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European Commissioner for Financial Stability,
Financial Services and Capital Markets Union
European Commission
Rue de la Loi 200
1049 Brussels
Belgium

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

Dear Commissioner McGuinness,

China Banking Association¹ (CBA) supports the EU’s efforts to strengthen banks’ resilience and enhance financial stability through the CRD6/CRR3 package(the Proposals), in the belief that this will also ensure the EU’s objective of continued and adequate financing for its economy. **Notwithstanding this, we do have several significant concerns regarding the provisions of the Proposals in relation to cross-border business and TCBs**, as highlighted hereafter. As we believe that it should be carefully calibrated, designed and implemented in a way that does not, unintentionally constrain TCBs’ ability to support the EU’s economy, leading to a reduction in choice for European businesses and a reduction in liquidity in EU financial markets. In the following paragraphs, **we argue that Chinese TCBs bring tangible benefits to the EU’s economy and have limited impact on the EU’s financial stability. We urge the European Commission to consider the critical contribution which the Chinese TCBs make to the European economy, and to strike the right balance between EU policy objectives.**

Chinese Banks in the EU

A branch or subsidiary established by third-country groups plays diverse roles in the EU economy and banking industry. Unlike the subsidiary’s positioning, TCBs with mainly wholesale operations in the EU, have relative advantages in facilitating access to a broader pool of capital and liquidity for the whole EU market. Therefore, TCBs often serve the large clients’ needs more efficiently. Moreover, TCBs provide credit services based on the strength

¹ The China Banking Association is a nationwide non-profit self-regulation organization in China, representing 769 member banks and other financial institutions in China.

of their parent legal entity, thus eventually the EU businesses and clients are able to enjoy lower funding costs and a variety of financing channels. In the meantime, the local economy and employment also benefit from this virtuous circle in general. Therefore, it is necessary to maintain the operation of TCBs since they play an irreplaceable role in the contribution to the EU financial prosperity in a different way than a subsidiary.

The potential subsidiarisation requirements in the Proposals deny that TCBs are integral to the parent legal entity. Chinese TCBs in the EU mainly provide wholesale business for companies in Europe and China, whereas the retail business size is relatively small. Given the profile, size, and simplicity of Chinese banks' business in the EU, if TCBs are required for subsidiarisation or reduction of the total assets to be less than EUR 30 billion, their ability to perform business operation will be severely restricted. As a result, it will affect the long-term accumulated good reputation between EU and China, and will not be conducive to the economic recovery of the EU in the post-epidemic era as well. In addition, it could be highlighted that EU-headquartered banks mainly used branches outside EU to carry out their operations. Therefore, the current proposal could result in an uneven playing field for EU-based TCBs due to more stringent regulatory requirements.

Limited impact of TCBs on the EU Financial Stability

In fact, the assets held by TCBs in the EU only account for less than 2% of the total EU banking assets (**and it does not exclude intragroup exposures**), constituting minimum influence on the whole EU banking system with very limited risk related.

Besides the supervision conducted by the host country authority, TCBs are also subject to the supervision from the home country authority. For Chinese TCBs, China Banking and Insurance Regulatory Commission (referred hereinafter as "CBIRC"), as the home country supervisory authority, is responsible for supervising and maintaining close cooperation with other supervisory authorities. EU Commission also recognized that China's supervisory and regulatory framework for financial services is of equivalence in 2014. Furthermore, Chinese Basel Framework is assessed as being compliant with the global standards agreed by the Basel Committee through BCBS's Regulatory Consistency Assessment Programme (RCAP). China is the only jurisdiction who obtains five "compliant" among 20 members.

Based on the regulatory cooperation mechanism, CBIRC has already signed memorandums of understanding on cooperation with the competent authorities of many EU countries. Therefore, we have justified reasons to believe that Chinese TCBs manage within the banking regulatory principals shared between EU and China, and do not weakened supervision in EU.

Additionally, for TCBs whose parent legal entities are the global systemically important banks (referred hereinafter as "G-SIBs"), they are already subject to the strictest requirements stipulated by the Financial Stability Board (referred hereinafter as "FSB") and Basel III. For instance, on the group level, certain Chinese Banks as G-SIBs, have implemented the regulatory obligations and formulated the recovery and resolution plan subject to

requirements from CBIRC following FSB's standards. All of their TCBs in the EU are included in the supervision scope of the Head Office. They adopt a single-point disposal strategy and maintain the Total Lost Absorb Capability (referred hereinafter as "TLAC"). In case of difficulties, each branch can get sufficient loss-absorbing capacity support from their Head Office to ensure the normal operation.

We fully understand the EU's concerns of trade-offs between efficiency and financial stability generated by the activities of cross-border banking groups through branch and subsidiary. Nevertheless, considering all the benefits of TCBs to the EU and limited impact of TCBs on financial stability, the regulatory measures in the Proposals would be deemed as disproportionate.

Comprehensive Impact Assessment for Latest Regulatory Reform

Moreover, frequent structural changes have been raised in the EU's regulation against third-country groups in recent years. By introducing CRD 5 in 2019, the EU has required financial institutions in third countries that meet the conditions to establish IPU before the end of 2023. So far, the actual effects of those new regulations have not been clear to assess whether they are performing as intended. It's too hasty to further strengthen the regulatory legislation against TCBs. At the current stage, influenced by the unprecedented epidemic, the prospects for economic recovery in Europe remain uncertain. It is not deemed appropriate to further increase operating and compliance costs of TCBs. As a more feasible alternative, it is recommended to postpone and reinstate the discussion for new regulatory measures against TCBs after the final implementation completion of IPU establishment and reasonable observation period.

In addition, for a third country banking group, which has already a subsidiary/IPU in a member state, an additional subsidiary (following the subsidiarisation of a TCB) should not make sense from the legal perspective; in such a case, it should be ensured by the legislators, that a smooth merger with an existing subsidiary/IPU is possible, including a smooth transfer of contracts (e.g. in case of long-term lending arrangements of the TCB to be "subsidiarised") to a potentially existing subsidiary/IPU in the same member state WITHOUT complex client mailing campaigns; otherwise complex client mailing campaigns would be necessary to transfer agreements from the TCB, with the client acceptance, to the existing subsidiary/IPU. If, following the instruction to create a subsidiary, a third country banking group decides to "close"/liquidate the TCB (without a merger), a smooth transfer of contracts to a potentially existing subsidiary/IPU in the same member state WITHOUT complex client mailing campaigns should be possible.

Based on above backgrounds, we draw your attention to the following comments to the points in the Proposals concerning TCBs for which the CBA requests further consideration.

1. Proportionate regulatory treatment towards TCBs

1.1 The new and additional regulations in the Proposals on TCBs should be held for further

consideration, at least a full set assessment of IPU regulations should be taken before any further regulatory proposals on TCBs being put forward.

The Proposals aim to have appropriate visibility over TCBs by both national competent authorities and EU-wide authorities. However, we are in the view that the EU's concern for visibility over the TCBs should be addressed not by the proposed regulations that potentially could cause drastic change with consequential impact on the EU economy, but by engaging with the home authority through the cooperation mechanism, and in a close liaison between the national competent authorities and EU-wide authorities. If this proves insufficient, the primary option to be considered should be how the framework itself can be empowered to address the emerging risks, as opposed to introducing additional host requirements by way of new and/or additional regulations.

Therefore we strongly request reconsider the necessity of the new and additional regulations in the Proposals on TCBs. Even if some regulatory measures against TCBs prove to be considered, we would urge that the "Title VI" of the Proposals should be held for decisions until a reasonable observation period for IPU regulations being fulfilled. The actual influence of the new legislation in CRD 5 related with IPU cannot be assessed yet, sufficient time shall be given first, instead of hurrying to impose additional strict measures.

1.2 The Chinese G-SIBs should be exempted from systemic importance assessment and the subsequent obligations as systemically important TCBs.

China's G-SIBs and their overseas institutions have always adhered to the strictest regulatory compliance as stipulated by the FSB. Even if the local competent authorities might provide exemption on liquidity and capital requirements (based on the assessment on the strict conditions with respect to the equivalence of the prudential regime and with respect to comparability of the resolution regime in the home country jurisdiction), the regulation ratios are still monitored, reported and managed in accordance with the limits set by the Head Office. Therefore, it will not burden the EU's financial stability in any case.

2. The thresholds apply to TCBs should exclude intra group activities and be proportionate to their market influence.

The ability for third country banking groups to transact with their own branches, subsidiaries or affiliates established in the EU is a critical factor in how global banks operate their global business and manage the risks. It is also important for the TCBs to expand and diversify funding sources through intra group transactions, which in turn bring in a wider global wholesale market and permit the bank to support the EU economy efficiently.

However, the Proposals do not differentiate between intra-group transactions and other external transactions in all aspects of the thresholds apply to TCBs. For example, the criterion of "interconnected activities" set out in Article 48j.1 (a) would target any TCBs that is interconnected with other branches or subsidiaries within the third country banking group. The criterion of interconnectedness does not per se pose any particular risks and third-country groups which operate via multiple branches or via a branch and a subsidiary should only be subject to structural measures if authorities detect significant risks related to

their business models. Furthermore, CBIRC, does not impose such regulatory restrictions on European banks' branches in China, thus not allowing Chinese banks to compete on a level playing field.

In addition, the threshold of Euro30b for subsidiarisation requirements does not match with the fact that the assets held by TCBs in the EU only account for less than 2% of the total EU banking assets (**and it does not exclude intragroup exposures**), constituting minimum influence on the whole EU banking system with very limited risk related. Due to constraint of liquidity and capital, subsidiaries are generally unsuitable for providing large transactions and global financial services/products. Therefore, normally large businesses are operated by TCBs. Assessment of systemic importance of TCBs merely from the assets size is not reasonable. Business nature, risk related should be consulted to make the judgment for systemic importance.

Therefore, we are of the view that the Proposals should be amended to ensure that intra-group activities by TCBs can continue. And the thresholds apply to TCBs should exclude intra group activities, and raised to be proportionate with market influence of TCBs in the EU market. In the view that the assets held by TCBs in the EU only account for less than 2% of the total EU banking assets, posing minimum influence on the whole EU banking system with very limited risk related, we recommend the removal of systemic importance assessment on TCBs.

Moreover, EBA's report on the treatment of incoming TCBs clearly expressed that TCBs taking retail deposits are regarded as riskier regardless of their assets size. **Therefore, the definition of the systemic importance shall consider and be proportionated to the size of retail deposits and/or exclude TCBs from the assessment of systemic importance when they do not hold retail deposits.**

3. The allocation of supervisory responsibilities should privilege NCAs

3.1 The lead competent authority, or, where applicable, EBA' shall be removed

TCBs do not benefit from the European passport. Therefore, services provided and activities performed are limited to their home country. For institutions carrying out their activities at national level only (TCBs), the supervision, control and assessment of the systemic importance shall remain under the supervision of national competent authorities. The same shall apply for the decisions listed under article 48.k.4.(b). The EBA should stick to its primary function of standard-setter and not substitute itself to NCAs. Therefore, the concept of 'lead competent authority, or, where applicable, EBA' shall be removed as it is intrusive and conflict with the geographical limitations of the activities of the TCBs.

3.2 Reverse systemic importance assessment logic

The lead competent authority shall justify the needs to impose the decisions listed under article 48.k.4.(b) instead of having to justify that the absence of requirements on TCBs would lead to a significant increase in the risk that those branches pose to financial stability and market integrity of the Union or the Member States. Competent Authorities should have the

burden of proof to demonstrate the appropriateness of proposed corrective measures, not the other way round.

4. The corrective measures taken to TCBs of systemic importance should be gradual

4.1 Subsidiarisation would be the last resort measure where imposing additional Pillar 2 requirements or restructuring have not been sufficient.

The Proposals stipulate that a competent authority may require a TCB to subsidiarise or take other actions such as restructuring their activities to fall below the relevant €30bn threshold, imposing additional requirements on TCBs. We would argue that the mentioned three corrective measures should be imposed step by step to commensurate with the risks identified from TCBs, starting from imposing additional requirements, then restructuring activities, **subsidiarisation would be the last resort measure.**

4.2 TCBs shall be exempted from structural measures based on supervision equivalence of home country

The corrective measures taken to TCBs should take the supervision equivalence of home country into consideration. Should the supervision of the third country group has been regarded as equivalent supervisory and regulatory framework with that of the EU, we would argue that imposing additional requirements for the systematically important TCBs should be sufficient instead of structural corrective measures as restructuring activities and Subsidiarisation.

4.3 The timeframe to comply with corrective measures should be proportionate with the action being undertaken.

In the event of a requirement to subsidiarise, the proposed 3-month grace period in Article 48k (6) is insufficient to allow banks to make necessary changes to legal structures. We are of the view that the grace period should be agreed between NCAs and the TCBs, based on the degree and nature of the systemic risk posed by the TCB.

5. Liquidity requirements for class 1 TCBs should be compatible with ultimate objective of liquidity requirements

5.1 Apply zero-floor to the interest rate of assets in the escrow account to satisfy minimum capital endowment and liquidity requirements.

Based on S&P Global Market Intelligence data on 6 May 2021, the largest European banks have struggled to grow net interest income since the European Central Bank (referred hereinafter as “ECB”) introduced negative rates in June 2014. Especially in 2020, Eurozone banks paid EUR 8.5 billion to the ECB in negative interest charges, the highest-ever amount. Due to the potential compliance cost for keeping assets in the escrow account, the negative interest rate will erode the bank’s assets in the escrow account, resulting in the incompliance with minimum capital endowment in turn. The pledge requirement does not seem compatible with the ultimate objective of liquidity requirements, i.e. to cover and anticipate potential outflows.

Thus we are of the view that zero-floor to the interest rate of assets in the escrow account

should be applied to satisfy minimum capital endowment and liquidity requirement.

5.2 Recognize the liquid assets deposited in the escrow account with the central bank as high quality liquid assets (referred hereinafter as “HQLA”).

According to Article 48f of the Proposals, TCBs shall be required to deposit the liquid assets held in an escrow account. In view of the fact that TCBs have already complied with the liquidity requirements in accordance with Article 412 of Regulation (EU) No 575/2013, we believe that the liquid assets be deposited in the escrow account with the central bank of Member States should be recognized as HQLA when calculating liquidity ratios.

6. Article 21c would restrict cross-border business dramatically

Article 21c proposes that non-EU undertakings must establish a branch in a Member State to provide certain services in that Member State except where they are provided on a “reverse solicitation” basis. The article, if implemented, would lead to a severe reduction in the choice of financial service providers for EU businesses, would dramatically restrict the flow of credit and other financial services into the EU from firms operating on a cross-border basis without an EU branch. This reduction in choice and competition could reduce the quality of service and increase costs for EU businesses, and would oblige at the same time non-bank service providers and presumably also most banks to exit the EU market and unwind contractual arrangements, which may potentially be impossible.

Thus we believe that it is important that TCBs are allowed to continue to conduct cross-border transactions into other EU Member States. The Article 21c should be deleted.

As stated at the outset, Chinese banks are committed to contributing to a fair and free EU financial market, as well as to economic growth in Europe through the provision of financial services to EU businesses and clients. We appreciate the opportunity to comment on the draft CRD VI package and are keen to work with EU policymakers to get to policy outcomes that strike a balance between enhanced financial stability and long-term economic growth in the region. We are happy to form dialogues between policies makers and the industry to explore possible solutions.

Yours sincerely,

China Banking Association