Alert European Union 9/2024

Update on cross-border issues with regard to CRD VI

Geneva, 08.03.2024

1. References

1.1 Sources

The texts of CRD VI and CRR III are available under:

> https://data.consilium.europa.eu/doc/document/ST-15883-2023-INIT/en/pdf
> https://data.consilium.europa.eu/doc/document/ST-15882-2023-INIT/en/pdf

1.2 Country Manuals

CM PB	CM EAM	CM Products	CM AM	CM Credits	CM Trustee	CM InsDist
Yes	No	No	No	Yes	No	No

1.3 Topics

Banking Services; Credit Services; Cross border Logic

1.4 Key Words

Branch; CRD6

2. Context

In December 2023, the preparatory bodies of the European Council and Parliament endorsed and published the texts of the so-called **banking package**, consisting of a legislative act "CRD VI") to amend the Capital Requirements Directive (Directive 2013/36/EU) and a legislative act ("CRR III") to amend the Capital Requirements Regulation (Regulation No (EU) 2013/575). The texts remain to be adopted by the European Parliament Plenary and the Council (possibly in April or May 2024) and will then be published in the Official Journal of the EU. After publication, there will be an 18-month transposition period for Member States to implement CRD VI into national law, followed by a 12-month special transitional period until the cross-border restrictions will be applied.

The following alert focuses on the impact to be expected by CRD VI on third-country financial intermediaries' ability to **solicit and/or provide banking services on a cross-border basis in(to) the EEA.**

2.1. Current regulation of banking services in the EU

To date, and until the coming into force of the above-mentioned banking package, the regulation of, and in particular the licensing requirements for banking services within the EEA is and will be fragmented. While the Capital Requirements Directive requires Member States to subject the activity of credit institutions to a licensing requirement and reserves the right to

take deposits or other repayable funds from the public to credit institutions, the licensing requirements for other types of banking services are regulated by the individual Member States and there are in particular no explicit legal provisions on an EU level on cross-border banking services provided by third-country financial intermediaries. It is, to a great extent, up to the individual Member States to provide for a national legal framework (and/or practice of the supervisory authorities) regulating such services.

There are three main approaches (which may also be combined) currently to be observed among Member States: (1) The possibility for third-country credit institutions to acquire a type of **cross-border license or exemption**, (2) Requiring the **establishment of a branch** for the active performance of banking activities in or into the Member State, by tolerating at the same time activities based on reverse solicitation to a varying degree, and (3) Requiring **no license for certain banking activities**.

> Examples for cross-border exemption-set ups include:

- **Germany:** A so-called "Freistellung" (exemption) authorises a third-country credit institution (adequately supervised in its country of establishment) to actively promote the exempted banking services in or into Germany without establishing a local presence. Payment services are excluded from the exempction and the solicitation of private clients is limited insofar as the first contact with such retail clients must take place via a determined credit institution (i.e. German credit institution, a German branch of an EU credit institution, or a passported credit institution domiciled in another EU Member State);
- **Italy:** Third-country credit institutions may offer/provide banking services to Italian clients without establishing a branch/subsidiary, based on an authorisation issued by the Bank of Italy under the freedom to provide services regime («LPS licensing regime»);
- **Spain:** Third-country credit institutions aiming at the cross-border performance of banking activities in or into Spain without a local presence may request a respective authorisation from the Bank of Spain. However, the activities for which such an authorisation can be sought exclude deposit taking/the raising of funds.

> Typically, Member States already today requiring the establishment of a branch for the performance of (all or certain) banking activities do not have an explicit legal basis for a reverse solicitation exemption, but do, in practice and to a certain extent, tolerate activities by unlicensed third-country bank based on reverse solicitation (i.e. the initiative of the prospect on their territory):

- Some Member States tolerate such activities both when performed via remote means of communication into said State and on the State's territory;
- Reverse solicitation via remote means of communication is currently deemed to be tolerated by all Member States, with varying levels of tolerance;
- Two special cases are worth mentioning:
    - o France's banking monopoly may be infringed even if a banking activity does not constitute solicitation. This is the case if the foreign financial

intermediary's activity can be linked to France in application of the so called "bundle of indicators method";

- Sweden applies the lasting presence test with regard to cross-border banking activities. This means that banking activities into (or occasionally in) Sweden are tolerated by the authorities both actively and upon request as long as they do not reach a critical level of intensity. Only when the activities by an unlicensed third-country bank are deemed to be "habitual", they become subject to a licensing requirement.

- In a number of EEA Member States, lending activities (or certain types of them) are not considered a reserved activity and/or not subject to licensing requirements (in particular: corporate lending). In Ireland, for example, the provision of credit to non-retail clients such as corporate bodies does not trigger a license requirement, as commercial/corporate lending is not a regulated activity. Please note however, that there are Member States that require a banking license also for credit activities as soon as the financial intermediary also performs fundraising/taking of deposits.

2.2. New cross-border regime according to CRD VI/CRR III

Article 21c CRD VI obliges EU Member States to require financial intermediaries established in a third country to set up a **branch in their territory** and apply for authorisation to commence or continue conducting core banking services in the relevant Member State. CRD VI does not define the term "in the Member State". Although there are sources stating that the background materials of the banking package do not allow to draw an unequivocal conclusion on the term and that Member States could have a certain leeway of interpretation concerning this point, it is likely to be understood as meaning banking activities both on an EU Member State's territory and via remote means of communication into a Member State.

According to Article 47 CRD VI, the branch requirement will apply to financial intermediaries performing so-called **"core banking services".** Financial intermediaries are deemed to perform core banking services if

- They accept deposits or other repayable funds (**deposit taking**), and/or
- They would be qualified as a credit institution if established in the EU and that they perform:
  - Lending business, including, inter alia: consumer credit, credit agreements relating to immovable property, factoring, with or without recourse, financing of commercial transactions (including forfeiting); and/or issue
  - Guarantees and (credit) commitments (thus impacting the trade finance business).

Please note that according to Article 4(1)(b) CRR, certain types of investment firms do also qualify as credit institutions within the above-mentioned meaning. This is the case of firms dealing on own account or underwriting financial instruments and they or their group have a certain size (current threshold EUR 30 billion). On the other hand, the same article explicitly **excludes funds, commodity dealers and insurance companies** from the scope of application.

CRD VI explicitly excludes the possibility of EU branches of third-country entities performing cross-border banking services into other EU Member States. **For each Member State, an individual branch** has to be set up in order to service prospects and clients domiciled in said Member State.

2.3. Exemptions

Some activities are generally exempt from this branch requirement pursuant to Article 21c no. 2 CRD VI and can be summarized as:

> **Investment services** according to Annex 1, Section A MiFID II; and
> **Interbank** as well as **intragroup services**.

Article 21c further contains an exemption for activities performed upon **reverse solicitation. No branch is required** when a client or counterparty approaches an undertaking established in a third country at its own exclusive initiative for the provision of any core banking service as defined in Article 47(1) CRD VI.

According to the information available to date, the reverse solicitation principle to be introduced by CRD VI should be in line with the corresponding principle laid down in Article 42 MiFID II for investment services. Similar to MiFID II, CRD VI points out that the initiative by a prospect or client shall not entitle the third-country financial intermediary to market other categories of products, activities or services than those that the person had solicited.

It is noteworthy that CRD VI obliges Member States to ensure that competent authorities have the power to require credit institutions and branches established in the relevant Member State to provide them with, as CRD VI calls it, "the information they require" to **monitor the services provided upon reverse solicitation into the EU** by their **third-country group companies**. This issue will have to be tackled by the relevant (EU and third-country) supervisory authorities, as there may be relevant obstacles (such as, for example, banking secrecy rules) to the transmission of such third-country information by a group company to their Member State regulator.

2.4. Cross-border licenses

One of the fundamental questions with respect to the new CRD VI framework is the destiny of the current cross-border licenses granted by some EU countries. There are no clear answers in this respect yet. However, following a literal interpretation of the draft text as proposed today, it must be expected that no new cross-border exemptions can (and will) be granted after the date of applicability of the CRD VI framework.

> With regard to Italy, experts are of the opinion that no new exemptions will be granted and that existing exemptions are likely to be abolished;
> German experts point out that the German Federal Financial Supervisory Authority (BaFin), in view of the CRD VI framework approaching, has continuously been decreasing the number of Freistellung exemptions (or vereinfachte Freistellung exemptions, specifically in the case of Swiss entities) granted to third-country entities. At the same time, newer BaFin decisions on the Freistellung exemption contain an explicit clause that

they may be repealed by BaFin if needed. It is unclear for the time being whether and to what degree granted exemptions will remain in force;

- The same holds true for the Spanish cross-border license for banking services. It has to be noted, however, that it is, already today, of small practical relevance. On the one hand, it does not allow fund raising activities (anymore), on the other hand, local experts indicate that only a handful of North American banks have made use of the possibility in the past.

Nevertheless, it is important to note that the regulatory process is not yet complete. Therefore, it cannot be ruled out that we will see a reversal of the trend linked to the willingness of some member states to reserve legislative autonomy with regard to cross-border licensing deliveries. The non-EU states concerned, first and foremost Switzerland and the UK, should also take action as soon as possible to try to negotiate a more liberal and ultimately more attractive solution for all parties involved.

2.5. Grandfathering

Article 3 CRD VI on the transposition of the new rules in connection with Article 21c paragraph 5 state that in order to **preserve clients' acquired rights under existing contracts**, the branch requirement does **not apply to existing contracts** that were entered into six months or more before the end of the transitional period. It remains to be seen how the term "existing contract" should be interpreted and if there will be clarification on the level of implementing legislation and/or on the level of each individual EEA Member State. In any case, Recital 3a of CRD VI already warns that "such (grandfathering) measures should apply solely for the purpose of facilitating the transition to the implementation of the provisions of this Directive and should be narrowly framed to avoid instances of circumvention". Special contracts like revolving credit facilities or master agreements containing several individual sub-agreements are likely to pose particular challenges.

2.6. Prerequisites for setting up of new branches and for the continued use of existing branches (short summary)

CRD VI contains detailed rules on the establishment of branches. These concern among others the authorisation requirements, rules for the branch management bodies according to the European Banking Authority (EBA) guidance on fit and proper requirements, booking requirements and a classification of branches in two different classes according to the risk they pose to financial stability. These requirements do not form part of the present alert, nevertheless, one point is worthy to be highlighted:

Article 48j of CRD VI states that the national supervisory authorities must be granted the power to **require establishing a subsidiary** (instead of a branch), provided certain conditions are fulfilled. Such conditions are the degree of systemic importance of the branch or a high aggregate amount of assets by a third-country group in the EU. Notable is also the fact that the requirement to establish a subsidiary may be imposed if a third-country branch is engaging (or has engaged previously) in the performance of **prohibited cross-border services** in(to) other EU Member States.

Concerning already existing branches performing core banking services within the meaning of CRD VI, it shall only be pointed out within the context of the present alert that the new harmonized minimum requirements will also apply to them. As the setting of requirements for branch establishment with regard to banking services was until now largely in the competence of the individual Member States, branches of third-country credit institutions in certain jurisdictions will have to re-apply for authorisation as their current set-up does not match the minimum requirements of CRD VI. If a Member State is already compliant with the new CRD VI rules and thus the branches already comply with the minimum requirements, Member States may waive re-authorisation if the branch has been established **at least 12 months** before the applicability of CRD VI.

3. Comments

While the new banking package and with it the harmonised rules on cross-border core banking services are a big move forward in the EU regulatory landscape, the **impact on the day-to-day business of many third-country financial intermediaries** with regard to their banking clients in the EU **might in practice be less fundamental than anticipated**. Already today, with respect to a majority of EU Member States, there is no other alternative for third-country financial intermediaries than to rely on reverse solicitation and they will be able continue to do so under the new CRD VI framework.

For banking activities upon a prospect's or client's request via remote means of communication into a Member State, there will even be more -respectively for the first time any- legal certainty concerning their admissibility. The practice of certain Member States' authorities, such as for example Poland, to increasingly restrict the tolerance of banking activities upon request even via remote means of communication, will have to be abolished. Member States such as France will, on their side, no longer be able to restrict activities of this type by evoking the banking monopoly.

Therefore, with the coming into force of CRD VI, **there will be an explicit legal basis for unlicensed third-country financial intermediaries to rely on reverse solicitation for banking activities via remote means of communication into an EU Member State.**

It remains to be seen how banking activities upon a prospect's or client's request on the territory of an EU Member State will be handled. Most likely, it will be up to the individual Member States to determine the geographical scope of the exemption, as in the case of MiFID II (Article 42). It can be imagined that Member States that already tolerate banking activities on their territory upon request today may be willing to maintain the status quo.

In essence, on the basis of what is known today, it can be assumed that for reverse solicitation for banking services, the wheel will not be reinvented, but that the principles already established (notably by ESMA) will be applied *mutatis mutandis*.

Intermediaries holding and making use of a cross-border license or other kind of exemption, will, in contrast, likely be significantly affected. For the time being, the future of these

exemptions is still uncertain, but it has to be expected that existing exemptions will be revoked and no new exemptions will be granted any more.

4. Practical Implications

4.1 Immediate Action

There are several lines of action financial intermediaries that will be subject to the CRD VI framework for **cross-border banking services** should analyse:

- Thoroughly review their **cross-border policies for the Common Market**, including internal instructions, guidelines and other tools. A special focus should be laid on solid documenting, tracking and evidencing tools for reverse solicitation relationships with banking clients, including adequate control mechanisms. This is of particular importance for third-country financial intermediaries having group establishments in the EU, as CRD VI awards the authorities the capacity to demand information from the EU entities on services provided on a reverse solicitation basis by the non-EU entities;
- **Analyse the type of core banking services subject to CRD VI** that are provided (or will be provided) by the financial intermediary and assess the i**mpact of the future branch requirement on the relevant business**. This is particularly important for activities like trade financing (letters of guarantee, etc) or corporate lending that, depending on the Member State, may not have been subject to a licensing requirement until now;
- With regard to the **grandfathering rules** applicable to existing contracts, financial intermediaries need to ensure that until the deadline of "six months before the end of the transitional period" (roughly in two years), all existing contracts, and future contracts concluded until the deadline with clients for the relevant core banking services are up to date, set down in writing and duly documented. The possibilities of extension or renewal of existing contracts, as well as the continuation of revolving or framework contracts under the grandfathering rules need to be analysed.

4.2 Follow-up Action

CRD VI attributes a list of tasks to EBA concerning implementing legislation, reviews and guidelines. The **evolution of the banking package needs to be monitored closely** in order to be able to take necessary measures in a timely manner. The current framework will need - and therefore there will be upcoming- substantial clarification and concretization, both on EU and on Member States level.

One of the fundamental issues to be solved is the future of the existing cross-border licenses or **exemptions.** For the time being, no reliable information is available concerning (in particular) a possible grandfathering of existing exemptions. **BRP is in close contact with local experts in EEA jurisdictions** that do currently offer the possibility of acquiring an exemption (in particular Italy and Germany) and will inform about the evolution of the matter in separate alerts in due time.

We are at your disposal for any questions you may have.

Best regards,

BRP Bizzozero & Partners SA

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