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Unrestricted

Director General, Anneli Tuominen

Director-General Mr Olivier Guersent
Directorate-General for Financial Stability, Financial Services and Capital Markets Union
European Commission
1049 Bruxelles/Brussel

More prudent supervisory powers needed for branch supervision

Dear Mr Guersent,

May I kindly raise your awareness regarding a structural banking sector development in the Nordic countries that relates to the conversion of significant subsidiaries into branches. In relation to this development I have to my regret noticed that existing supervisory tools are unfortunately lagging behind banking sector developments. In my view these concerns should be thoroughly addressed in the context of the current CRR/CRD Review aimed at further strengthening the supervisory framework. My concerns relate mainly to supervisory issues, but as you will certainly understand, we also face similar challenges with regard to recovery and resolution, and deposit insurance.

The process of ‘branchification’ is in line with the key EU fundaments of the single market. However, the recent development of creating large or even systemic branches represents a new trend and clearly shows that we are heading towards unexplored territory with overly narrow supervisory tools. For many banks, the branch structure offers easier access to providing services in several countries across the European Union. For the time being, branches have been rather small in relation to the host country’s economy and have provided financial services mainly to specific customer segments, for example. I am becoming increasingly concerned about the ‘branchification’ of significant subsidiaries in host country economies, which in Finland, for example, will in future constitute a large share, perhaps even half of the highly concentrated Finnish banking system.

Existing supervisory tools are appropriate in cases where the branches are small or negligible in the host country where they operate. The existing CRD art. 51 concept of significant branch does not at all fit branches of a systemic nature. When the branch is defined as significant according to CRD art. 51, there are some more instruments available for the host authority. These could be deemed enough in the case of small branches, and potentially also for branches with a market share of deposits in the range of 2–10%. However, if the market share of a branch is higher than 10% of the given host economy, more tools will be needed for the host authority to supervise branches in order to ensure financial stability and a level playing field. Branches with large market shares will have an impact on macroprudential and financial stability, increasing interconnection and hence the risk of contagion.

The existing regulatory framework only provides for receipt of information and being a member of the college, and in that way ‘participating’ in supervision without powers; everything else is strongly linked to willingness and openness on the part of the home authority. This requires a cooperation agreement, i.e. a voluntary intention of willingness to cooperate. This kind of agreement would most likely work well in good times, but it is questionable if it would work when a situation escalates and deteriorates for a financial group and its branch.

The shortage of branch supervisory tools also emerged during the IMF FSAP mission in 2016. The FIN-FSA, in line with the conclusions of the mission, takes the view that systemically important branches play a key role in the financial stability of the local financial system.

Therefore, I am proposing to include adjustments to the CRR/CRD-package, increasing supervisory powers for the host supervisors of systemically important branches **where the home supervisor is different from the host**. There should be specific requirements for a joint agreement on most important decisions, such as capital and liquidity requirements, model approvals, approval of recovery plans and issues relating to authorizations etc.

Possible amendments should also include the following aspects:

- Amendment to supervisory powers of branch host supervisors regarding group-level decision-making and branch (especially related branch) governance and risk management, asset quality and issues related to liquidity risk.
- A new concept of joint supervision of the banks by the home authority and the host supervisor of a systemic branch. This concept could be leveraged from the SSM joint supervisory team concept, which jointly supervises a supervised entity’s operations in different countries and benefits from local knowledge. This would mean that actual supervision would be done jointly by different authorities.
- A new decision-making model that would take into account joint supervision of a bank. This would mean decision-making would be conducted jointly by the home authority and the host supervisor of a significant branch.
- New prudential requirements could also be developed for branches. This could be done by adapting existing requirements (for example, for subsidiaries) and modifying them to fit systemic branches.

Finally, I would expect that enhancing the role and powers of a branch’s host authority would also be in the interest of the home authorities. Shared supervisory work and decision-making would at the end of the day lead to state-of-the-art supervision of systemic branches and entire banking groups. I believe we now need to take further steps in order to ensure proper and effective prudential supervision of cross-border banks regardless of the legal structure they choose for their cross-border operations.

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