Further fragmentation on the way

As part of a broad package of amendments to the Capital Requirements Directive (CRD) and Capital Requirements Regulation (CRR), the European Commission proposed on 23 November 2016 that banks headquartered in non-European Union (EU) countries be required to set up an intermediate holding company for their subsidiaries in the EU. This move corresponds to an earlier measure taken by the United States with respect to foreign banking organizations. The EU measure will further fragment global banking. It will also make it more difficult for firms based in the UK to access the EU-27 market post-Brexit, even if the UK regime were found to be equivalent to that of the EU-27.

EU Intermediate Holding Companies (IHC)

In order to improve supervision, resolution and financial stability, the European Commission is proposing to introduce a new framework for third-country groups with significant activities in the EU. This will implement international standards on internal loss-absorbing capacity for non-EU Globally systemically important banks (G-SIBs) and simplify and strengthen the resolution process of third-country groups with significant activities in the EU. It is similar to the recent US requirements for large foreign banks to set up local Intermediate Holding Companies (US IHCs) in the United States. The intermediate EU parent undertaking can be either a financial holding company subject to the requirements of the CRR and the CRD, or an existing or new EU institution.

The EU IHC requirement applies to all G-SIBs headquartered outside the EU with a subsidiary in the EU and to any other third-country group that owns two or more institutions (credit institutions or investment firms) established in the EU with total assets of at least €30 billion (the assets of both subsidiaries and branches of those third-country groups will be taken into account in the calculation). Where qualifying third-country banking groups have established subsidiaries within the EU, these will need to be consolidated under an existing institution or new IHC.

Like the US IHC, the EU IHC will have to meet local requirements, including without limitation, enhanced EU prudential standards, EU regulatory reporting and accounting standards, and EU governance norms. These
differ from those in the US and there is little prospect that they will converge. Note that once the UK exits the EU, it will be neither US nor EU, but a third (still to be defined) regime. Depending on the terms of Brexit, adherence to the UK regime may only guarantee access to the UK market.

What do affected groups need to consider?

► Banks will need to choose which jurisdiction to set up an EU IHC or which entity to use as the EU parent.
► Banks should consider whether to use the European form of incorporation (SE) or that of the Member State in which the entity is located.
► Within the Eurozone, an IHC will almost certainly be classed as significant and directly supervised by the European Central Bank (ECB). Outside the Eurozone, the entity will be supervised by the relevant National Competent Authority.
► Any revised corporate structure will need to consider capital, liquidity, corporate and risk governance, national accounting standards and tax implications (e.g., deferred tax implications, intangibles, assets with adverse risk weights). The transitional impacts will also be important.
► Institutions should consider the perspectives of and engage with their home country supervisor.

How long will it take for any legislation to be finalized?

This is an initial proposal by the European Commission that also needs to be agreed by the European Parliament and European Council (heads of government) before it is adopted as EU law. This can be a lengthy process, which we would expect to last at least two years, and we will see some amendments to the proposal. There will likely be transitional provisions for implementation once the legislation is adopted.

What does it mean for my Brexit planning?

As the UK exits the EU, the UK will become a third country as far as the EU IHC requirement is concerned, even if the EU finds the UK regulatory regime to be equivalent to that of the EU. Consequently, a UK subsidiary of a non-EU global banking group cannot serve as the EU IHC for the group. Such a group will have to establish an EU IHC in one of the EU-27 Member States, as will any UK-headquartered G-SIB or banking group with two or more subsidiaries in the EU-27.

What does it mean for my resolution planning?

Banking groups should take the introduction of an EU IHC requirement as a further signal that authorities are de facto moving toward a multiple point of entry resolution strategy with limited cooperation among authorities across jurisdictions.
Questions

• Am I a G-SII or do I plan to have more than €30 billion in assets inside the EU in subsidiaries?
• Do I plan on having more than one entity (subsidiary) in the EU? Should I consider rationalizing my footprint to one institution to simplify my structure?
• How will I use any existing or new branches that can sit outside IHC requirement?
• If I qualify for EU IHC requirements, in which EU jurisdiction should I host my IHC?
• Does this change my analysis of existing restructuring plans or scenarios?
• Can I ensure that any business changes I am considering post-Brexit will not conflict with the IHC proposal?
• How might this impact my recovery and resolution plan, particularly if I am looking at multiple single points of entry resolution? Do I need to plan ahead?
• How might a revised IHC structure affect group capital flows and my internal loss-absorbing capital?

Further information

For further information, please contact one of the following or your usual EY contact:

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