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Brexit for 日本の銀行 in Germany

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Brexit Top Topics for Japanese Banks in Germany

Management Summary

- After the UK’s official exit from the EU and the start of the transition period until 31 December 2020, third country banks, including Japanese banks, still need to **consider both European and German regulations in force**. The primary areas include framing the day 2 plan, choosing from different booking models, complying with supervisory expectations on outsourcing, transfer pricing.
- Assessing the **impact of recent regulatory requirements** is important in order to ensure prompt action and compliance at all times. Some of the recent regulatory developments that will have a big impact on the Japanese banks include the **requirement to establish an intermediate parent undertaking** (**IPU**) for third country banks. This could result in restructuring the EU footprint under a single top-tier IPU and the new investment firm categorisation system by the **new prudential requirements for investment firms** that will apply **from 26 June 2021**.
- Compliance with the above mentioned regulations requires a certain level of implementation effort on the side of the third country banks. While doing that, **effective communication with the head office** and the rest of the group is of vital importance in order **avoid non-compliance due to delayed managerial decisions**. It becomes critical to effectively communicate German specifics and supervisors’ expectation to the group’s headquarter and to consider them in global processes/IT.
- In addition to the above, opportunities to increase the product and client base by making use of the local benefits should be carefully assessed in order to **optimize profits** vis-à-vis implementation costs of the German entity.

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Implications arising from the current regulatory environment

The Withdrawal Agreement governing the exit of the UK from the EU came into force as of 31 January 2020. This marks the start of a transition period until 31 December 2020. Considering the deadline, banks are facing the immediate challenge that the German entity has to be **up and running** already today.

Day 2 Plan

BaFin expects banks to detail out their **day 2 plan** (formerly: glide path), i.e. to continuously reduce the backing out of Market Risk to global booking hubs. This will lead to a build-up of local risk management capacity; on top of that BaFin increasingly asks banks to plan for their recovery and resolution.

Booking Models

This will have a direct impact on the discussion around booking models: Supervisory expectations here are the opposite of what would be efficient form the point of view of a global banking group. Since ECB already requires banks to detail out their day 2 plan, it is no longer an option to simply prepare for a local booking strategy. Instead banks have to chose between two approaches:

- One approach is to break the global booking model and manage the risk of the Germany entity locally.
- A more visionary approach is to shift an entire global portfolio to Europe/Germany. This makes sense if large parts of the portfolio are anyway managed from the local entity, e.g. Euro denominated transactions.

Outsourcing

BaFin expects banks to reduce the level of **outsourcing**, particularly to avoid outsourcing concentration on the parent company.

Transfer Pricing

In the same vein banks need to master transfer pricing and inducements in order to demonstrate their full grasp on these topics against tax authorities.

Basel

It will be implemented in some variation in the jurisdiction of the Group headquarter but will be implemented differently in the EU (e.g. CRR II, FRTB). Detailed comparison between the different sets of regulation required to call out differences in content and timelines.

Direct ECB Supervision

When the local banks grow and hit the threshold of Euro 30 bn they will come under direct ECB supervision and will have to fulfill yet another set of requirements. Strategic decisions to be made now in order to align that point in time with the banking group’s strategy for the European operations.

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Recent regulatory developments to consider (I)

Investment Firm Review

- Regulation on the prudential requirements for investment firms (IFR) and Directive on the prudential supervision of investment firms (IFD) came into force on 25 December 2019. IFR/IFD **introduces a new prudential regime for certain investment firms**, tailored to their **activities and asset size** and revises the **MiFID II/MiFIR third-country regime** for investment services. IFD/IFR will **apply from 26 June 2021.**
- A specific prudential regime is required for investment firms which are not systemic by virtue of their size and interconnectedness with other financial and economic actors. Systemic investment firms should, however, remain subject to the existing prudential framework under CRD/CRR. The largest and most interconnected investment firms have business models and risk profiles that are similar to those of significant credit institutions and should be treated as such.

While many investment firms will see a tailored regime as a positive step, the implications of the new regime will differ from firm to firm. Each firm will need to assess what the regime change means for it and take action accordingly.
The new categorization of investment firm could potentially lead to less requirements particularly for smaller investment firms. But to find the optimal scale and size has again become more complex.

The four-tier categorisation system based on the scale and scope of activities undertaken by investment firms is adopted :

Class 1: Systemic investment firms

Class 1-: Large investment firms

Class 2: Larger investment firms

Class 3: Small and non-interconnected investment firms

* Class 1, 1-, 2 and 3 are not official IFR/IFD terminology, but used for ease to distinguish between the different categories

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Recent regulatory developments to consider (II)

Intermediate Parent Undertaking (IPU)

- The requirement for third country groups to restructure their EU footprint under a single top-tier IPU would have been relevant with or without Brexit. For some banking groups at least one IPU will have to be set up. For Japanese banking groups, where a **split of certain banking activities** is required by their domestic regulation, this will lead to **at least two IPUs** having to be set up. The questions around a cost-efficient setup could lead to some knock-on restructuring of the current EU operations.
- CRD V came into force on 27 June 2019, but it still requires **transposition** by all Member States into domestic law **before December 28, 2020**.
- Thre **threshold** for creating an IPU is **EUR 40bn total asset** across a third country group's European operations, including subsidiary and branch assets. The figures can simply be aggregated and do not have to be consolidated according to any specific GAAP. The total assets of each credit institution and investment firm in the Union of the same third country-group and the total assets of each branch of the third-country group authorized in the Union in accordance with the CRD, MiFID and MiFIR.
- In light of the above, third-country groups operating through more than one institution in the Union and with a total value of **assets equal to or greater than EUR 40 billion on 27 June 2019** should have an IPU (or two IPUs) by **30 December 2023.**

Effective communication with the Group

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With the importance of the German entity increasing, it becomes vital to effectively communicate German specifics such as the mentioned European and national regulations and supervisors' expectation to the group's headquarter and to consider them in global processes/IT.

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Profit optimisation with the newly established subsidiaries

- Banks have to **increase profitability**. Newly established subsidiaries need to quickly develop their own business, since they can't only rely on clients to switch over from their UK parent company.
- There is an opportunity here to increase the product and client base by making use of the local benefits, which are:
  - **Germany's AAA country rating** which potentially translates into a prime rating for the institution.
  - The **natural hedge** against the Euro
  - Access to **additional sources of funding** in Germany and direct access to **ECB funding**.
  - The subsidiary may also expand its portfolio with new **German-specific products** like Schuldscheindarlehen to increase its footprint in the competitive German market.
  - Establishing a strong financial infrastructure for new German clients such as the German **Mittelstand** should also be taken into consideration.