAs' Joint Guidelines on the characteristics of a risk-based approach to AML/CFT supervision and the steps to be taken when conducting supervision on a risk-sensitive basis: <http://www.eba.europa.eu/regulation-and-policy/anti-money-laundering-and-e-money/guidelines-on-risk-based-supervision>.

95. The calculation of risk-weighted exposure amounts on the basis of internal models requires permission by competent authorities, which is granted under the conditions set out in the CRR. To obtain permission, the institution should submit applications in accordance with Articles 143(1), 151(4) and (9), 283, 312(2) and 363 CRR. Institutions shall obtain permission from competent authorities for material model extensions and changes also on the basis of Commission Delegated Regulation (EU) 529/2014<sup>70</sup> and Commission Delegated Regulation (EU) 2015/942<sup>71</sup> (collectively referred to as the ‘Regulations on Model Changes and Extensions’).
96. Where applications for the permissions referred to in Articles 143(1), 151(4) and (9), 283, 312(2) and 363 CRR are submitted by an EU parent institution and its subsidiaries, or jointly by the subsidiaries of an EU parent (mixed) financial holding company, competent authorities should jointly assess these applications and determine if and on what terms and conditions the permissions should be granted in line with Article 20 CRR and Commission Implementing Regulation (EU) 2016/100 (the ‘Regulation on Model Joint Decisions’).<sup>72</sup> The Regulation also covers joint decisions regarding the approval of material model extensions and changes. The assessment and approval process should be facilitated through the framework of colleges of supervisors.<sup>73</sup>
97. To facilitate the approval of permissions to use internal models by competent authorities, the EBA has developed a number of technical standards specifying the assessment methodology to be used when assessing the compliance of the internal models with the requirements of CRR<sup>74</sup> (commonly referred to as ‘EBA Model Validation Standards’), whose adoption by the Commission is still pending. The EBA Model Validation RTS should

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<sup>70</sup> Commission Delegated Regulation (EU) No 529/2014 of 12 March 2014 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for assessing the materiality of extensions and changes of the Internal Ratings Based Approach and the Advanced Measurement Approach (OJ L 148/36).

<sup>71</sup> Commission Delegated Regulation (EU) 2014/942 of 4 March 2015 amending Delegated Regulation (EU) No 529/2014 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council as regards regulatory technical standards for assessing the materiality of extensions and changes of internal approaches when calculating own funds requirements for market risk (OJ L 154/1).

<sup>72</sup> Commission Implementing Regulation (EU) 2016/100 of 16 October 2015 laying down implementing technical standards specifying the joint decision process with regard to the application for certain prudential permissions pursuant to Regulation (EU) No 575/2013 of the European Parliament and of the Council (OJ L21/45).

<sup>73</sup> As provided for in Commission Delegated Regulation (EU) 2016/98 of 16 October 2015 supplementing Directive 2013/36/EU of the European Parliament and of the Council with regard to regulatory technical standards for specifying the general conditions for the functioning of colleges of supervisors (OJ L21/2) and Commission Implementing Regulation (EU) 2016/99 of 16 October 2015 laying down implementing technical standards with regard to determining the operational functioning of the colleges of supervisors according to Directive 2013/36/EU of the European Parliament and of the Council (OJ L 21/21) (collectively referred to as the ‘Regulations on Supervisory Colleges’).

<sup>74</sup> Draft RTS on the specification of the assessment methodology for competent authorities regarding the compliance of an institutions with the requirements to use the IRB Approach in accordance with Articles 144(2), 173(3) and 180(3)(b) of Regulation (EU) No 575/2013; Draft RTS on the specification of the assessment methodology for competent authorities regarding the compliance of an institutions with the requirements to use the internal models for market risk and assessment of significant share under points (b) and (c) of Article 363(4) of Regulation (EU) No 575/2013; Draft RTS on the specification of the assessment methodology under which competent authorities permit institutions to use the Advanced Measurement Approaches (AMA) for operational risk in accordance with Article 312 of Regulation (EU) 575/2013.



be adopted as soon as possible, given that they provide a mechanism by which the assessments of other competent authorities can be taken into account – in the context of Brexit, this would include the assessment of the UK competent authority.

98. On the basis of Article 2 of Commission Delegated Regulation (EU) No 529/2014 and Article 1(2) of Commission Delegated Regulation (EU) No 942/2015, extensions and changes are classified into three categories: (a) material<sup>75</sup> extensions or changes as defined in Articles 143(3), 312(2) and 363(3) of Regulation (EU) No 575/2013; (b) other extensions and changes that require notification before their implementation (and defined in the annexes to the two Delegated Regulations); and (c) other extensions and changes that require notification after their implementation.

99. With respect to the different scenarios that could be envisaged in the context of Brexit, from the perspective of EU27 competent authorities, the following should apply:

a. An existing EU27 subsidiary of a UK parent institution holds a permission to use internal models based on a **joint decision** concluded before Brexit between the UK acting as consolidating supervisor and the competent authorities of the EU27 subsidiary, and **no changes** in the models or exposures/portfolios covered by the models are required: under this scenario, the EU27 competent authorities should continue ongoing monitoring of the performance of the models in accordance with Article 101 CRD and also as part of their Supervisory Review and Evaluation Process (SREP).

b. An existing EU27 subsidiary of a UK parent institution holds a permission to use internal models based on a **joint decision** concluded before Brexit between the UK acting as a consolidating supervisor and the competent authorities of the EU27 subsidiaries, but, because of Brexit-related circumstances, **additional model approvals, model changes or extensions of scope affecting the UK parent and the EU subsidiary** are required: under this scenario, an institution should submit before the date of the UK's withdrawal from the EU to the EU27 competent authorities a new application regarding the planned model changes, extensions, or initial approvals to be applied for in relation to the EU27 subsidiary (on a solo and consolidated basis). The EU27 competent authorities should assess the application in accordance with existing legislation, in particular the EBA Model Validation Standards.

c. An existing EU27 subsidiary of a UK parent institution holds a permission to use internal models based on a **joint decision** concluded before Brexit between the UK acting as consolidating supervisors and the competent authorities of EU27

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<sup>75</sup> The notion of 'materiality' is defined according to Article 4(1) for the IRB approach and Article 6(1) for the AMA of the Delegated Regulation (EU) No 529/2014, while for IMA it is defined according to Article 1(2) of the Delegated Regulation (EU) No 942/2015.



subsidiaries and, because of Brexit-related circumstances, **additional initial model approvals, model changes or extensions of scope affecting only the EU subsidiary** are required: under this scenario, an institution should submit before the date of the UK's withdrawal from the EU a new application regarding the planned model changes, extensions or initial approvals to be applied for in relation to the EU27 subsidiary (on a solo basis). The EU27 competent authorities should assess the application in accordance with the existing legislation, in particular the EBA Model Validation Standards.

d. An existing EU27 subsidiary of a UK parent holds a permission to use internal models based on a **joint decision** concluded before Brexit between the UK acting as consolidating supervisor and the competent authority of the EU27 subsidiary, and, because of Brexit-related circumstances, the EU **subsidiary is turned into an entity consolidating all EU27 entities and exposures** (e.g. Intermediate EU Parent Undertaking): under this scenario, an institution should submit before the date of the withdrawal of the UK from the EU a new application for the internal models to be applied for in relation to the consolidating EU27 entity (**on a consolidated basis**). The EU27 competent authorities should assess the application for model approval in accordance with the existing legislation, in particular the EBA Model Validation Standards.

Where relevant, for other existing EU27 subsidiaries, an institution should notify EU27 competent authorities regarding the planned model changes, new model approvals or extensions (on a solo basis), and the EU27 competent authorities should assess the changes to the existing models in accordance with the existing legislation.

Where an institution would apply to use the internal models at both the new EU27 consolidated level and solo level for individual EU27 subsidiaries, the EU27 competent authorities should follow the process of the joint assessment and joint decision in accordance with the existing legislation, in particular the EBA Model Validation Standards and Commission Implementing Regulation (EU) 2016/100.

e. The UK parent sets up a **new EU27 company** as an entity **consolidating all EU27 entities and exposures** (e.g. Intermediate EU Parent Undertaking): under this scenario, an institution should submit a new application for the internal models to be applied for in relation to the new consolidating EU27 entity (**on a consolidated basis**). The EU27 competent authority should assess the application in accordance with the existing legislation, in particular the EBA Model Validation Standards.

Where relevant, for other existing EU27 subsidiaries, an institution should notify EU27 competent authorities regarding the planned model changes, extensions or

initial model approvals (on a solo basis), and the EU27 competent authorities should assess the applications in accordance with the existing legislation.

Where an institution would apply to use the internal models at both the new EU27 consolidated level and solo level for individual EU27 subsidiaries, the EU27 competent authorities should follow the process of the joint assessment and joint decision in accordance with the existing legislation, in particular the EBA Model Validation Standards and Commission Implementing Regulation (EU) 2016/100.

f. An EU27 branch of a UK parent is 'converted' into an EU27 subsidiary of that UK parent: under this scenario, an institution should submit a new application for the internal models to be applied for in relation to the new EU27 subsidiary (on a solo basis). The EU27 competent authorities should follow the procedure for a new application for model approval in accordance with the existing legislation, in particular the EBA Model Validation Standards.

g. An EU27 branch of a UK parent becomes a third country branch in the EU27: under this scenario, the EU27 competent authorities should follow relevant national legislation regulating supervision of third country branches.

h. An EU27 parent institution has a branch or subsidiary in the UK and Brexit-related circumstances will entail changes in internal models approved before Brexit by means of a joint decision between the EU27 competent authority acting as consolidating supervisor and the UK authority as signatory of the joint decision of the model approval: under this scenario, the EU27 competent authorities should continue ongoing monitoring of the performance of the models in accordance with Article 101 CRD and also as part of SREP, and assess the changes to the existing models from the perspective of the materiality of the changes or extensions and follow the procedure for approving model changes or extensions in accordance with the existing legislation, in particular Commission Delegated Regulation (EU) No 529/2014.

100. Where it is clear that these applications are unlikely to be processed before the institution needs a decision, the competent authorities may take account of assessments carried out by other competent authorities, including the UK competent authority provided that existing model approvals have been granted by the UK competent authorities and the scope and content of the approvals match the portfolios that will exist in the new/expanded entity. Where this greater reliance is placed on the assessment of the UK competent authorities, a schedule should be established by EU27 competent authorities to conduct a review having regard to the requirements set out in Article 101 CRD.

101. The EBA acknowledges that, in the context of the withdrawal of the UK from the EU, supervisory cooperation and coordination are crucial. This cooperation should be evident amongst EU27 competent authorities dealing with relocation requests and

related authorisations and permissions from institutions currently based in the UK. In addition, cooperation and coordination between EU27 competent authorities and UK competent authorities remain vital, both at present and in the future in the light of the interlinkages between the respective financial sectors. The EBA aims to foster regulatory and supervisory cooperation and coordination both at present and with respect to the future relationship with UK competent authorities.

### III. Internal governance, outsourcing, risk transfers and ‘empty shell’ companies

#### A. Internal governance and outsourcing

102. EU authorised institutions should have robust governance arrangements<sup>76</sup> including an outsourcing policy that considers the impact of the outsourcing on the institution’s business and the risks it faces. The EBA has published guidelines on internal governance to ensure a harmonised application of the CRD requirements. In response to Brexit, institutions active in the UK may decide to move parts of their activities into the EU. Competent authorities should ensure that these institutions have sound governance arrangements within the authorising Member State to ensure the sound operation of their activities within the chosen jurisdiction; so-called ‘letter-box’ or ‘empty shell’ entities do not meet those regulatory requirements.

#### A. Competent authorities should require and assess the soundness and effectiveness of institutions’ governance arrangements

103. In line with Article 13(2) CRD, institutions should have at least two suitable persons who effectively direct the business and should have a registered office and its head office in the Member State which granted it authorisation and in which it actually carries out its business. The EBA has issued guidelines on the suitability of members of the management body and key function holders.<sup>77</sup> With regard

104. to authorisations and the ongoing supervision of newly set up institutions, competent authorities should ensure that the management body and key function holders effectively perform their function in the Member State of establishment and, together with the key function holders, they are suitable at all times to perform their function effectively. It is not sufficient that management and steer is provided by the parent undertaking. Members of the management body of the newly established

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<sup>76</sup> Article 74 CRD. In addition, the EBA has issued guidelines on internal governance that specify the requirements encoded within the CRD.

<sup>77</sup> See: <https://www.eba.europa.eu/documents/10180/1972984/Joint+ESMA+and+EBA+Guidelines+on+the+assessment+of+su+itability+of+members+of+the+management+body+and+key+function+holders+%28EBA-GL-2017-12%29.pdf/43592777-a543-4a42-8d39-530dd4401832>.

institution need to have, individually and collectively, sufficient knowledge, skills and experience to fulfil their role and must be independent of mind. The members of the management body must commit sufficient time to perform their function in order to cover all the necessary subjects in depth, in particular the establishment of business and risk strategies and the management of the main risks.

105. The management body of the newly established institution is responsible for the definition and implementation of institutions' governance arrangements.<sup>78</sup> Given this, it should ensure a suitable and transparent organisational and operational structure for that institution and should have a written description of it. The structure should promote and demonstrate the effective and prudent management of an institution at individual, sub-consolidated and consolidated levels. In particular, institutions must implement a robust internal control framework and a risk strategy. The management body should be responsible for establishing and monitoring the adequacy and effectiveness of the internal control framework, processes and mechanisms, and for overseeing all business lines and internal units, including internal control functions (e.g. risk management, compliance and internal audit functions). Institutions should establish, maintain and regularly update adequate written internal control policies, mechanisms and procedures, which should be approved by the management body. To this end, the internal risk management function and internal control functions must be effective and have sufficient resources and standing.

106. The management body of the newly established institution should ensure that the internal control functions are independent of the business lines they control, including that there is an adequate segregation of duties, and that they have the appropriate financial and human resources as well as powers to effectively perform their role. They should have an adequate number of qualified staff. Staff should remain qualified on an ongoing basis and should receive training as necessary.

## **B. Substance of institutions and outsourcing**

107. Outsourcing may be used to reduce costs, to achieve strategic aims and to increase business resilience. Its potential scope and impact can be seen across many business activities, including information technology (e.g. cloud computing) and specific operations (e.g. some aspects of finance and accounting, internal control tasks, back-office activities). Increased reliance on the service provider regarding the outsourced activities, in particular with regard to critical or important operational activities, may have an impact on the ability of institutions to manage their risks and monitor their compliance with CRD/CRR requirements.

108. When relocating activities after Brexit, UK institutions may decide to set up structures in the EU that rely to a large part on outsourced services, provided by the UK

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<sup>78</sup> Article 88 CRD.

parent institution or other group entities, and try to relocate only a very limited number of staff to EU subsidiaries or branches. To this end, competent authorities should ensure that outsourcing is not used with the intention of stripping the institution's corporate substance and of setting up only a legal vehicle with the sole purpose of benefiting from an EU passport.

109. The general principle encoded in Article 74 CRD, that institutions must have robust governance arrangements, also includes outsourcing. The Committee of European Banking Supervisors (CEBS) has issued guidelines on outsourcing that are due to be revised.<sup>79</sup> Institutions must monitor and manage any outsourced activity, and competent authorities should ensure that outsourced activities are part of their overall supervisory review and that outsourcing arrangements do not pose any obstacle to their effective supervision. To this end, and in accordance with the CEBS Guidelines on Outsourcing, the institution may outsource any activity as long as it does not impair:

- the orderliness of the conduct of the outsourcing institution's business or of the financial services provided;
- the senior management's ability to manage and monitor the authorised entity's business and its authorised activities; or
- the ability of other internal governance bodies, such as the management body, to fulfil their oversight tasks in relation to the senior management.

110. In order to ensure the appropriate management of outsourced activities, institutions must retain an appropriate organisation to oversee and manage the relationship with the service provider (third party or internal service provider) and in particular have control functions in place that manage the risks related to the outsourcing contracts and outsourced activities. Institutions must be able to insource any outsourced activities within an appropriate timeframe.

111. Institutions must apply due diligence when outsourcing activities. This includes that the institution assesses the risks of outsourcing contracts and establishes a framework that ensure that all risks are managed. It must be ensured that the activities of the institution are appropriately executed. To this end, service level agreements are defined as part of the outsourcing contract. Such service level agreements are to be monitored and the institution needs to have an appropriate number of qualified staff to ensure this.

### **C. Remuneration**

112. The CRD comprises specific requirements on institutions' remuneration frameworks, and competent authorities should also pay particular attention to

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<sup>79</sup> CEBS has issued Guidelines on Outsourcing which are still in force, but which will be updated and replaced by EBA Guidelines by the end of 2018. The Guidelines differentiate between material outsourcing, for which stricter requirements apply, and non-material outsourcing.

remuneration practices. The EBA has already published guidelines on sound remuneration policies, its opinion on proportionality and several benchmarking reports on remuneration practices within the EU. As identified within the EBA's opinion on proportionality,<sup>80</sup> the national implementation of the remuneration framework, in particular with regard to the application of proportionality, has led to some extent to an un-level playing field in this area. Such differences may have an impact on decisions of institutions when relocating staff to entities within the EU, as the conditions of the remuneration framework may, in some Member States, be more suited to attract staff or to provide a higher level of cost flexibility (for example the limitation of the ratio between the variable and the fixed remuneration to 100% for staff whose professional activities have a material impact on the institution's risk profile).

113. A few Member States allow the limitation on the ratio between the variable and fixed components of remuneration to be waived, or exclude whole institutions or certain subsidiaries of institutions (e.g. asset management companies) from the application of all the remuneration provisions regarding the variable remuneration of identified staff in Article 94 of Directive 2013/36/EU.<sup>81</sup> The harmonisation of applicable waivers has already been suggested to the EU Commission.

## **B. 'Empty shell' companies, back-to-back and intragroup operations**

114. It is possible that a UK-based institution will establish an entity in the EU27 solely in order to get access to the Single Market, with no intention to transfer or set up a local management unit. Under this structure, the subsidiary, instead of identifying and managing the risk stemming from selling financial instruments, derivatives or credit products to EU clients, could simply transfer all risks via back-to-back or intragroup transactions to the non-EU27 parent undertaking.
115. The main concerns with such transactions are linked to the business model and governance arrangement of the newly established EU27 entity. In this regard, institutions might be tempted to keep them as 'empty shells', as the risks would be passed to other group entities or the parent undertaking located outside the EU27.
116. The CRR does not establish any specific requirement regarding back-to-back trading or intragroup credits and the possibility of establishing an 'empty shell' company (setting aside general governance and risk management requirements, which also apply in any case). Institutions must fulfil at all times all requirements that they had to meet to receive authorisation, including a programme of operations setting out the types of business envisaged and the structural organisation of the credit institution including

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<sup>80</sup> See: <http://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-25+Opinion+on+the+Application+of+Proportionality.pdf>.

<sup>81</sup> For further details please refer to the opinion of the European Banking Authority on the application of the principle of proportionality to the remuneration provisions in Directive 2013/36/EU.

governance arrangements as well as an outsourcing policy and strategy that considers the impact of the outsourcing on the institution's business and the risks it faces.

117. In line with Articles 13, 47, 74, 76, 88, 109 and 123 CRD, as well as with existing EBA Guidelines on internal governance,<sup>82</sup> published on 27 September 2011, competent authorities should, in line with Article 123(2) CRD, assess whether or not the institutions have an appropriate and transparent corporate structure that is 'fit for purpose', and have implemented appropriate governance arrangements to ensure that the outsourced activities do not affect their substance.
118. As has been mentioned, these requirements apply in any case; however, they are particularly relevant for banks applying an internal model for capital purposes. In this regard, the governance requirements for these institutions are far more stringent, both in the CRR (Articles 368 and 369 for market models, Articles 144 and 185-191 for credit models) and in the assessment methodology regulatory technical standards for internal models approaches in market and credit risk.
119. The risk of facing so-called 'empty shell' companies, whereby exposures are initiated locally, booked locally and extended to local counterparties but would see their related risks matched and taken for management by a parent or sister financial company located in a third country, is potentially a source of concern for supervisors. This risk is not new in any manner but probably more serious in the event of hastily organised relocations or restructuring of a banking group/investment firm.

#### **A. Back-to-back and intragroup transactions**

120. Back-to-back trading allows an institution to offer its clients complex trading instruments, potentially without having all the necessary infrastructure and risk capabilities to manage them, since all the underlying risks of these market transactions are effectively transferred to another institution of the group, which manages these transactions as part of its own trading portfolio.
121. Intragroup transactions may be used by institutions to transfer credit risk from one subsidiary or group entity to another. They may, however, be used for other purposes as well, such as the transfer of liquidity or re-financing, both of which reinforce the concentration in and/or dependence upon the parent institution. Unlike market risk, these transactions are generally not directly related to client activities or necessities except for financing midcaps, large corporates and other institutions where such structures are established for the purpose of credit risk mitigation and re-financing.
122. Transactions will be booked by the legal entity that performed them and any mirroring/back-to-back or intragroup transactions with another entity of the same group

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<sup>82</sup> See: [https://www.eba.europa.eu/documents/10180/103861/EBA-BS-2011-116-final-EBA-Guidelines-on-Internal-Governance-%282%29\\_1.pdf](https://www.eba.europa.eu/documents/10180/103861/EBA-BS-2011-116-final-EBA-Guidelines-on-Internal-Governance-%282%29_1.pdf).



will also be recognised by this legal entity. Under accounting rules, all transactions would be recognised by a legal entity at the individual level, regardless of whether a transaction is intragroup or with third parties (i.e. they cannot be offset against each other). At consolidated group level, intragroup transactions would be eliminated against each other so that only transactions with external parties appear. The risks to the legal entity may be minimal, but at the group level the risks will still exist. Importantly, while market risks can effectively be minimised for the institution engaging in back-to-back trading, and credit risks can effectively be minimised via intragroup credit transactions, this type of activity can pose significant counterparty risk.

123. It is clear that, in the event of the default of the institution to which the market or credit risks have been transferred, in addition to any losses stemming from the materialisation of counterparty risk, the portfolio of perfectly hedged market transactions, or perfectly re-financed and secured credit exposures, would become completely open, because of the disappearance of the transactions maintained with the defaulted counterparty. This event can pose significant challenges for the EU27 institution, at least from the following four perspectives:

- i. potential losses: stemming from the credit and/or market exposures with the institution to which risks had been transferred;
- ii. capital requirements: because of the sudden jump in capital requirements as a result of the unhedged or unsecured portfolios or missing re-financing structures;
- iii. operational issues: because of the need to manage the open book actively; and
- iv. risk management issues: since the institution would have to be able to identify, measure, manage and control the risk of the open book, and may not have the capability, resources and expertise to do so.

124. In this regard, the EU27 entity must have enough capital above the Pillar 1 minimum requirement (i.e. stemming from Pillar 2 requirements that arise as part of SREP), as well as in-house risk management and operational capabilities, to 'absorb' any material unhedged or unsecured portfolio that would appear in the event of the default of the institution to which the risks have been transferred, manage it actively and, if needed, unwind the positions in an orderly way.

125. Institutions should ensure that back-to-back and intragroup transactions are appropriately reflected in their market and credit risk strategies, as well as in their management of large exposures.

#### **IV. Resolution and deposit guarantee schemes**

126. Resolution is one of the pillars of the post-crisis regulatory reforms, and the changes it entails are still being implemented by authorities and institutions. The



departure of the UK from the EU requires appropriate adjustments to be made to the actions taken or planned by authorities and institutions. In particular, authorities should take into account (i) any restructuring undertaken by institutions to respond to Brexit; (ii) the possibility that the use of their administrative powers may not be automatically recognised by UK courts;<sup>83</sup> and (iii) the need to ensure that they are satisfied with their ability to write down or convert liabilities issued under English law when determining MREL and planning for the use of the bail-in tool.

127. The legal architecture<sup>84</sup> underpinning resolution planning and the setting of MREL in the European Union provides sufficient tools and powers for authorities and institutions to respond to the challenges posed by Brexit. This opinion aims to highlight aspects of that legal framework that are particularly relevant for authorities and to outline practical steps that should be taken in applying the framework in the context of the changes resulting from Brexit. Authorities and institutions should also have regard to the fact that the European Commission has issued proposals<sup>85</sup> for targeted amendments to the relevant legal framework.

128. As far as possible, disruption to resolution planning and to the removal of impediments to resolvability should be minimised. In this regard, continued cooperation with the UK authorities in the area of resolution would be welcome. Guaranteed statutory recognition by the UK of resolution actions taken by EU27 resolution authorities would further minimise the impact, for instance in the area of MREL. In the absence of this, however, EU27 resolution authorities and institutions need to be prepared to take action now to adapt to the changes entailed by Brexit.

129. The Union law on resolution ensures<sup>86</sup> that, when applying the resolution tools and exercising the resolution powers, resolution authorities are not subject to approval, consent or procedural requirements that would otherwise apply by virtue of law or contract. It also ensures that resolution authorities can exercise resolution powers irrespective of any restriction on, or requirement for consent for, transfer of the financial instruments, rights, assets or liabilities in question that might otherwise apply.

130. Of particular importance, Union law also ensures<sup>87</sup> the following:

- a. where a transfer of shares, other instruments of ownership, or assets, rights or liabilities includes assets that are located in a Member State other than the State of the resolution authority or rights or liabilities under the law of a Member State

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<sup>83</sup> Similarly, UK resolution actions would not automatically be recognised in the EU27, but instead EU27 resolution authorities would have to consider if they would recognise and enforce those resolution actions under Articles 94 and 95 BRRD.

<sup>84</sup> Primarily the BRRD and the Single Resolution Mechanism Regulation (SRMR), Regulation (EU) 806/2014.

<sup>85</sup> See: [http://europa.eu/rapid/press-release\\_IP-16-3731\\_en.htm](http://europa.eu/rapid/press-release_IP-16-3731_en.htm).

<sup>86</sup> Article 63(2) BRRD.

<sup>87</sup> Article 66 BRRD.

other than the State of the resolution authority, that all national laws of the Member State provide that the transfer has effect in or under the law of that other Member State;

- b. that the resolution authority that has made or intends to make the transfer will be provided by all Member States with all reasonable assistance to ensure that the shares or other instruments of ownership or assets, rights or liabilities are transferred to the recipient in accordance with any applicable requirements of national law;
- c. that shareholders, creditors and third parties that are affected by the transfer of shares, other instruments of ownership, assets, rights or liabilities are prevented from challenging or setting aside the transfer under any provision of law of the Member State where the assets are located or of the law governing the shares, other instruments of ownership, rights or liabilities;
- d. that where a resolution authority of a Member State (Member State A) exercises the write-down or conversion powers, including in relation to capital instruments, and the eligible liabilities or relevant capital instruments of the institution under resolution including instruments or liabilities that are governed by the law of a Member State other than the State of the resolution authority that exercised the write down or conversion powers (Member State B) or liabilities owed to creditors located in Member State B, Member State B shall ensure that the principal amount of those liabilities or instruments is reduced, or liabilities or instruments are converted, in accordance with the exercise of the write-down or conversion powers by the resolution authority of Member State A;
- e. that creditors that are affected by the exercise of write-down or conversion powers are not entitled to challenge the reduction of the principal amount of the instrument or liability or its conversion, as the case may be, under any provision of law of Member State B; and
- f. that the following are determined in accordance with the law of the Member State of the resolution authority: (a) the right for shareholders, creditors and third parties to challenge a transfer of shares, other instruments of ownership, assets, rights or liabilities; (b) the right for creditors to challenge the reduction of the principal amount, or the conversion, of an instrument or liability; and (c) the safeguards for partial transfers, as referred to in Chapter VII BRRD in relation to assets, rights or liabilities.

131. Union law also ensures<sup>88</sup> that a crisis prevention measure or a crisis management measure, including the occurrence of any event directly linked to the application of such a

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<sup>88</sup> Article 68 BRRD.

measure, shall not, per se, under a contract entered into by the entity, be deemed to be an enforcement event or insolvency proceedings, nor shall in principle make it possible for anyone (a) to exercise any termination, suspension, modification, netting or set-off rights, including in relation to a contract entered into by a subsidiary, the obligations under which are guaranteed or otherwise supported by a group entity or by any group entity which includes cross-default provisions; (b) to obtain possession, exercise control or enforce any security over any property of the institution or of any group entity in relation to a contract which includes cross-default provisions; or (c) to affect any contractual rights of the institution or any group entity in relation to a contract which includes cross-default provisions.

132. On the assumption that UK becomes a third country, the above provisions will, in principle, not bind the UK legislature or UK courts, while crisis prevention and resolution action undertaken by EU27 authorities will not be automatically recognised by the UK courts.

133. The EBA is, therefore, of the opinion that in at least two areas, resolution planning and the removal of impediments on the one hand and the determination of MREL on the other hand, EU27 authorities should, both on an individual basis and when working collectively in the context of joint decision making within resolution colleges, carefully consider the inherent legal uncertainty caused by Brexit. Resolution authorities should therefore endeavour to implement the recommendations set out in this opinion.

134. Additionally, the BRRD aims to ensure that there are sufficient resources available in resolution financing arrangements so that they can be used to support resolution actions taken by resolution authorities. In order to achieve this aim, institutions which might be subject to such resolution action are required to pay ex ante contributions to resolution financing arrangements. Contributions are required from authorised credit institutions and investment firms (which are within the scope of the BRRD), as well as from third country branches. After the UK ceases to be a member of the EU, branches of UK institutions operating in the EU27 will become third country branches, and may be subject to resolution action by EU27 resolution authorities under Article 96 BRRD. The resolution authorities of EU27 jurisdictions should be prepared to ensure that such branches contribute to the relevant resolution financing arrangement so that the financing of the possible resolution of any such third country branch can be assured.

135. Without an agreement to the contrary, the UK will become a third country for the purposes of EU law after Brexit. The BRRD already contains provisions setting out how cooperation with third country authorities should be structured, as well as how resolution planning and actions should be carried out in respect of institutions which are headquartered in a third country, as well as for third country branches. In this regard, EU27 authorities should be prepared to engage with the UK authorities under the relevant legislation, and to put in place appropriate decision-making structures for UK-parented institutions, for instance to establish European resolution colleges under Article 89 BRRD. The EBA stands ready to assist in this regard. Similarly, EU27 resolution

authorities should have regard to the relevant provisions in the BRRD relating to the exchange of information with third country authorities, namely Articles 90(3) and 98 BRRD; the exchange of information between the UK and EU27 authorities should be continued to the extent possible under the provisions of BRRD.

136. Given the systemic role of CCPs, there has been increasing activity around CCP resolution planning globally, and actions in that space could have an impact on banks that are either clearing members or clients of CCPs. There is both FSB Guidance on CCP Resolution,<sup>89</sup> as well as a Commission proposal for a Regulation on CCP Recovery and Resolution,<sup>90</sup> currently under discussion by the Council and European Parliament. Around the world, and in particular in the UK and other EU Member States, CCP ‘home’ resolution authorities (i.e. authorities responsible for CCPs established in their jurisdiction) are already making the first steps to resolution planning for CCPs. In general, some ‘host’ competent and resolution authorities (i.e. authorities responsible for banks in jurisdictions other than that of the CCP) are involved in such resolution planning, as they are invited to the relevant Crisis Management Groups, on the basis of the FSB Guidance. However, other competent and resolution authorities are absent from these discussions. Such absent authorities have at least the comfort that, for EU CCPs, any resolution planning or resolution action would eventually be governed by an EU Regulation, with the establishment of resolution colleges and other relevant arrangements. However, third country CCPs will naturally not be covered by the provisions of the Regulation. Given the reliance of EU banks on UK CCPs for the clearing of derivatives, securities and repo products, EU competent and resolution authorities may have an interest in engaging with UK authorities on CCP resolution planning.

137. Therefore, resolution authorities should actively explore the options for engagement with UK CCP resolution authorities on the basis of the FSB Guidance, and in particular the provisions for Crisis Management Group (CMG) and non-CMG engagement (Section 9).

#### **A. Deposit guarantee schemes**

138. Deposit protection is one of the key pillars of crisis management. At present, the EU legal framework<sup>91</sup> sets out in detail how the cross-border protection of depositors should be dealt with within the EU, as well as how to engage with third country branches. This framework is adequate to deal with the changes brought about by Brexit. Nevertheless, this opinion sets out a number of recommendations to authorities

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<sup>89</sup> See: <http://www.fsb.org/2017/07/guidance-on-central-counterparty-resolution-and-resolution-planning-2/>.

<sup>90</sup> See: [https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-markets/post-trade-services/recovery-and-resolution-central-counterparties-ccps\\_en](https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-markets/post-trade-services/recovery-and-resolution-central-counterparties-ccps_en).

<sup>91</sup> Primarily the Deposit Guarantee Scheme Directive (DGSD), Directive 2014/49/EU.

responsible for DGSs in the EU ('designated authorities')<sup>92</sup> on how they can prepare for Brexit.

139. The DGSD establishes the manner in which designated authorities should consider whether or not third country branches operating in their jurisdiction should be required to join the local DGS. An equivalence assessment of the protection provided by the home third country's deposit protection is required. This will be relevant once the UK becomes a third country, in the absence of an agreement to the contrary.

140. In addition, the protection of depositors of EU institutions operating through branches in the UK is also an important consideration. Clarity on the DGS responsible for the protection of such depositors should be achieved as soon as possible on a bilateral basis between the relevant authorities.

141. On this basis, EU designated authorities should engage with the UK designated authority to clarify which DGS will be responsible for protection of depositors at branches of EU institutions based in the UK. Appropriate measures should be put in place to protect such depositors depending on the agreement between the UK designated authority and EU designated authorities in this regard. The EBA stands ready to assist EU27 designated authorities as a central contact point in terms of future engagement with the UK designated authority.

142. It is also crucial that depositors are at all times kept informed of the deposit guarantee scheme to which they are affiliated, and otherwise are provided with relevant information. This is particularly important in circumstances where institutions make organisational and structural changes in response to Brexit that entail changes to the deposit guarantee scheme to which they are affiliated.

143. In that regard, designated authorities should ensure that institutions provide depositors with all relevant information<sup>93</sup> for them to be able to identify the deposit guarantee scheme of which those institutions are members.

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<sup>92</sup> Within the meaning of Article 2(1)(18) DGSD.

<sup>93</sup> Having regard to the requirements of Article 16 DGSD.

# Annex to the report

## **Key questions to which competent authorities should have regard when assessing applications for authorisation as a credit institution**

### Overview

1. An applicant may be authorised only where the competent authority is satisfied that the requirements for authorisation specified in Articles 10-14 CRD and, in accordance with Article 8(1) CRD, national law are met with a view to ensuring the sound and prudent management of credit institutions.
2. In assessing applications for authorisation as credit institutions, competent authorities should have regard to the key questions referred to in paragraphs 3-43. Explanatory notes are provided to reflect the content of the opinion and to assist the authorities but do not form part of the questions.

### Application status

3. Is the application complete, i.e. does it include all information, including supporting material, demonstrating that the applicant will be ready, willing and able to comply with all applicable regulatory requirements and commence the activities of a credit institution?

#### **Explanatory notes**

*It is important that the information presented in the application is accurate and complete otherwise the consideration of the application will be slowed down and the applicant's suitability to be authorised may be called into question.*

*The determination of completeness is also relevant to the timeframe for the consideration of the application: Article 15 CRD requires competent authorities to notify applicants of their decision within six months of receipt of a complete application or, where the application is incomplete, within six months of receipt of the complete application (and in any event within 12 months of the receipt of the application).*

*In assessing completeness, pending adoption by the European Commission, the competent authorities should use as a reference point the EBA's draft RTS and ITS on the information to be included in an application for authorisation (pursuant to the mandate prescribed in Article 8(2) CRD). The RTS and ITS are intended to standardise the information to be presented in an application for authorisation as a credit institution and the format in which the information should be presented. In so doing, the RTS and ITS are intended to mitigate the risk of divergent practices by listing and gathering the required information to enable the competent authorities to make decisions on applications for authorisation.*

## The applicant credit institution

### Name, LEI and website

4. What is the name of the applicant? Does the applicant propose to change its name after the date of the application or from an already used commercial names to which previous activities extended via a branch/passporting were linked?
5. Does the applicant use or propose to use a different trading name? Is any credit institution using that name already?
6. Does the applicant have an LEI number?
7. Does the applicant (plan to) have a website?

### Legal form

8. What is the applicant's legal form (e.g. incorporated company, partnership, natural person)?
9. In relation to legal persons:
  - a. when and where was the applicant incorporated or formed;
  - b. have the articles of association, or equivalent constitutional documents, and evidence of registration with the register designated by the law of the relevant Member State in accordance with Article 3 of Directive 68/151/EEC been provided; and
  - c. do the details provided in the application match those available in any relevant central register, commercial register, companies register or similar public register?

#### Explanatory notes

*It is important for the competent authority to have full information on the identity of the applicant, in particular in the context of understanding, where the entity has already a presence in the Member State concerned, how it will be structured and operate should it receive a new licence to operate as a credit institution.*

*For instance, a group with a credit institution authorised in the UK may have a branch in another Member State (A). In the context of Brexit, the group may decide to establish a newly incorporated entity in A for which it seeks a licence as a credit institution. The competent authority receiving the application will need to understand what legal form the applicant will take, what its LEI will be (as the entity will not be able to rely on the LEI assigned to the credit institution located in the UK), how any existing customer website will be updated to make it clear that customers would be transacting with a new credit institution and no longer the credit institution 'passporting' into the Member State via the branch, etc.*

### Accounting year end

10. What is the date of the applicant's accounting year end?

### Location of offices

11. If the applicant is a legal person, does it have a registered office in the Member State? Is the applicant's head office in the same Member State as the registered office? If not, where is it?
12. If the applicant is not a legal person, does the applicant have its head office in the Member State in which it proposes to carry out its business?
13. Has the applicant provided sufficient explanation for its choice of jurisdiction, including how this is related to its business structure, programme of activities and geographical distribution of activities?

#### **Explanatory notes**

*Where the applicant is a legal person, the head office must be in the same Member State as the registered office; where the applicant is a natural person, the head office must be in the Member State in which it actually carries out its business (Article 13(2) CRD).*

*As is clear from recital (16) CRD, competent authorities should refuse authorisation where factors such as the geographical distribution of activities indicate clearly that an applicant has opted for the legal system of one Member State for the purpose of evading the stricter standards in force in another Member State within whose territory it carries out or intends to carry out the greater part of its activities.*

*See further the explanatory notes in relation to the 'programme of operations'.*

## History of the applicant

### Regulatory status

14. Has the applicant previously carried out commercial or other activities? If so, in relation to the applicant and any of its subsidiaries:
  - a. are any licences, authorisations, registrations or other permissions to carry out activities in the financial services sector granted by a competent authority or other public sector entity in any Member State or third country:
    - i. currently held or
    - ii. pending approval;



- b. have any licences, authorisations, registrations or other permissions to carry out activities in the financial services sector granted by a competent authority or other public sector entity in any Member State or third country been revoked;
- c. has a decision been taken not to proceed with any licences, authorisations, registrations or other permissions to carry out activities in the financial services sector granted by a competent authority or other public sector entity in any Member State or third country?

### Significant events

- 15. Has a significant event relating to the applicant or any of its subsidiaries taken place?
- 16. Is a significant event taking place in relation to the credit institution or any of its subsidiaries?

#### Explanatory notes

*It is important that the competent authority assess the history of the applicant in order to determine if, having regard to the regulatory history and any significant events in relation to the applicant or any of its subsidiaries, the applicant is suitable to carry out the activities of a credit institution and can be supervised effectively.*

*'Significant event' is to be interpreted in accordance with the definition set out below.*

*In relation to the 'conversion' of branches to subsidiary applicant credit institutions, the competent authority may have regard to the activities undertaken in its jurisdiction by the branch and the management of those activities.*

## Programme of activities

### Nature of activities

- 17. What regulated activities does the applicant intend to carry out (e.g. pursuant to Annex I CRD, other EU sectoral measures and any applicable national legislation regulating the carrying out of certain activities)? Do the regulated activities align with the proposed business model?
- 18. Which SREP business model category would the applicant fall into (section 2.1.1 of the EBA's Guidelines on common procedures and methodologies for the supervisory review and evaluation process<sup>94</sup>)?

<sup>94</sup>

See:

<https://www.eba.europa.eu/documents/10180/935249/EBA-GL-2014-13+%28Guidelines+on+SREP+methodologies+and+processes%29.pdf/4b842c7e-3294-4947-94cd-ad7f94405d66>.

**Explanatory notes**

*It is essential that the scope of the requested permission correspond with the description of the proposed business and regulated activities of the applicant. The carrying out of a regulated activity without appropriate permission could result in the imposition of a criminal or civil sanction in accordance with the regulations and controls in force in the relevant Member State.*

*In addition, anticipating the SREP business model category of the applicant would help in determining if special requirements have to be formulated alongside the granting of the licence.*

**Deposit guarantee scheme**

19. Has the applicant confirmed that, before or upon authorisation, it will become a member of a deposit guarantee scheme officially recognised in the Member State in accordance with Article 4(3) of Directive 2014/49/EU?

**Explanatory notes**

*It is a requirement pursuant to Directive 2014/49/EU (the DGSD) for all credit institutions to participate in a deposit guarantee scheme.*

**Institutional protection scheme**

20. Has the applicant entered into, or does the applicant propose to enter into, an institutional protection scheme within the meaning of Article 113(7) CRR?

## Financial information

21. What is the financial situation of the applicant, taking account, in particular, of:
- the forecast information on the applicant at an individual level and, where applicable, at consolidated group and sub-consolidated levels, at least on a base case and stress case scenario basis for three years;
  - the statutory financial statements of the applicant at the individual level and, where applicable, at the consolidated group and sub-consolidated levels for at least the last three financial years where the applicant has been in operation;
  - where relevant, the outline of any indebtedness incurred or expected to be incurred by the applicant credit institution;

- d. where relevant, the outline of any security interest, guarantees or indemnities granted or expected to be granted by the applicant prior to the commencement of its activities as a credit institution;
- e. where available, information about the credit rating of the applicant credit institution and the overall rating of its group; and
- f. where relevant, an analysis of the scope of consolidated supervision?

**Explanatory notes**

*It is vital for the applicant to demonstrate that it has appropriate financial resources, including under stressed scenarios, in order to show its financial viability. Where the applicant is in a group, information about the financial position of the group is also relevant to this assessment.*

*For considerations relating to applicants in a group, see further the sections on the 'programme of operations', 'structural organisation', 'internal control mechanism', 'audit' and 'shareholders or members with qualifying holdings, 20 largest shareholders or members'.*

**Frameworks and policies**

22. Has the applicant provided outlines of the following frameworks and policies:

- a. risk management framework;
- b. liquidity risk management policy;
- c. funding concentration and diversification policy;
- d. collateral management policy;
- e. deposit policy;
- f. credit and lending policy;
- g. concentration risk policy;
- h. provisioning policy;
- i. dividend distribution policy; and
- j. trading book policy?

23. Does the applicant propose to engage in back-to-back or intragroup operations to transfer risk to another group entity? If so:

- a. what is the rationale for this approach;
- b. has the applicant demonstrated sufficient resources to fully manage counterparty credit risk and any material risks that are to be transferred in the event of the failure of that counterparty; and
- c. what are the residual risks?

### **Explanatory notes**

*It is important that the applicant has prepared outlines of frameworks and policies that demonstrate that it is sufficiently prepared to carry out the activities referred to in its programme of activities and to manage relevant risks and to show that its business will be conducted in a prudent manner.*

*It is not necessary for the applicant to have in place at the date of submission of the application full frameworks and policies but it is important that the competent authority be satisfied that the applicant has the capacity to put in place the necessary measures in relation to the carrying out of its activities, which can be checked after authorisation as a matter of ongoing supervision.*

*If the application results from a former branch conversion or the setting up a subsidiary from a group already licensed, the history of supervisory decisions and regulatory ratios should be exchanged; in particular, all (joint) decisions should be exchanged, by virtue of CRD provisions on information exchange for EU licensed entities or cooperative agreement as established for non-EU licensed parent entities, respectively.*

*Taking on board a forward-looking perspective, the competent authority will check that prudential reporting capacities will be available at once. Both the competent authority and the applicant would benefit from considering a set of simulated prudential ratios to make sure the credit institution's business is started on the right footing.*

*Where it is proposed that the applicant engage in back-to-back or intragroup operations to transfer risk to another group entity, the competent authority should verify that the applicant has adequate resources to fully manage counterparty credit risk and any material risks that are to be transferred in the event of the failure of that counterparty.*

*Competent authorities should assess likely concentration risk and the proposals for management and controls, paying special attention to large exposures or concentration risks that may result from proposals to use systemic back-to-back operations.*

*In relation to proposals to use internal models, where the applicant's business (including its portfolio of exposures) is similar to that of another credit institution in the group entity which has already a permission to use internal models, a competent authority will consider whether or not the 'use test' and the 'experience test' (assessed according to the provisions of Chapter 4 of the draft RTS on the specification of the assessment methodology for competent authorities regarding the compliance of an institutions with the requirements to use the IRB Approach in accordance with Articles 144(2), 173(3) and 180(3)(b) of Regulation (EU) No 575/2013) are satisfied in relation to the applicant, and, subject to the application of the existing EU framework for models approval, may accept the use of internal models for the applicant.*

## Recovery plan

24. Where applicable, has the applicant provided a description of its process for the development of a recovery plan within the meaning of point (32) of Article 2(1) of Directive 2014/59/EU?

### Explanatory notes

*It is important that the applicant show, where a recovery plan would be required in accordance with Articles 6 and 7 of Directive 2014/59/EU (the BRRD), sufficient preparedness to prepare a recovery plan within the meaning of point (32) of Article 2(1) of the BRRD, as this complements other financial information in demonstrating its preparedness to respond to financial stresses.*

## Programme of operations, structural organisation, internal control systems and auditors

### Programme of operations

25. Does the applicant have a programme of operations, including information on planned business and structural organisation (e.g. geographical distribution of activities, initial and ongoing viability, target market, customer segmentation, products, services and delivery channels, likely business and regulatory risk factors, and overall strategy)?
26. Does the applicant propose, following authorisation, to submit an application to carry out business in another Member State through the establishment of a branch or through the cross-border provision of services?

### Explanatory notes

*It is vital for the applicant to establish the credibility of its programme of operations and demonstrate the viability of its business model, including under stress scenarios, and to show the effect of key assumptions underpinning the business model not being met. In assessing the credibility and viability of the programme of operations, the competent authority will also take account of the financial information provided as well as simulated for the next [3] years (e.g. balance sheet, profits and loss, cash flow, etc.).*

*It is also important to ensure that the geographic location of its business activities is well understood, particularly in relation to any activities in the UK, having regard to the fact that the UK will, on its withdrawal from the EU, become a third country in the absence of any alternative agreement between the UK and the EU.*

### Structural organisation, including outsourcing

27. Has the applicant in place an appropriate organisational structure, taking account of:

- a. the terms of reference of the management body;
- b. the description of the human, technical and legal resources allocated to the various planned activities (e.g. ITS, commercial, legal, internal control and compliance functions);
- c. the description of the interplay between the applicant's various functions;
- d. the names of each payment, clearing or settlement system of which the applicant intends to be, directly or indirectly, a member during the first year of operations; and
- e. the description of the applicant's IT infrastructure, including the systems in use or to be used, hosting arrangements, organisation of the IT function, IT strategy and governance?

#### **Explanatory notes**

*It is important that the applicant demonstrate that its organisational structure is suitable to its business model and will ensure that its business is conducted in a prudent manner and enable the proper management of risk.*

*Particular regard should be had to the extent to which the applicant may choose to rely on services provided by entities (e.g. service companies in the group) or payment, clearing and settlement systems established outside the jurisdiction (e.g. in the UK), having regard to the fact that the UK will, on its withdrawal from the EU, become a third country in the absence of any alternative agreement between the UK and the remaining Member States.*

28. Where relevant, are the arrangements for outsourcing in line with the principles set out in the CEBS Guidelines on outsourcing,<sup>95</sup> taking account of the outline of external and intragroup outsourcing to support the applicant's operations, the outline of oversight responsibilities and arrangements, systems and controls for each material outsourced function, and the outline of the service level agreements and arrangements?

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<sup>95</sup> See: <http://www.eba.europa.eu/documents/10180/104404/GL02OutsourcingGuidelines.pdf.pdf>.

### **Explanatory notes**

*Competent authorities should not allow outsourcing to such an extent that credit institutions would be operating as 'empty shell' companies.*

*Concretely, outsourcing arrangements should not impair the effective direction of business, or the ability of the competent authority to carry out supervision. Given this, the competent authority must be satisfied that responsibility for outsourced functions is retained by the applicant and does not involve a delegation of senior management responsibility where core competence at senior operational level in house should be able to resume direct control in extremis (the CEBS Guidelines on Outsourcing from 2006). The arrangements should also ensure that the competent authority would have full access to all information needed to fulfil its supervisory functions. Again, in relation to activities proposed to be outsourced to entities in the UK, competent authorities should have regard to the fact that the UK will, on its withdrawal from the EU, become a third country in the absence of any alternative agreement between the UK and the EU.*

### **Internal control mechanism**

29. Has the applicant provided an appropriate explanation of its internal control framework taking account of:

- a. the overview of the internal organisation of the compliance function;
- b. the outline of the following policies and procedures relevant to activities identified in the programme of activities:
  - i. whistleblowing policy,
  - ii. conflicts of interest policy,
  - iii. complaints handling policy,
  - iv. market abuse policy,
  - v. policy promoting diversity of the management body,
  - vi. remuneration policy,
  - vii. product governance policy,
  - viii. business continuity plan and policy and
- c. the outline of the systems and policies for assessing and managing the risks of money laundering and terrorist financing?

### **Explanatory notes**

*The applicant must demonstrate that the internal control framework is sufficient to ensure the appropriate management of risks.*



### Audit

30. Does the applicant have in place appropriate auditing arrangements, taking account of the description of the internal audit resources, the outline of the methodology and internal audit plan for the next three years, the outline of the internal audit policy, and the identity of the applicant's statutory auditors or audit firm?

### Prudential reporting

31. Has the applicant demonstrated sufficient preparedness for the regulatory reporting obligations that would be applicable to it should it be authorised as a credit institution?

#### **Explanatory notes**

*The applicant must demonstrate that it is sufficiently prepared to fulfil the regulatory reporting obligations that would be applicable to it as an authorised credit institution as a matter of ongoing supervision.*

### Initial capital

32. Does the applicant hold separate own funds or have initial capital of at least EUR 5 million (or such lesser amount as permitted under the law of the Member State in accordance with Article 12(4) CRD)? If not, is the envisaged plan and implementation deadline appropriate to ensure that the initial capital is paid up in full before the commencing the activity of a credit institution?
33. Does the initial capital comprise only one or more of the items referred to in Article 26(1)(a)-(e) of the CRR (Common Equity Tier 1 items), namely:
- a. capital instruments, provided that the conditions laid down in Article 28 CRR (Common Equity Tier 1 instruments) or, where applicable, Article 29 CRR (capital instruments issued by mutual, cooperative societies, saving institutions and similar institutions) are met;
  - b. share premium accounts related to the instruments referred to in point (a);
  - c. retained earnings;
  - d. accumulated other comprehensive income;
  - e. other reserves?
34. Are the applicant's capital resources sufficient to meet the capital resources requirements, taking account of the nature and level of risks to which the applicant will be exposed both at authorisation and through a severe but plausible stress?

**Explanatory notes**

*Competent authorities are required to refuse authorisation to commence the activity of a credit institution where the initial capital is less than EUR 5 million (or such lower amount as may be specified under national law) and where the capital is not of a sufficiently high quality (Article 12 CRD).*

## Effective direction

35. Are there at least two persons effectively directing the business of the applicant credit institution?

**Explanatory notes**

*Competent authorities are required to refuse authorisation to commence the activity of a credit institution where fewer than two persons effectively direct the business of the applicant (Article 13(1) CRD).*

36. Do the proposed members of the management body meet the requirements referred to in Article 91(1) CRD (i.e. be of sufficiently good repute and possess sufficient knowledge, skills and experience to perform their duties) taking account of [*the GL on the assessment of the suitability of members of the management body once approved*]?<sup>96</sup>
37. Has the applicant in place a suitable board membership and structure? In particular, has the applicant demonstrated the skills, experience, propriety and suitability required individually and collectively by the board for the business model proposed?

## Shareholders or members with qualifying holdings, 20 largest shareholders or members

38. Has the applicant provided sufficient information in order to enable the assessment of the shareholders or members with qualifying holdings or, where no person or other entity has, or will in the case of authorisation have, a qualifying holding, the 20 largest shareholders or members in accordance with the Joint Guidelines on the prudential assessment of acquisitions and increases of qualifying holdings in the financial sector?<sup>97</sup>
39. Where the applicant is in a group, does its dependence on/independence from group entities mean it can be effectively supervised?

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<sup>96</sup> See: <https://www.eba.europa.eu/regulation-and-policy/internal-governance/joint-esma-and-eba-guidelines-on-the-assessment-of-the-suitability-of-members-of-the-management-body>.

<sup>97</sup> See: [https://esas-joint-committee.europa.eu/Publications/Guidelines/JC%20GL%202016%2001%20\(Joint%20Guidelines%20on%20prudential%20assessment%20of%20acquisitions%20and%20increases%20of%20qualifying%20holdings%20-%20Final\).pdf](https://esas-joint-committee.europa.eu/Publications/Guidelines/JC%20GL%202016%2001%20(Joint%20Guidelines%20on%20prudential%20assessment%20of%20acquisitions%20and%20increases%20of%20qualifying%20holdings%20-%20Final).pdf).

#### **Explanatory notes**

*Competent authorities should have particular regard to the group structure, in order to ensure that shareholders or members falling within the previously described categories are suitable having regard to their integrity, professional competence, reputation, experience and financial soundness, taking account of the need to ensure the sound and prudent management of the credit institution (see further Article 14(2) CRD).*

*See further the next section in relation to the consideration of obstacles which may prevent the effective exercise of supervisory functions.*

## Obstacles which may prevent the effective exercise of the supervisory functions of the competent authorities

40. Are there any circumstances or situations, including those of a legal, geographical, financial or technical nature, that could prevent the effective exercise of supervisory functions, including where relevant supervision on a consolidated basis?

#### **Explanatory notes**

*Such circumstances or situations might involve the nature of the close links that exist, the interactions of laws, regulations or administrative provisions of a third country, the possibility of exchanging information, the complexity and transparency of the structure of the group, the geographical location, and the activities performed or to be performed by members of the group or applicant credit institution or by the person or persons having such close links (see further Article 14(3) CRD).*

## Requirements for authorisation specified in national law pursuant to Article 8(1) CRD

41. Have any requirements for authorisation specified under national law been satisfied?

#### **Explanatory notes**

*Pursuant to Article 8(1) CRD Member States may specify requirements for authorisation in addition to those specified under EU law. Any such requirements must be notified to the EBA.*

## Consultation with competent authorities

42. Have the requirements for the competent authority to consult with other competent authorities been fulfilled (see Article 16 CRD)?

### **Explanatory notes**

*Before granting authorisation, competent authorities are required to consult with the competent authorities of another Member State in specified cases (see Article 16 CRD).*

*In relation to applications relating to the UK's withdrawal from the EU, the competent authorities should seek information as appropriate from the UK authorities in order to facilitate the efficient progress of the consideration of the applications.*

*To this end, competent authorities are expected to share information with one another on a timely basis in the course of the consideration of the application.*

## **Grounds for refusal of authorisation**

43. Taking into the outcome of the assessment of the application, are there any grounds to refuse authorisation?

### **Definition of ‘significant event’**

*‘Significant event’ includes each of the following matters:*

*(i) whether the applicant credit institution or any of its subsidiaries has ever been subject to a declaration of a moratorium of any indebtedness, to a restructuring or reorganisation process affecting its creditors, including measures involving the possibility of a suspension of payments, suspension of enforcement measures or reduction of claims, to a dissolution, to winding-up proceedings within the meaning specified in Article 2 of Directive 2001/24/EC, or to administration or other insolvency or similar proceedings;*

*(ii) whether the applicant credit institution or any of its subsidiaries has ever been the subject of any administrative penalty or civil or administrative judgment or arbitration or other adjudicative dispute resolution award or decision or of any judgment on the commission of a criminal offence, in each case resulting in a finding against the applicant credit institution or any of its subsidiaries, which was not set aside and against which no appeal is pending or may be filed (except in the case of administrative penalties imposed under Article 65, 66 or 67 of Directive 2013/36/EU and of criminal convictions, in respect of which information shall also be provided for rulings still subject to appeal), including, in particular:*

- any unsatisfied judgments or awards outstanding,*
- any settlements reached with any legal or natural person, having regard to the monetary terms of the settlements or to the circumstances in which they have been reached, in a subject matter which relates to the financial services sector,*
- any criminal conviction or civil or administrative penalty or other civil or administrative measure taken by any authority in respect of fraud, dishonesty, corruption, money laundering, terrorist financing or other financial crime or of failure to put in place adequate policies and procedures to prevent such events,*
- any criminal conviction or civil or administrative penalty or other civil or administrative measure taken by any authority in the financial services sector,*
- any criminal conviction or civil or administrative penalty or other civil or administrative measure in respect of a breach of legislation or regulatory requirements relating to the financial services sector or to consumer protection,*
- any other formal complaints made against it by its clients or former clients which have been resolved in favour of the complainant by a non-judicial third party,*
- any criminal conviction or civil or administrative penalties or other civil or administrative measures in respect of the carrying out of any unauthorised regulated activity and*
- any criminal conviction or civil or administrative penalties or other civil or administrative measures in respect of the carrying out of any unauthorised regulated activity;*

*(iii) whether the applicant credit institution or any of its subsidiaries is, as of the date of the application, involved in any proceedings, criminal, civil or administrative investigations or other events referred to in any of the items listed in points (i) and (ii).*