III

(Preparatory acts)

EUROPEAN CENTRAL BANK

OPINION OF THE EUROPEAN CENTRAL BANK

of 27 April 2022

on the Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/36/EU as regards supervisory powers, sanctions, third-country branches, environmental, social and governance risk

(CON/2022/16)

(2022/C 248/03)

Introduction and legal basis

On 17 and 21 January 2022 the European Central Bank (ECB) received requests from the European Parliament and the Council of the European Union for an opinion on the Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/36/EU as regards supervisory powers, sanctions, third-country branches, environmental, social and governance risk ([1]) (hereinafter the ‘proposed amendments to the CRD’).

The proposed amendments to the CRD are closely linked to another proposal on which the ECB received a consultation request, namely the Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 575/2013 as regards requirements for credit risk, credit valuation adjustment risk, operational risk, market risk and the output floor ([2]) (together with the proposed amendments to the CRD, the ‘Commission’s banking reform package’).

The ECB’s competence to deliver an opinion is based on Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union since the proposed amendments to the CRD contain provisions affecting the ECB’s tasks concerning the prudential supervision of credit institutions pursuant to Article 127(6) of the Treaty and the European System of Central Banks’ contribution to the smooth conduct of policies relating to the stability of the financial system, as referred to in Article 127(5) of the Treaty. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

General observations

The ECB strongly supports the Commission’s banking reform package, which implements important elements of the global regulatory reform agenda into Union legislation. This will reinforce the EU Single Rulebook and substantially strengthen the regulatory framework in areas where supervisory authorities have identified gaps that could potentially lead to risks being insufficiently monitored and covered.

First, enhancing the way environmental, social and governance (ESG) risks are addressed by imposing stricter requirements and by broadening the supervisory toolkit in this area will help to ensure that institutions proactively develop enhanced risk management frameworks, thereby reducing the probability of the build-up of excessive risks by individual institutions and the financial system as a whole.

([1]) COM(2021) 663 final.
([2]) COM(2021) 664 final.

Second, the faithful implementation of the output floor will reduce unwarranted risk weight variability [3] and it is welcome that there will be no double-counting of risks with respect to other requirements, while operational complexities should be avoided.

Third, harmonised provisions for the assessment of banks' directors and key staff (fit and proper assessments) will facilitate supervisory effectiveness and enhance sound governance.

Fourth, a common set of rules for branches of third-country banking groups operating in Member States will replace heterogeneous national approaches and strengthen the single market.

Fifth, further harmonising national powers related to the acquisition of qualifying holdings, transfers of assets or liabilities, mergers or divisions, as well as the sanctioning regime, will ensure the consistency and robustness of the framework.

Sixth, the ECB calls for consistency between Directive 2013/36/EU of the European Parliament and of the Council [4] (hereinafter 'the CRD') and Council Regulation (EU) No 1024/2013 [5], on matters relating to supervisory independence in general and conflicts of interest in particular. In limiting **possible** conflicts of interest, a **strict but** proportional and flexible approach is important, allowing due consideration of each individual situation.

Finally, allowing supervisors to withdraw the authorisation of credit institutions that have been declared failing or likely to fail, but do not qualify for resolution because the public interest criterion is not met, will facilitate the orderly exit of these banks from the market [6].

This opinion addresses issues of particular importance to the ECB, which have been divided into the sections listed below.

1. Environmental, social and governance risks (ESG risks)

1.1. *Support for the proposed amendments*

The ECB strongly welcomes the proposal of the Commission to enhance the requirements with respect to ESG risks for credit institutions and the respective mandate for competent authorities. The ECB shares the view that ESG risks can have far-reaching implications for the stability of both individual institutions and the financial system as a whole. The Commission has rightly set ambitious targets for the adaptation of the EU to the impacts of ESG risks and its transition towards a sustainable economy, involving specific changes to its productive system over a limited time horizon. The strategy highlights that 'the success of the European Green Deal depends on the contribution of all economic stakeholders and on their incentives to meet our targets. To that end, financial institutions must translate EU sustainability goals into their long-term financing strategies and decision-making processes' [7]. The transition and the associated risks affect almost all sectors of the economy and have widespread impacts across regions; they moreover depend on decarbonisation policies, shifts in consumer and investor preferences as well as technological changes. These widespread impacts warrant bespoke strategies as well as enhanced risk management capabilities to ensure the resilience of the business models of credit institutions in the short, medium and long term and to avoid the build-up of excessive transition risk in their portfolios. It is therefore crucial that credit institutions monitor the risk arising from the misalignment of their portfolios with the transition objectives of the EU, thereby setting ambitious and concrete timelines, including intermediate milestones, for the purpose of their strategic planning.

(3) See, regarding the general implementation of the output floor, Opinion CON/2022/11 of the European Central Bank of 24 March 2022 on a proposal for amendments to Regulation (EU) No 575/2013 as regards requirements for credit risk, credit valuation adjustment risk, operational risk, market risk and the output floor. All ECB opinions are available on EUR-Lex.

(4) 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, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

(5) 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).

(6) See, in particular, ECB contribution to the European Commission's targeted consultation on the review of the crisis management and deposit insurance framework, p. 9, available on the ECB website at www.ecb.europa.eu

(7) See Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions of 6 July 2021: Strategy for Financing the Transition to a Sustainable Economy, COM(2021) 390 final, p. 14.

The ECB supports the proposal to cover ESG risks more explicitly in supervisory requirements, which will help minimise the threats that these risks pose to individual institutions and financial stability. The need for better bank-internal risk management and more supervisory scrutiny regarding these risks has been highlighted by a recent ECB supervisory assessment. This comprehensive exercise revealed that no institution is close to fully aligning their practices with supervisory expectations on climate-related and environmental (C&E) risks and that institutions themselves consider 90 % of their reported practices to be only partially or not at all aligned with the ECB's supervisory expectations ([8]).

The ECB acknowledges the prioritisation of C&E risks over social and governance factors, also in light of the differences in methodologies. C&E risks notably comprise threats stemming from the required transition towards a more sustainable economy and the adaptation to increasing physical threats. Transition and physical risks are special compared to other prudential risks and as they build up over time, careful planning and clear mitigation strategies are needed, while decisive and immediate short-term action may be required to mitigate long-term impacts.

The ECB supports the proposed requirement for credit institutions to develop specific plans to monitor and address ESG risks arising in the short, medium and long term. This will ensure that credit institutions measure ESG risks over longer-time horizons and thoroughly assess the structural changes that are likely to occur within the industries they are exposed to, according to the transition pathways determined by the EU legal framework ([9]). The requirement to develop such plans will increase transparency on the risks to which the financial system is exposed. Furthermore, it will also ensure that credit institutions proactively review, also in relation to the EU's transition objectives, whether their strategies sufficiently incorporate ESG-related considerations, thereby mitigating reputational risks or risks arising from rapidly changing market sentiment as well.

The ECB stands ready to collaborate with EU agencies to monitor credit institutions' progress in developing their specific plans (new Article 76(2)) and stresses the need for timely action on this front. The ECB sees a need to prioritise the resilience and adaptation of institutions to the long-term negative impacts of ESG risks. The proposed European Banking Authority (EBA) guidelines on the content of institutions' plans (new Article 87a(5)(b)) will be particularly important in this regard, and the ECB considers therefore that these guidelines should be published within 12 months. Conversely, a deadline of 24 months seems more appropriate for the proposed guidelines on minimum standards and reference methodologies (new Article 87a(5)(a)).

Proper internal risk management, including specific planning, will also facilitate the assessment by competent and macroprudential authorities of ESG risks. In the context of the further articulation of the requirement for credit institutions to manage all material risks, by testing their resilience to the long-term negative impacts of C&E risks, the ECB welcomes the enhancement of the related supervisory powers in a manner that is consistent with the time horizon for the materialisation of ESG risks. This will allow the ECB to more effectively address ESG risks, starting with climate-related and environmental risks, affecting the prudential situation of the credit institution (e.g. capital and liquidity) also in the medium to long term (i.e. 5-10 years). Such requirements will also help macroprudential authorities to mitigate the system-wide repercussions of ESG risks, notably analysing their systemic aspects, e.g. through economy-wide climate stress testing. All this should provide the ECB with more adequate tools to help avert, jointly with the other relevant authorities, the build-up of stranded assets on credit institutions' balance sheets and ensuring complementarity between the microprudential and macroprudential approaches.

With respect to the macroprudential toolbox, the ECB also welcomes the clarification in a recital of the proposed amendments to the CRD that the systemic risk buffer (SyRB) framework may already be used to address various kinds of systemic risks, including risks related to climate change. To the extent that risks related to climate change have the potential to have serious negative consequences for the financial system and the real economy in Member States, a SyRB rate can be introduced to mitigate those risks.

([8]) *The state of climate and environmental risk management in the banking sector – Report on the supervisory review of banks' approaches to manage climate and environmental risks*, November 2021, available on the ECB website at www.ecb.europa.eu

([9]) E.g. Regulation (EU) 2019/631 of the European Parliament and of the Council of 17 April 2019 setting CO_2 emission performance standards for new passenger cars and for new light commercial vehicles, and repealing Regulations (EC) No 443/2009 and (EU) No 510/2011 (OJ L 111, 25.4.2019, p. 13). Such standards directly affect credit institutions, via their counterparties, in the short, medium and long term.

1.2. *Resilience to long-term negative impacts of ESG risks*

With respect to the scenarios and methods to assess resilience to long-term negative impacts of ESG risks, particularly climate change and environmental degradation, the ECB wishes to highlight the fact that the challenges they pose to the financial sector can only be assessed and addressed by integrating scientific analysis into policymaking. The contribution of scientific research, financial sector entities and environmental agencies will be instrumental in this respect. The ECB welcomes the Commission's commitment to strengthen the cooperation among all relevant public authorities, including supervisors and that such cooperation is intended 'to help define intermediate targets for the financial sector' ([10]). Nevertheless, it would be useful to recall, in the recitals of the proposed amendments to the CRD, the commitment made in Action point 5.c of the Strategy for Financing the Transition to a Sustainable Economy (COM(2021) 390 final). Specifically, it is important to stress that the Commission has committed to strengthen the cooperation with the ECB, the European Systemic Risk Board, the European Supervisory Authorities and the European Environment Agency and that such cooperation is intended to help define intermediate targets for the financial sector, understand better whether ongoing and prospective progress is sufficient, and thus facilitate taking a more collaborative policy action by all relevant public authorities where necessary. The ECB would welcome a reference to such commitment also in the context of the mandate established in the new Article 87a(5)(c) of the CRD.

2. **Output floor**

The ECB welcomes the introduction of the output floor, which is an important element of the Basel III reforms ([11]). The ECB notes that the proposed amendments to the CRD include some mechanisms governing the interaction between the output floor and the setting of (i) supervisory Pillar 2 requirements and (ii) macroprudential buffers.

The ECB agrees with the overall objective of avoiding double-counting of risks within the microprudential and macroprudential frameworks and with the intention of ensuring that the respective requirements remain appropriate. With regard to the Pillar 2 requirements, the ECB wishes to underline the fact that there is already a general requirement to avoid any double-counting of risks and, therefore, stands ready to ensure that no such double-counting of risks occurs within its remit. With respect to macroprudential buffers, as presently used, these address macroprudential risks which are different from the output floor's target of reducing risks of excessive variability or lack of comparability of risk weights from the use of internal models by the institution.

Furthermore, the proposal requires that the nominal amount of Pillar 2 requirements does not immediately increase as a result of an institution becoming bound by the output floor. The ECB agrees with the underlying objective and the spirit of these provisions to neutralise unwarranted arithmetic effects on Pillar 2 requirements arising from the introduction of the output floor and stands ready to undertake the necessary steps to neutralise this impact.

It is important that the proposed mechanisms are respectful of existing supervisory and macroprudential practices and avoid operational complexities and administrative burdens for competent and macroprudential authorities. In particular, with regard to Pillar 2 requirements, as already mentioned, the ECB considers that competent authorities are already mandated, in the current regulatory framework, to avoid double-counting of risks and unwarranted changes in prudential requirements, and that the guidelines issued by the EBA under Article 107(3) of the CRD provide a sound legal basis for establishing a common methodology for achieving this. While the ECB therefore does not see the need for permanently enshrining in Level 1 legislation how the output floor should be taken into account when setting Pillar 2 requirements, it takes note of the specific legislative proposal on this issue and stresses the need to ensure that the proposed provision – including the temporary freeze – does not permanently interfere with both the current Pillar 2 approach and its frequency. The ECB is of the view that the instantaneous neutralisation should take place at the moment when the bank becomes bound by the floor. In subsequent years any needed adjustment would be done in the context of the regular supervisory review and evaluation process.

EU legislators may wish to provide the EBA with a specific mandate to develop guidelines on how competent authorities should deal with the impact of the output floor when setting Pillar 2 requirements, as defined in the Commission's proposal for a Regulation amending Regulation (EU) No 575/2013 (Article 465(1)). Should EU legislators wish to include a legislative reference to this issue, the ECB has also provided suggestions in the technical

([10]) See Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions of 6 July 2021: Strategy for Financing the Transition to a Sustainable Economy, COM(2021) 390 final, p. 17.

([11]) See also Opinion CON/2022/11, which provides more detailed comments on the implementation of the output floor, notably with respect to its level of application and transitional arrangements.

working document on how the legislative draft could be amended to be respectful of both the current Pillar 2 approach and its frequency, while also explicitly regulating the interaction between the output floor and Pillar 2 requirements in the Level 1 text.

With regard to the SyRB, the ECB has strong concerns with regard to the proposed requirement for a mandatory review of its calibration, which includes a dynamic cap on the buffer, freezing it at pre-output floor levels until such a review has been concluded and the outcome published.

There are three reasons for these concerns.

First, the proposed mandatory review increases the complexity of the framework and the administrative burden, as it implies that authorities would need to review the calibration of the SyRB for each credit institution becoming bound by the output floor individually. Second, a temporary cap and institution-specific review of the SyRB is at odds with the macroprudential nature of the buffer and its (sub-) sector-wide application. This would establish an unwarranted specific treatment of an individual credit institution which is affected by a SyRB and becomes bound by the output floor. Third, the CRD already includes adequate provisions for the regular review of capital buffers, which are sufficient to ensure any required changes in the implemented rates.

The ECB has similar concerns regarding the proposed requirement to review the calibration of the other systemically important institutions (O-SII) buffer when the output floor becomes binding. Similar to the review of the SyRB, this obligation to review the O-SII buffer increases the complexity of the framework and the administrative burden. Moreover, the O-SII buffer regular reviews are already provided for in the CRD.

Instead of the proposed review mechanism of the SyRB when the output floor becomes binding for a credit institution, the ECB proposes the insertion of an explicit clarification specifying that the SyRB may not be used to address the risk that is captured by the output floor, regardless of whether the output floor becomes binding for a specific institution or not. This clarification should preferably be inserted as a recital but could also be inserted in an article of the CRD. It should address any potential concerns that risks could be double-counted under the output floor and the SyRB. The same reasoning and clarification could also be implemented in relation to the O-SII buffer.

3. **Fit and proper**

3.1. *Support for the proposed amendments*

The ECB strongly welcomes the proposal of the Commission to revise the fit and proper framework. The supervision of the fitness and propriety of members of the management board of credit institutions is a key supervisory tool that is essential to improve the governance of credit institutions. Good governance in credit institutions increases their resilience to adverse market developments and is a key prerequisite for financial stability. Within its supervisory activities the ECB still sees a considerable need to plug gaps and to raise the bar in the quality of governance frameworks ([12]), and therefore strongly welcomes the strengthening of the supervisory toolkit as proposed by the Commission. The current fit and proper framework stands out as one of the least harmonised areas of supervisory law due to the divergence of national laws implementing the CRD. These differences hamper the efficiency of the ECB's fit and proper supervision and have hindered the level playing field within the EU. The Commission proposals constitute a major step forward, as they would ensure a more consistent, efficient and effective supervision of board members and of key function holders, focusing on the more important issues for prudential supervision. This is the case especially in relation to matters such as (i) the establishment of clear deadlines and processes for all Member States; (ii) the need for the occurrence of new facts in order to assess renewals of terms of office; (iii) mandatory *ex ante* assessments for the most impactful institutions; (iv) the assessment of key function holders; (v) the removal of the CEO-Chair waiver from Article 88 of the CRD; and (vi) the credit institution's responsibility for ensuring the suitability of their board members.

The ECB considers that an adequate level of proportionality should be embedded in the new framework, which would also benefit from an even more proportionate approach to fit and proper assessments by competent authorities. While the proposed framework in general already takes a duly proportionate approach to fit and proper assessments (including by limiting *ex ante* assessments to large institutions), the ECB is open to further explore and discuss

([12]) Deficiencies in management bodies' steering capabilities are among the key vulnerabilities of credit institutions listed in the ECB's supervisory priorities for 2022-2024, which will inform the supervisory review and examination process, available on the ECB website at www.ecb.europa.eu avenues to ensure the appropriate level of proportionality of the new framework. In particular, proportionality allows competent authorities to focus their resources on the most important assessments.

Finally, the ECB notes that the *ex ante* fit and proper assessments envisaged in the proposed amendments to the CRD do not affect the statutory rights of certain bodies to appoint representatives to supervised entities' boards under national law.

Notwithstanding the overall strong support for the proposed changes, the ECB provides, both below and in the technical working document, a number of comments on specific aspects.

3.2. *Clarification that the proposed ex ante fit and proper assessments are only of a procedural nature: Recital 38 of the proposed amendments to the CRD*

Recital 38 highlights the importance of the suitability assessment of large institutions' members of the management body before those members take up their position. While the ECB strongly supports the envisaged proportionate *ex ante* assessment, it could be further clarified that the proposed provisions on *ex ante* fit and proper assessment are mostly procedural and do not affect national statutory rights of certain bodies or legal entities to appoint representatives to supervised entities' management bodies under applicable national law. Therefore, the ECB proposes the introduction of an additional clarification to Recital 38, which aims at reassuring Members States that any statutory rights based in applicable national law shall not be affected by the proposed amendments to the CRD. Nevertheless, appropriate safeguards should be in place to ensure the suitability of these representatives, such as an effective supervision of the suitability of the management body as a whole (collective suitability) and follow-up measures to tackle potential conflicts of interest and issues related to time commitment and experience where necessary.

3.3. *Introduction of a 2-day deadline for the acknowledgement of receipt: new Articles 91b(3) and 91d(3) of the CRD*

The suggested deadline of only 2 days for the written acknowledgement of receipt would in practice be extremely challenging to meet by all competent authorities involved due to the very high inflow of fit and proper applications and the extensive documentation that needs to be checked. Specifically, in the many cases where the application concerns multiple appointees, this deadline might not be achievable for supervisors. Overall, this provision may jeopardise meeting the given deadline for fit and proper procedures.

The ECB thus urges the deletion of the 2-day deadline.

3.4. *Mandate to develop implementing technical standards (ITS) on standard forms, templates and procedures for the provision of information: new Articles 91b(10) and 91d(8) of the CRD*

The ECB is responsible for the effective and consistent functioning of the Single Supervisory Mechanism (SSM). In this respect, progress has been made within the SSM as regards the consistent use of forms and IT solutions for the purposes of processing fit and proper applications. The ECB thus underlines that the ITS should be consistent with this harmonisation effort and could possibly leverage the infrastructure already developed.

In light of the above, the ECB proposes the insertion, in the relevant provisions or recitals, of a reference encouraging the EBA to build on the best existing practices and tools when developing the ITS.

3.5. *Procedural consequences where supervised entities do not comply with obligations and deadlines: new Articles 91b(7) and 91d(6) of the CRD*

The supervisory powers available to supervisors in cases where entities do not reply to requests for additional information within the given deadline do not include the power for the competent authorities to declare the application incomplete requiring, as a consequence, the submission of a new application. The ECB therefore calls for the introduction of an additional legal basis allowing competent authorities to consider an application incomplete, with the consequent need for its re-submission. This would ensure that there is a procedural consequence for breach of the deadlines for the provision of additional documentation or information, without prejudice to the possibility for the entity to submit a new application thereby initiating a new procedure.

In light of the above, the ECB proposes adding such an additional procedural consequence in the new Articles 91b(4) and 91d(4) of the CRD.

3.6. *Possibility to extend the assessment period where information is requested from other parties*

New Articles 91b(4) and 91d(4) of the CRD allow for the extension of the assessment period where competent authorities request additional documentation or information from entities, but not where documentation or information is requested by other parties, e.g. judicial authorities and/or other supervisory authorities. The latter is a very common occurrence which often consumes more time.

The ECB therefore proposes that these provisions be amended to also cover situations in which documentation or information is required from other entities/authorities.

3.7. *Possibility for entities to conduct the (internal) suitability assessment of board members after they have taken up their positions: new Article 91a(2) of the CRD*

A new Article 91a(2), second subparagraph, of the CRD allows for the appointment of members of the management body, in urgent contexts, without any kind of suitability assessment. The ECB is concerned that this possibility may lead to the appointment of unsuitable candidates, also due to the ambiguity underlying the interpretation of the terms 'strictly necessary' and 'immediately' used in that context.

Therefore, the ECB proposes that entities should be required to perform a suitability assessment before members of the management body take up their position even in the most exceptional cases. Nevertheless, in such a scenario a lighter assessment might be warranted, under conditions to be specified in guidelines developed by the EBA. These guidelines would also give guidance on cases that might be considered urgent, i.e. when it is strictly necessary to immediately replace board members.

4. **Third-country branches (TCBs) requirements**

The harmonisation of the TCB framework is important to establish a comprehensive view on the activities of third country groups in the EU, to align practices within the EU and to ensure a level playing field for third country groups in the EU and European credit institutions by avoiding possibilities for regulatory arbitrage, while at the same time not preventing the access of third country groups to the EU financial market via the establishment of branches. The ECB considers it essential to provide the relevant competent authorities with effective supervisory tools. The harmonisation of the TCB framework is also an opportunity to align the EU's requirements with comparable standards in other major jurisdictions and maintain global openness of the Single Market.

Against this background, the ECB welcomes the harmonised minimum standards for the authorisation and withdrawal of authorisations of branches, as well as in the area of internal governance and risk controls and the increased harmonised reporting requirements. The ECB also welcomes the power for competent authorities to require TCBs to establish a subsidiary in cases of systemic importance, which should not be subject to an automatic trigger but rather to an open-outcome supervisory assessment mechanism, once certain thresholds are reached. In addition, the new framework will allow comprehensive supervision via enhanced cooperation between supervisors, for example by including Class 1 TCBs in colleges of supervisors. In this regard the ECB also appreciates the efforts of the Commission to ensure an adequate involvement of supervisors of other group entities (i.e. subsidiaries) in the decisions that affect the structure of the operations of third country groups in the EU.

Furthermore, the ECB supports the clarification that TCBs may only conduct the activities for which they have been authorised and solely within the territory of the Member State that has provided such authorisation, and that conducting such activities on a cross-border basis within the territories of the Union is expressly prohibited.

In addition to its strong support for the proposal, the ECB proposes amendments in the following areas.

To ensure that the actual size of the activities of a branch is captured, thus helping to avoid that third country groups use specific booking practices to stay under the thresholds, it is important that not only the assets that are booked in the branch are taken into consideration, but also the assets that are originated by the branch but booked remotely to another location, to the extent that this practice is considered feasible under the new legislation. While the proposed amendments to the CRD include a mandate for the EBA to develop regulatory technical standards on booking arrangements, the ECB considers that it would be more effective to include in the CRD itself also a direct clarification as to how to calculate the assets of a branch for the purposes of assessing thresholds (e.g. for the classification of the branches as Class 1 and for the assessment of systemic importance).

Furthermore, the ECB proposes that the aggregated information on the assets and liabilities held or booked by a third country group's subsidiaries and third country branches in the Union, which the third country branches are required to report to their competent authority, should also be made available to the competent authorities that are responsible for the supervision of the subsidiaries of that third country group. This proposal will allow for a comprehensive overview and analysis of the European footprint of third country groups. To this end, the ECB also proposes that the scope of this reporting requirement related to services provided by the head undertaking is enhanced to capture also the direct provision of cross border investment services by the third country group and the investment services that are provided by the third country group on the basis of reverse solicitation.

5. **Direct provision of banking services in the EU by third country undertakings**

5.1. *Requirement to establish a branch for the provision of banking services by third country undertakings: new Article 21c of the CRD*

The ECB welcomes the clarification included in the new Article 21c of the CRD that, in order to provide banking services within the Union, third country undertakings must either establish a branch or create a subsidiary in any of the territories of the Union, in order to avoid unregulated and unsupervised activities creating risks to financial stability in the EU.

However, the ECB considers that the scope of core banking services included within the new Article 21c of the CRD is unclear. Therefore, the ECB invites the Union legislative bodies to clarify the wording of the new Article 21c of the CRD and in particular to provide a clear list of core banking services included within this article, taking into consideration also existing requirements in other EU law that regulate particular services, such as payment services and electronic money**,** as well as the impact of the new article on the liquidity of global financial markets.

6. **Supervisory powers**

The ECB welcomes the proposed amendments to the CRD as regards supervisory powers as they further harmonise three types of powers, by requiring the competent authority to assess (i) acquisitions of holdings in financial and non-financial sector entities; (ii) material transfers of assets and (iii) mergers/divisions. The present divergence in national powers in these three respects and the fact that the ECB currently exercises such powers only when available under national law leads to an uneven playing field and renders the ECB's supervisory actions within the SSM less efficient. A common set of rules on core prudential powers will simultaneously foster harmonisation within the internal market and increase the overall quality and efficacy of supervision. Further coordination between these new supervisory powers and powers already provided for in the CRD is needed. To this end, the ECB provides some drafting recommendations in the technical working document.

The ECB welcomes, in particular, the fact that the Commission's proposal recognises the necessity to align the powers provided for in Title III, Chapters 3, 4 and 5, of the CRD concerning acquisitions of a qualifying holding in a credit institution and acquisitions of a material holding by an institution. However, this alignment should not only provide for the exchange of information between the competent authorities, but also provide for the process and timing of the relevant procedures occurring simultaneously for the same operation.

In addition to this procedural alignment, a clear distinction should be made between the concept of a 'qualifying holding', which should be focused on the impact of an acquisition on the target credit institution, and a 'material acquisition', which should be focused on the impact of an acquisition on the acquirer.

Furthermore, in line with its earlier expressed stance ([13]), the ECB encourages the inclusion of additional supervisory powers on (i) the amendment of credit institutions' articles of association, (ii) related party transactions, and (iii) material outsourcing arrangements. The harmonisation of these powers remains necessary and would help to progress further towards a genuine single rulebook and reduce regulatory fragmentation across the SSM.

7. **Administrative sanctions**

The proposed amendments to the CRD reflect the ECB's position on the matter ([14]). All efforts to further harmonise and strengthen the sanctioning and enforcement powers at Union level are welcomed, which will foster the effective enforcement of prudential requirements within the Union. In particular, it is noted that the enforcement powers of competent authorities are enhanced by introducing the possibility to impose periodic penalty payments as a new enforcement measure aimed at restoring compliance with prudential requirements and that such measure is without prejudice to the subsequent possibility of sanctioning the occurrence of the breach. It is therefore crucial that the distinction between this new enforcement measure, administrative penalties and other administrative measures under the CRD is also reflected in the Member States' transposition into national law. Moreover, the ECB also welcomes the fact that the list of breaches subject to administrative penalties is extended and that the definition of 'total annual turnover' is clarified.

8. **Supervisory benchmarking**

The ECB welcomes the amendments proposed to Article 78 of the CRD and, in particular, the fact that these amendments expand the scope of supervisory benchmarking to models used by credit institutions in order to calculate expected credit losses under IFRS9. This is very important to ensure the robustness of models which are used, inter alia, by credit institutions which do not have approved internal models for the determination of their capital requirements for credit risk. The addition of the alternative standardised approach for market risk to the scope of supervisory benchmarking is also welcomed as a complement to the information from the internal model approach and as an additional step towards the full implementation of the Basel market risk framework in the EU.

Furthermore, the ECB welcomes the proposal to give the EBA the flexibility to conduct the benchmarking exercises on a biennial basis. The ECB recommends giving even more flexibility to the EBA to set the frequency of these exercises. The ECB also proposes that the exercises are more clearly defined.

Finally, the ECB suggests that institutions should not be required to submit the results of their calculations to the competent authorities annually, i.e. also in years where the EBA does not conduct the exercise. Instead, the ECB proposes that the frequencies for submission and assessment are aligned, reducing the reporting burden for institutions.

9. **Disclosure**

The ECB welcomes the objective of the new integrated hub managed by the EBA for Pillar III disclosure by credit institutions, which aims to reduce the burden for banks and to facilitate the use of Pillar III information by all stakeholders. Supervisors could benefit from a centralised disclosure hub as it would make it easier for them to ensure the quality of Pillar III information.

The proposal is to apply a different approach in relation to the quantitative public disclosure of small and non-complex institutions (SNCIs) and larger credit institutions. For SNCIs, the EBA will use supervisory reporting to compile the corresponding (quantitative) public disclosure on the basis of a predefined mapping, while for larger institutions the EBA will receive the full disclosure files 'in electronic format' and will need to publish the files on the same day it receives them. This different approach does not seem justified. The same approach for quantitative disclosures could be applied to all credit institutions, regardless of their size and complexity, with the objective of reducing the reporting burden of all credit institutions. Also, the timeline for the EBA to publish Pillar III information on the centralised hub does not allow for the reconciliation between supervisory reporting and Pillar III disclosure

([13]) See paragraph 1.12.2 of Opinion CON/2017/46 of the European Central Bank of 8 November 2017 on amendments to the Union framework for capital requirements of credit institutions and investment firms (OJ C 34, 31.1.2018, p. 5).

([14]) See paragraph 1.15 of Opinion CON/2017/46.

information to be performed, which could lead to additional workload for supervisors and lack of clarity for investors and other users of Pillar III information. Moreover, qualitative disclosures and some quantitative disclosures cannot be extracted from supervisory reporting on the basis of the predefined mapping. This issue concerns both SNCIs and other institutions. Therefore, the process to submit such disclosures to the EBA should be clarified. Additional considerations regarding the envisaged Pillar III centralised disclosure hub are provided in the context of Opinion CON/2022/11.

Where the ECB recommends that the proposed amendments to the CRD are amended, a specific drafting proposal is set out in a separate technical working document accompanied by an explanatory text to this effect. The technical working document is available in English on EUR-Lex.

Done at Frankfurt am Main, 27 April 2022.

The President of the ECB
Christine LAGARDE