



**THE CONDITIONS FOR ESTABLISHMENT
OF SUBSIDIARIES AND BRANCHES IN THE
PROVISION OF BANKING SERVICES BY
NON-RESIDENT INSTITUTIONS**

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Executive Summary

In 2014, the Financial Stability Board (FSB), in collaboration with the IMF and OECD, prepared a report for G20 leaders that sought to assess the cross-border consistencies and global financial stability implications of structural banking reform measures based on information and perspectives collected from those originating the reforms and those jurisdictions that might be affected by these reforms. To further examine structural banking reform measures taken since 2008, the OECD circulated a survey (Survey on the Conditions for Establishment of Subsidiaries and Branches for the Provision of Banking Services by Non-Resident Institutions) to Delegates and Participants in the OECD Advisory Task Force on the Codes of Liberalisation and the OECD Committee on Financial Markets, which includes officials from central banks and finance ministries. This report describes the outcome of this survey, and was circulated to the FSB plenary in June 2016.

A range of measures having implications for non-resident banking or credit institutions were introduced or in force in the aftermath of the crisis. They include changes in the authorisation process or in the scope of permitted activities, as well as financial requirements, governance and risk management requirements, operational requirements, and ownership and control requirements. A larger number of jurisdictions have adopted measures that affect branches of non-resident banking institutions as compared with subsidiaries of non-resident banking institutions, but the margin of difference is not large in absolute terms as far as individual reform categories are concerned.

There are some countries which do not permit establishment of branches by non-resident banks or only after incorporation. Others do not permit branches of non-resident banks to operate in some banking services, mostly relevant to retail banking and/or deposit taking. There have been transitions from branches to subsidiaries in some jurisdictions and the reverse transition from subsidiaries to branches has also occurred, although sometimes only involving domestic institutions.

In terms of the possibility of requiring a non-resident bank to establish a subsidiary (or financial holding company) instead of a branch, in most cases the supervisory authority has the discretion to require this on a case-by-case basis and when certain conditions/thresholds are met. The survey results suggest that there has been some tightening since 2008 in regard to the conditions for non-resident banks to branch. Many of the higher threshold requirements are also related to the possible systemic impact in terms of the size and complexity of the banking institution.

Another observation is that there has been a convergence of requirements for non-resident bank subsidiaries and branches. The conditions for the establishment of a branch and subsidiary are the same or equivalent as those for local banks in most cases, and there are no cases in which more requirements are made towards branches/subsidiaries. While this would be expected for the establishment of subsidiaries under the principle of national treatment, and is mostly the case for branches operating solely in wholesale banking, branches operating in retail banking are in many cases also subject to financial and governance requirements similar to locally incorporated banks.

Most jurisdictions indicate that financial or prudential requirements are imposed on branches of non-resident banks. A key issue that is being increasingly monitored since the crisis concerns liquidity and many financial requirements identified are liquidity related, some of which have been introduced since the crisis.

While financial requirements on branches have been common, governance requirements on branches are less well known, but are imposed by most jurisdictions on branches of non-resident banks and have increased in recent years since the crisis. The 'fit and proper tests' are the most common (indeed, all countries that have governance requirements on branches apply a fit and proper test) but many also require a risk management and/or audit function in the branch. Half of the jurisdictions require the establishment of a board of directors/management board in branches, and some require the establishment of board committees.

While branching by non-resident banks remains a widely available option, a number of countries have applied certain safeguards to ensure the safety of depositors or to prevent deposit insurance from being activated for a branch. In particular, the financial and governance requirements that are now being imposed, while the same or equivalent to domestic banks, may limit the attractiveness of branching going forward.

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THE CONDITIONS FOR ESTABLISHMENT OF SUBSIDIARIES AND BRANCHES IN THE PROVISION OF BANKING SERVICES BY NON-RESIDENT INSTITUTIONS

Background and introduction

In 2014, the Financial Stability Board (FSB), in collaboration with the IMF and OECD, prepared a report for G20 leaders that sought to assess the cross-border consistencies and global financial stability implications of structural banking reform measures based on information and perspectives collected from those originating the reforms and those jurisdictions that might be affected by these reforms.¹

The report indicated, as part of its conclusions, that “a clearer picture is needed of the range of national requirements for capital and liquidity held locally (not only the requirements resulting from recent structural banking reforms, but also the requirements in existing regulations). The Basel Committee on Banking Supervision (BCBS) announced plans to take stock of jurisdictions’ current and prospective treatment of cross-border branches and subsidiaries and report its findings to the FSB by end-2015. The OECD intends to take stock of the consistency of requirements with the OECD Codes of Liberalisation of Capital Movements and of Current Invisible Operations and report to the FSB by end-2015.” In response to this mandate, the OECD circulated a survey (Survey on the Conditions for Establishment of Subsidiaries and Branches for the Provision of Banking Services by Non-Resident Institutions, hereafter “the survey”) to Delegates and Participants in the OECD Advisory Task Force on the Codes of Liberalisation and the OECD Committee on Financial Markets, which includes officials from central banks and finance ministries.

The OECD Codes are compatible with other international agreements, including the General Agreement on Trade in Services (GATS). The GATS and the Codes both promote goals of liberalisation, but there are some differences in the approaches taken. While the GATS promotes the liberalisation of “trade in services” (with the implications for capital movements and other transfers seen in that context), the Codes promote the liberalisation of capital movements and invisible transactions and transfers.² Thus, the liberalisation of payments and transfers for international transactions, or indeed capital movements, is not a primary objective of the GATS, but it might be viewed as a related condition.³ The GATS favours a “bottom-up” or “positive list” approach to defining countries’ individual commitments, meaning that the sectoral coverage of Members’ specific commitments are the result of negotiations, the Codes follow a “top-down” or “negative list”. Thus, the GATS seeks to achieve its goals through rounds of negotiation as opposed to unilateral liberalisation and peer persuasion as in the OECD approach. GATS negotiation of commitments means that progress towards liberalisation is achieved through mutual concessions, sometimes across different services sectors. Collecting and analysing data regarding the treatment of cross-border provision of financial services and the establishment of foreign banks’ subsidiaries and branches based on an established framework can help to inform and support discussions among financial services regulators and policymakers on reform proposals and their broader potential international impact.

¹ See *Structural Banking Reforms: Cross-Border Consistencies and Global Financial Stability Implications* (November 2014) available at www.financialstabilityboard.org/wp-content/uploads/r_141027.pdf.

² The GATS defines “trade in services” as including not only cross-border supply of services, but also the supply of services through the establishment of a commercial presence in the host country.

³ The GATS deals with payments, transfers and capital movements in Articles XI (Payments and Transfers), XII (Restrictions to Safeguard the Balance of Payments), and in footnote 8 to Article XVI (Market Access). GATS provisions dealing with payments, transfers, and capital movements constitute apply only to the sectors and modes in which a Member has undertaken specific commitments on market access and/or national treatment.

Consistent with this view, the methodology for the stocktaking undertaken in this report is based on the framework provided by the OECD Codes, in particular the CLCIO which covers services. It should be noted, however, that while the exercise looks at identified measures from the perspective of the Codes, it does not involve an actual assessment of the legal conformity of the measures taken by countries with the provisions of the OECD Codes or, where relevant, with any actual commitments that may exist under the instrument. Submissions from individual respondents are described in the text, however, only for purposes of illustrating particular types of measures. Otherwise, responses have been aggregated, with the responses summarised in accompanying figures.

The financial and economic crisis establishes the timeframe for examining reform measures, with the year 2008 as a starting point. The choice reflects the tendency for financial and economic crises to lead to major policy reforms. The history of banking and financial policy making can be viewed as a search for a structure that minimises instability, that is, one that prevents micro disturbances from feeding through to cause problems in other parts of the financial system or the broader economy. Hence, episodes of broader financial instability tend to be followed by significant changes to legal and regulatory frameworks, with a view toward correcting perceived shortcomings, especially at the national level. This time was no exception and a range of measures have been introduced in various jurisdictions in accordance to perceived domestic needs, but also taking account of the importance of cross-border issues as pertains to the activities of systemically important institutions. Examples of measures focused on the banking sector have included structural reforms related to permissible lines of business and operating structures, including limitations to branching; governance requirements related to risk management and internal controls; prudential requirements related to risk-based capital, leverage, and liquidity; collateral requirements and other financial requirements for branches; and changes in authorisation procedures.

Experience shows that measures introduced in response to crisis events or other serious economic and financial disturbances have sometimes had discriminatory effects on different types of market participants, in particular on non-resident providers. The survey underlying this report was designed in this context to facilitate a better understanding of the various regulatory reforms introduced in the wake of the crisis events. Of particular interest is the impact the measures have had on bank structures, especially on non-resident banks establishing abroad, but the survey has also sought to determine whether banking operations and the nature of the market have been affected. To explore these various issues the survey sought to identify the reforms that have been introduced since 2008, whether the reforms have had effects on non-resident banking/credit institutions operating through branch or subsidiary forms, and whether there have been any resultant changes in the nature of participation and/or competition in the market. Subsequent questions explore in more depth the issue of establishment, including the forms of establishment permitted in respondent jurisdictions, the requirements for establishment, and the degree to which these requirements are different for resident versus non-resident institutions.

The survey was sent to all OECD and FSB members. Responses were received from 26 OECD Members and from five non-OECD Members.⁴

Requirements for establishment by non-resident institutions

Conditions for the establishment of subsidiaries and/or branches are covered by the OECD Codes. Under the Codes, Members and Adherents have the obligation to remove restrictions on foreign direct investment, other capital movements and international services, unless they have lodged reservations

⁴ Responses to the survey were received from the following OECD Members: Australia, Austria, Belgium, Canada, Chile, Czech Republic, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Italy, Japan, Mexico, New Zealand, Poland, Portugal, Slovak Republic, Slovenia, Spain, Switzerland, Turkey, the United Kingdom and the United States. The following non-OECD Members provided survey responses: Brazil, Hong Kong-China, Russia, Singapore and South Africa.

regarding the types of operations they are not yet in a position to liberalise. The Codes provide for "standstill", which means that new restrictions should not be introduced that would reverse earlier liberalisation measures. Furthermore, countries are expected to eliminate reservations when the underlying restrictions no longer apply. The resulting so-called "ratchet effect" ensures that the status quo evolves in the direction of liberalisation.⁵

One of the core concepts in the Codes is the notion of "equivalence". For instance, the Codes' obligations regarding establishment and operation provide that the treatment of non-resident financial institutions wishing to offer or offering banking services by means of establishment of a subsidiary (entity incorporated under the law of the host country) or a branch (a non-incorporated entity established under the laws of the home country) should be no less favourable than that applied to domestic institutions in like circumstances (as detailed in Annex II to Annex A of the CLCIO and reproduced as Annex 1 to this report). The intended effect is that the establishment of non-resident enterprises should not be subject to more burdensome requirements than those applying to domestic enterprises (see paragraph 1 of the CLCIO). The equivalence test would also apply to "domestic laws, regulations and administrative practices needed to assure the soundness of the financial system or to protect depositors, savers and other claimants" (paragraph 7 of the CLCIO) and to "financial requirements" (paragraph 8 of the CLCIO).

As a principle and unless reservations are made to limit it in light of restrictions, conformity with the Codes requires freedom for transactions and transfers between residents and non-residents for operations covered by the Codes and adherence to the non-discrimination principle in the implementation of regulatory measures. It is important to note that adherence to the principle of non-discrimination requires only that the authorities grant equivalent treatment to residents and non-residents in "like circumstances". In this sense, the equivalence test opens the scope for measures that entail departures from strictly identical treatment between residents and non-residents to nonetheless be in conformity with the Codes (*i.e.* subject to an assessment by the OECD Investment Committee; see Box 1). In particular, under the Codes, countries may take measures for the maintenance of fair and orderly markets and sound institutions and for the protection of investors or other users of banking services, provided these measures do not discriminate against non-resident providers of such services. It should be noted, however, that reciprocity, whereby a given jurisdiction (A) makes decisions on establishment by non-resident subsidiaries and branches from another jurisdiction (B) conditional on jurisdiction (B) applying the same treatment to subsidiaries and branches from jurisdiction A, does not pass the equivalent treatment test.

Box 1. The Codes' equivalence test

As noted in the User's Guide to the OECD Codes of Liberalisation:

"Measures which differentiate between residents and non-residents are, however, not always contrary to the obligations of the Codes. The Committee has accepted as equivalent treatment certain cases where a different regime applies to non-residents as compared to residents. The condition is that this does not exceed what is necessary, for prudential or other purposes provided in the Codes, to place residents and non-residents on an equal footing.

*The principle of equivalent treatment has been developed in particular with regard to the establishment of branches or agencies by non-resident enterprises. When a foreign company establishes a subsidiary in the host country, the establishment takes place through incorporation, with the same guarantees and conditions (for example, minimum capital) as applies to resident investors. But where a foreign company decides to establish only a branch or agency, *i.e.* not to incorporate as a legal person, host country authorities may feel the need to impose special requirements for prudential reasons, which do not apply to branches of host-country enterprises. This need is recognised under the Codes, and differential treatment is accepted in such cases, but only if such requirements on branches of enterprises incorporated are not more burdensome than necessary for prudential or other purposes*

⁵ By means of Decisions, which are binding OECD acts, the Investment Committee, under authority delegated by the Council, gives effect to deletions or modifications of countries' reservations under the Codes.

provided in the Codes.

The terms “burdensome” and “necessary” may involve a certain degree of subjective judgment. Member countries have attempted, wherever possible, to agree on minimum conditions under which treatment would be considered “equivalent”, and thus not constitute a restriction under the Codes. Examples are the areas of banking and financial services, as well as insurance and private pensions services. Detailed provisions are included in the Current Invisibles Code regarding authorisation procedures, representation, and prudential and financial requirements which may apply to the establishment of branches and agencies of non-resident enterprises.”

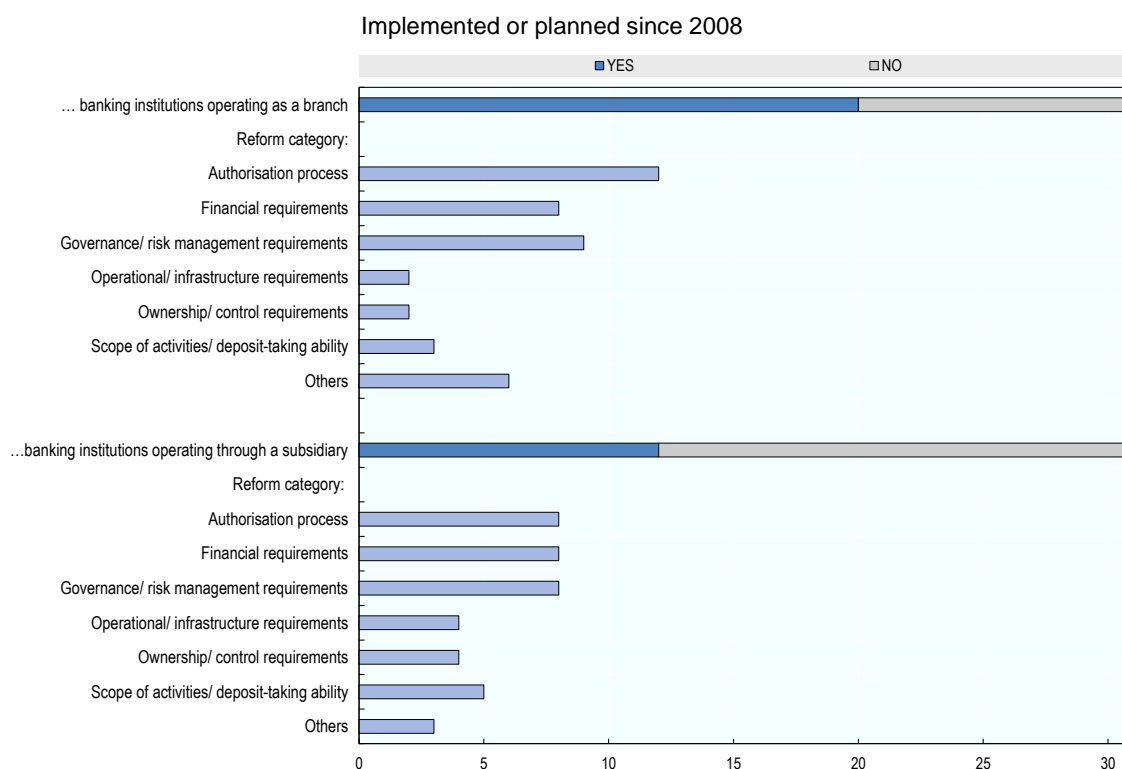
Source: OECD Codes of Liberalisation: User's Guide.

Against this backdrop, the balance of this report looks at the types of measures and requirements pertaining to banking or credit institutions that have been identified.

Forms of establishment

In general, a range of measures having implications for non-resident banking or credit institutions were introduced or in force in the aftermath of the crisis (Figure 1). As may be seen, the measures include changes in the authorisation process or in the scope of permitted activities, as well as financial requirements, governance and risk management requirements, operational requirements, and ownership and control requirements. In absolute terms, more jurisdictions have adopted measures that affect branches of non-resident banking institutions as compared with subsidiaries of non-resident banking institutions, but the margin of difference is not large in absolute terms as far as individual reform categories are concerned.

Figure 1. Reforms or guidance with implications for foreign banking institutions

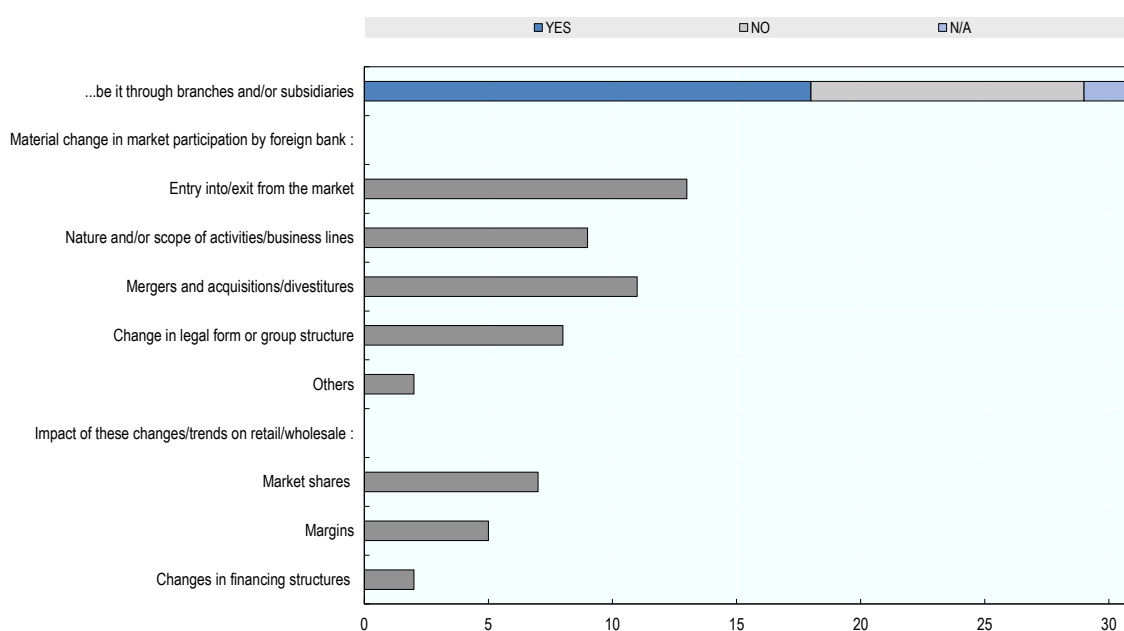


Source: OECD Survey on the Conditions for Establishment of Subsidiaries and Branches for the Provision of Banking Services by Non-Resident Institutions (2015).

The potential exists for reform measures to change the perceived economic advantages for non-resident institutions to operate in a particular host jurisdiction via branch or subsidiary form. In general, an institution’s response to material changes in the operating environment, either because of

changes in policy, the nature of competition or economic conditions, can include changes in the scale or scope of operations, changes in business models, or changes in structure. As to the specific question of whether there has been a change in the nature of participation in the domestic market by non-resident banking institutions, the evidence suggests that some noticeable changes have in fact occurred. This change most often took the form of entry into or exit from the market, followed in turn by mergers and acquisitions/divestitures, by changes in the nature and/or scope of activities/business lines, and changes in legal form or group structure (Figure 2). There does not appear to be clear instances where the nature of competition or number of foreign establishments has changed since 2008 as a result of changes in regulation. However, for example, in Brazil, there has been an increase in the number of banks controlled by foreign shareholders since 2008 - from 53 in 2008 to 60 in 2015. In turn, in 2015, a major foreign bank was acquired by a domestic private bank.

Figure 2. Changes in the nature of foreign bank participation in the market since 2008...



Source: OECD Survey on the Conditions for Establishment of Subsidiaries and Branches for the Provision of Banking Services by Non-Resident Institutions (2015).

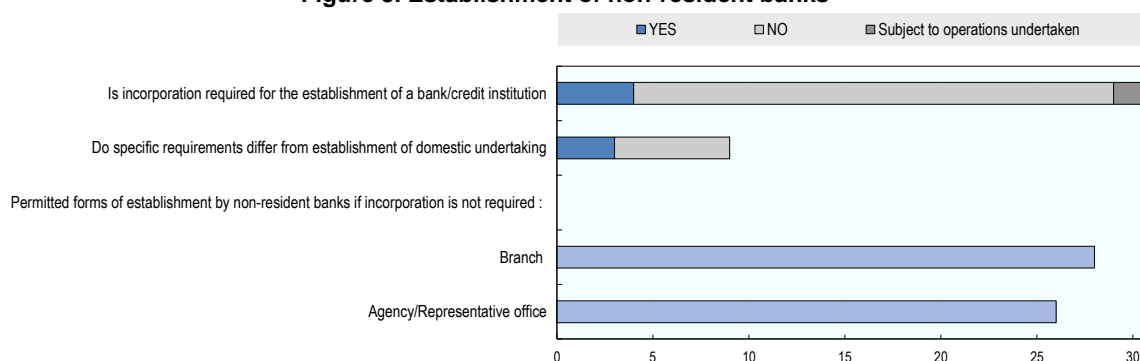
As for the impact of the change in the nature of foreign bank participation on competition in retail and/or wholesale markets, the more common changes were in market shares, in financing structures, and in margins. In a few cases, the rise in market share of branches and subsidiaries of foreign banks in terms of assets and deposits was said to have had a significant impact in both retail and wholesale markets, with some non-resident banks choosing as a consequence to concentrate on retail markets whereas others sought to perform better in wholesale market segments (e.g., Poland), but elsewhere the impact of the changes on competition were perceived as being limited overall.

Some regulatory measures have a direct effect on the forms of establishment by non-resident banking institutions. A primary example would be regulatory or legal provisions that require non-resident banks to incorporate as a condition for establishment of a bank/credit institution. Five countries require subsidiarisation of foreign undertakings, while two countries require subsidiarisation for the provision of specific banking services. In Mexico, for example, regulation does not permit the establishment of branches by non-resident banks. In Brazil, non-resident banks are not authorised to operate through branches, but must operate through subsidiaries. In the U.S., non-resident banking organisations with \$50 billion or more in U.S. non-branch assets are subject to a structural requirement to hold their U.S. subsidiaries through an intermediate holding company that must hold the ownership interest in virtually all U.S. subsidiaries (although they may still maintain a separate branch).

Most jurisdictions do not require incorporation as a general condition for establishment for non-resident banks/credit institutions (Figure 3). Where that is the case, permitted forms of establishment also include both branches and agencies/representative offices, in addition to subsidiaries. That said, representative offices generally are not permitted to carry out banking services, payment services or financial services.

While the majority of jurisdictions surveyed have not established specifically limit the form of establishment permitted for non-resident banking/credit institutions, many measures or reforms introduced or in place since 2008 have either directly or indirectly had implications for non-resident banking institutions intent on operating in a jurisdiction via branching. A common example includes measures directed at amending the authorisation process or other market entry criteria. Other measures having a bearing on the form of establishment include financial requirements and governance or risk management requirements.

Figure 3. Establishment of non-resident banks

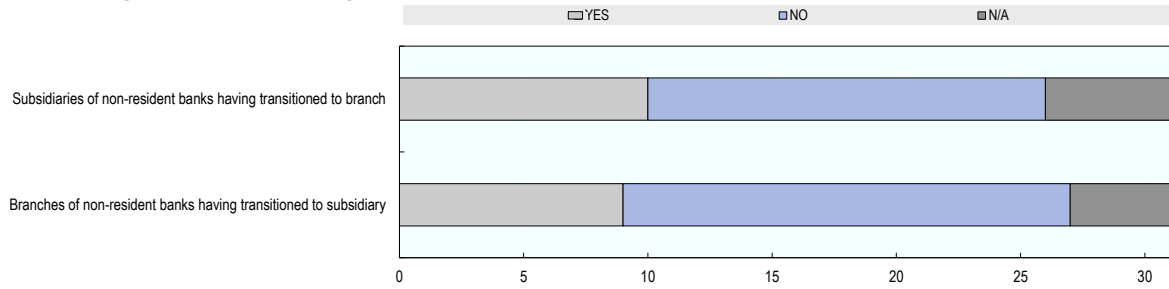


Source: OECD Survey on the Conditions for Establishment of Subsidiaries and Branches for the Provision of Banking Services by Non-Resident Institutions (2015).

In contrast to the measures affecting branching operations, few reforms or guidance have been directed at or have had implications for non-resident institutions operating through subsidiaries (Figure 1). Where such measures have been adopted, they largely have focussed on authorisation processes, financial requirements, and governance/risk management requirements. In a very few cases, measures entailing structural/operational/infrastructure requirements and measures affecting the scope of activities/deposit-taking ability of banking institutions operating through the subsidiary form have been introduced. In the U.S., for example, non-resident banking organisations with \$50 billion or more in U.S. non-branch assets are subject to a structural requirement to hold their U.S. subsidiaries through an intermediate holding company and comply with prudential requirements, but these requirements are generally equivalent to those required of domestic bank holding companies.

The response of foreign banking undertakings to changes in incentives favouring or challenging branching or subsidiary operations could include a switch in operating form, whereby branches of non-resident banks transition to a subsidiary or conversely subsidiaries of non-resident banks transition to a branch. Where such transitions actually did occur (Figure 4), the actual number was rather small in absolute terms, being limited in most cases to only one such transition or to two or three in a couple of jurisdictions (i.e. Spain, Slovak Republic, Poland). In Poland, branches were usually engaged in specialised banking activities, whereas the subsidiaries performed general banking business. When a transformation of a bank branch into a subsidiary took place, the scope of activities as well as the business model of a given entity changed respectively (from specialised to general banking, and to strengthen its presence in the market). This procedure has been reversed if the entity was transformed from a subsidiary into a branch, and was witnessed mainly among EU countries to take advantage of the banking passport regime, and otherwise owing to mergers and restructuring of groups.

Figure 4. Transitioning of non-resident banks to subsidiaries or branches since 2008



Source: OECD Survey on the Conditions for Establishment of Subsidiaries and Branches for the Provision of Banking Services by Non-Resident Institutions (2015).

Requirements for establishment of a branch or a subsidiary

In contrast to the GATS, which include a qualified “prudential exception” from their obligations, there is no specific prudential exception chapter or section under the Codes. The Codes do, however, allow derogations for serious economic and financial disturbances and for balance-of-payments problems, and as noted before, allow for domestic laws, regulations and administrative practices as needed to assure the soundness of the financial system or to protect depositors, savers and other claimants. Even so, the non-discrimination intent of the Codes still applies in that these measures are accepted under the Codes, but subject to the proviso that they should “not prevent the establishment of branches or agencies of non-resident enterprises on terms and conditions equivalent to those applying to domestic enterprises operating in the field of banking or financial services”.

The definition of "non-discrimination" or "equivalent treatment" under the Codes has been the subject of extensive jurisprudence, which can be found in country reports and cross-country reviews of Members' positions under specific items, including assessments pertaining to the Accession of new Members to the Organisation. OECD Members have reached understandings as to types of conforming measures, which are reflected in the Codes Users' Guide and in various reports from relevant OECD Committees. These understandings as regards conforming measures include the following:

- "fit" and "proper" tests of general application;
- financial requirements for branches of non-resident institutions equivalent to those required from domestic entities;
- review of investment, both foreign and domestic, at equity thresholds;
- rules on "widely-held" ownership;
- rules for consolidated supervision; including requirements imposed on financial institutions derived from the sharing of responsibilities between host and home country supervisors;
- the non-extension of emergency lending facilities to branches of non-residents institutions; and,
- requirements for home country authorities' adherence to international cooperation and information exchange standards as a prior condition for authorisation for establishment (such as existence of a memorandum of understanding or other forms of mutual arrangement between home and host country counterparts), to the extent that an equal and adequate opportunity is afforded to any interested Adherent countries to demonstrate that comparable circumstances exist for entering into similar arrangements.

Adherence to the principle of non-discrimination requires only that the authorities grant equivalent treatment to residents and non-residents in “like circumstances”. Extracts from the User's Guide on the Codes suggest the following: “Members are allowed considerable scope for national prudential

measures, as long as they do not discriminate against non-residents”; “measures which differentiate between residents and non-residents are, however, not always contrary to the obligations of the Codes. For example, certain cases in which a different regime applies to non-residents as compared to residents”, and “selective recognition agreements, which may affect the right to carry out operations covered by the Codes, are in general based on objective technical criteria and may be accepted as equivalent treatment. In other words, the different treatment is based on different circumstances and thus does not violate the non-discrimination provisions of the Codes”. These measures are considered non-discriminatory and do not call for reservations under the Codes.⁶

In addition, the CLCIO has specific provisions applying to licensing conditions and financial guarantees that may be imposed for the establishment of branches and are considered equivalent to those applying to domestic enterprises, so that the establishment of non-resident enterprises shall not be subject to more burdensome requirements than those applying to domestic enterprises (see Annex 1).

Different types of financial operations can raise different concerns for policy. For example, consumer protection considerations tend to be more important in measures directed at cross-border provision of financial services, while systemic stability becomes more important in concerns about FDI in financial services. Partly in this context, a distinction can be made between retail and wholesale banking services in addition to the distinction between branches versus subsidiaries. This section provides an overview of the responses addressing these issues.

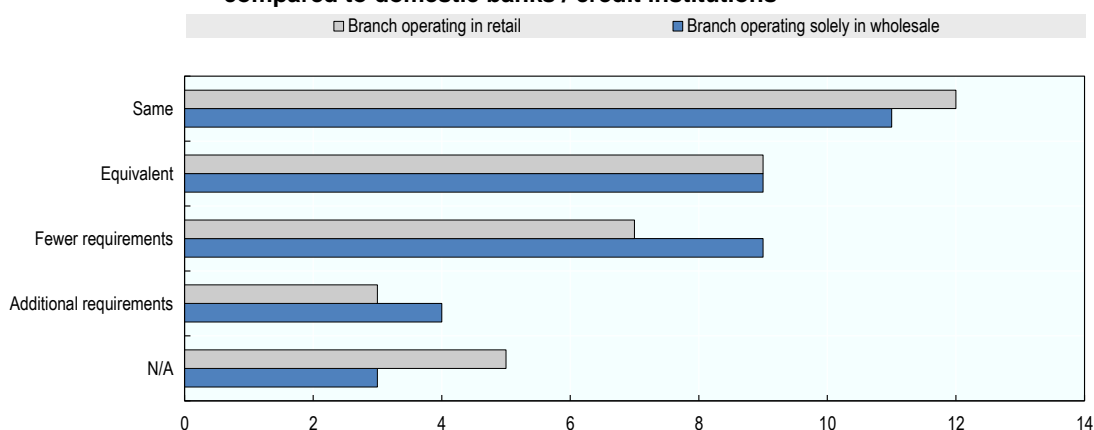
General requirements for a branch

Most jurisdictions (27 out of 31) allow non-resident banks or credit institutions to operate as branches (Figure 3). Brazil, Mexico, and Russia do not permit the establishment of branches of non-resident foreign banks. In South Africa, a foreign bank is allowed to establish branches within South Africa, after first incorporating as an external company pursuant to the Companies Act. Australia and New Zealand require establishment of a subsidiary for a foreign undertaking to carry out retail deposit taking that is of a significant size. In some cases, the grant of approval for branch operations is also contingent on the acceptance of the arrangement by the home supervisor, which itself may also have to meet certain requirements, such as having appropriate institutional capacity to subject the applicant bank’s parent to adequate prudential supervision (Figure 5).

The home supervisor of the parent bank may be required to sign a Memorandum of Understanding with the host supervisory authority, and in many cases must also be willing and able to cooperate with the host supervisor, including in the exchange of information and adherence to confidentiality requirements.

⁶ This includes the EU banking passport which is not discriminatory towards third-country bank branches.

Figure 5. Conditions of establishment of branches of non-resident bank/credit institutions compared to domestic banks / credit institutions



Source: OECD Survey on the Conditions for Establishment of Subsidiaries and Branches for the Provision of Banking Services by Non-Resident Institutions (2015).

Some jurisdictions impose fewer requirements on branches of non-resident institutions, provided the parent institution satisfies certain conditions (Figure 5). Jurisdictions imposing fewer requirements on authorised branches of non-resident banks identify a number of differences in the requirements, including the following cases:

- the full range of prudential requirements on branches of non-resident banks are not required including capital adequacy requirements, large exposures, liquidity ratio, etc. (e.g. Australia)
- a branch is not subject to capital, liquidity or leverage requirements and to fewer governance requirements (e.g. Canada, Singapore)

For members of the European Union (EU), the procedures for establishment of branches are different for EU-based applicants versus non-EU applicants, in the sense that the establishment of a branch of a parent credit institution not established in the EU would depend on requirements set by the relevant member state, while rules governing establishment of branches of EU-based institutions are set by law and are fully harmonised (passporting).

In the U.S., branches are generally subject to fewer or less burdensome financial requirements than domestic banks. For example, unlike domestic banks, U.S. branches of non-resident banks are not subject to U.S. regulatory capital requirements or stress testing requirements in recognition that branches are a direct extension of the foreign bank and not subsidiary operations.

Financial authorities sometimes draw distinctions between retail banking operations and wholesale banking operations, with a view towards offering greater protection for less sophisticated investors as compared with institutions and other professional entities (Figure 5). The limit on eligibility for deposit insurance is one example, with branches of non-resident foreign institutions sometimes excluded from the protection, as is the case in Australia, Canada, Japan and Poland. In the U.S., branches of non-resident banking organisations (with the exception of a limited number of grandfathered branches with FDIC insurance), may not engage in retail deposit taking and, hence, are not eligible for deposit insurance. They may, however, engage in retail lending and other transactions.

While limitations on eligibility for deposit insurance may be generally the case, they do not always result in differential conditions for establishment. In some cases, the conditions for establishment of a branch of a non-resident bank/credit institution are similar for retail banking and wholesale banking operations, as compared with those for domestic institutions. Similarly, the conditions for establishment of a branch in wholesale banking are generally either the same as those applying to domestic banks/credit institutions or equivalent for non-resident and domestic institutions.

In a few jurisdictions (e.g. EU members), there are reportedly no differences between the requirements for establishment of branches operating exclusively in wholesale banking, as compared with branches operating in retail banking. What generally matters is the localisation of the parent bank establishment (in or out EU/EEA).

While the majority of countries do not have pre-set specific requirements for establishment of a branch or subsidiary of a non-resident institution, in a few jurisdictions additional specific requirements apply for a non-resident institution to establish a branch in retail banking. For example, local incorporation is required in a few jurisdictions if the applicant bank wishes to undertake “material” deposit taking, defined in some cases as deposits above a given threshold amount (as in Australia and New Zealand) or in other cases relative to the overall scale of retail deposit taking activity (as in Hong Kong-China and the UK).

The application of such conditions in regard to authorisation could potentially raise issues under the Codes should they prove to be substantially more burdensome in practice for foreign banks, i.e., lack of equivalent treatment. In the event that countries subject to the Codes find that conditions for establishment were to raise issues regarding equivalent treatment, they could seek redress under the Codes.⁷

In the UK, the approach to branches of non-resident institutions is centred on an assessment of the branch’s UK activities. Subject to this, the Prudential Regulatory Authority (PRA) will need to establish the equivalence of the home state supervisor’s (HSS) supervision of the whole firm, agree a clear division of prudential supervisory responsibilities for the branch with the HSS and obtain assurance from the HSS over resolution. The PRA will permit non-EEA branches undertaking retail banking activities beyond *de minimis* levels, only if there is a very high level of assurance from the HSS over resolvability of the non-resident institution including its UK branch. Further, non-EEA branches are expected to focus on wholesale banking and to do so at a level that is not critical to the UK economy, i.e., an interruption to the provision of service would not cause financial instability in the United Kingdom. These factors will be assessed comprehensively, with the assessment of the threshold varying by firm (see Annex 2 for details).

In Belgium, there is not a threshold *per se*, but the National Bank may refuse (or withdraw) authorisation for establishing a branch, based amongst other things on the scale of the branch in relation to the credit institution, and may require the setting up of a subsidiary if it is of the opinion that this is required for the protection of depositors or for a sound and prudent management of the institution or even for the stability of the financial system.

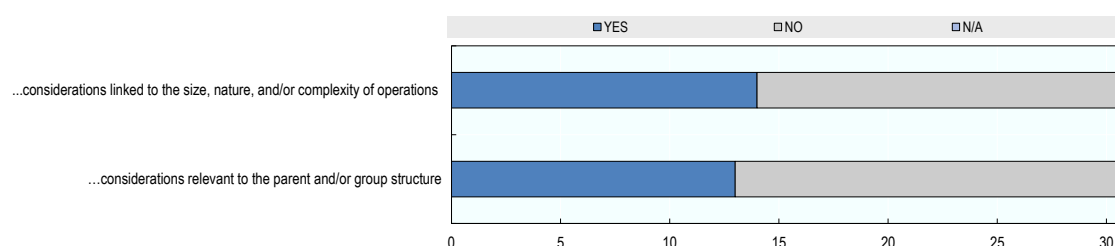
In South Africa, while the establishment of branches by foreign institutions are nominally permitted in name, application for the establishment of a branch of a foreign institution requires that applicants comply with all applicable South African legislation, which includes the requirement to incorporate as an external company, effectively prohibiting cross-branching as generally understood. In addition, South Africa imposes additional criteria on branches such as the parent institution’s total assets must be at least USD 1 billion and the parent bank needs to have a long-term investment grade credit rating by an internationally recognised rating agency. In the Slovak Republic, the initial capital for depository activities and mortgage lending of branches has been increased to EUR 33.2 million.

More generally, several jurisdictions have considerations for establishment linked to the size (e.g., France and Spain), nature, and/or the complexity (e.g. Hungary) of the operations of the

⁷ Article 16(a) of the Codes states that “if a Member considers that the measures of liberalisation taken or maintained by another Member, in accordance with Article 2(a), are frustrated by internal arrangements likely to restrict the possibility of effecting transactions and transfers, and if it considers itself prejudiced by such arrangements, for instance because of their discriminatory effect, it may refer to the Organisation.”

branch/subsidiary being established (Figure 6). When a branch’s activities are deemed to be systemically important to the local market, subsidiarisation may be required (e.g. New Zealand).

Figure 6. Considerations which may lead to a requirement to establish a subsidiary in lieu of a branch

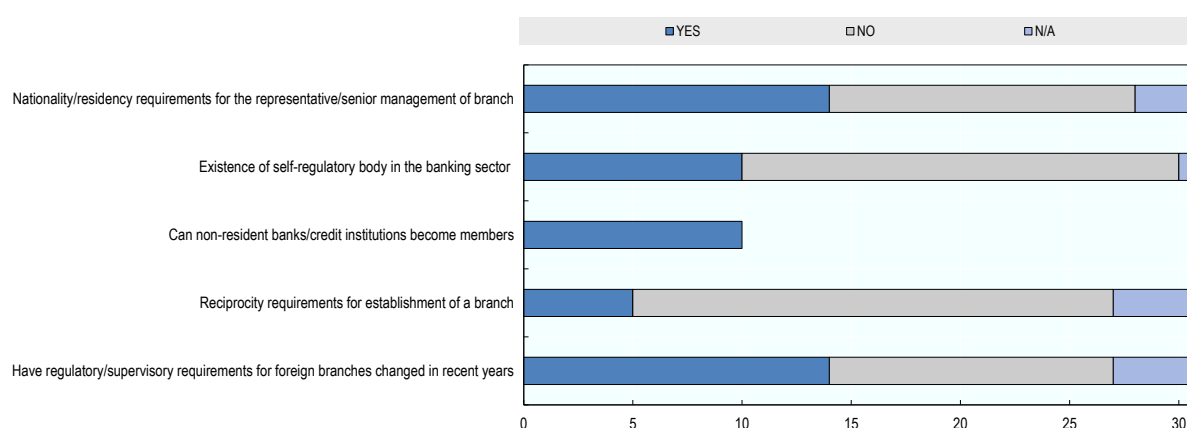


Source: OECD Survey on the Conditions for Establishment of Subsidiaries and Branches for the Provision of Banking Services by Non-Resident Institutions (2015).

In the case of EU branches, competent authorities of the home and host Member States may reach an agreement to deem a branch as a “significant branch” according to factors such as whether the market share of the branch in terms of deposits exceeds 2%, the likely impact of a suspension or closure of the operations of the institution on systemic liquidity and the payment, clearing and settlement system, and the size and the importance of the branch in terms of number of clients within the context of the banking or financial system. In Spain, significant branches are subject to closer surveillance, especially, in terms of liquidity management and have to appoint a risk committee and a remuneration committee or an equivalent arrangement organised by the head office. In France, the criterion is that “branches with five billion euros or more in total assets, on a social or consolidated basis, must appoint a risk committee and a remuneration committee”. The U.S. applies enhanced liquidity and risk management requirements to branches of a foreign bank that exceed certain asset thresholds, and additional requirements, such as asset maintenance requirements, may be applied to the branches of a foreign bank if the foreign bank is not subject to (or does not meet) certain home-country requirements in regard to risk-based and leverage capital, capital stress testing, or liquidity risk management.

In general, considerations related to the parent and/or group structure of a branch/subsidiary being established do not lead to any additional requirements. There are exceptions, however, which can include additional requirements for prudential purposes, covering access to information of the undertaking, information on prospective group organisational restructurings, such as undertakings (e.g. covering access to information on the corporate group), potential group organisational restructurings, and additional financial requirements (e.g. Canada), or a very high level of assurance regarding the resolvability of the undertaking (UK) (Figure 7).

Figure 7. Requirements for the establishment of branches/subsidiaries



Source: OECD Survey on the Conditions for Establishment of Subsidiaries and Branches for the Provision of Banking Services by Non-Resident Institutions (2015).

More generally, some countries have indicated that systemic risk considerations may lead a foreign undertaking, whether it is a subsidiary or branch, to be subject to additional requirements, although the same would also be applicable to domestic bank/credit institutions. In Singapore, all banks will be assessed annually for their systemic importance to Singapore, based on the bank's size, interconnectedness, substitutability and complexity. The Monetary Authority of Singapore (MAS) will apply a range of policy measures on the identified domestically systemically important banks (D-SIBs), such as requiring locally-incorporated D-SIBs to maintain minimum capital requirements that are 2% points higher than the Basel III capital requirements. A foreign bank branch identified as a D-SIB would be required to meet enhanced disclosures, recovery and resolution planning, effective risk data aggregation and risk reporting, and liquidity coverage ratio requirements.

In Hong Kong, China, the Hong Kong Monetary Authority (HKMA) generally requires that a person who holds more than 50% of the share capital of an authorised institution ("AI" which are licensed banks, restricted licence banks and deposit-taking business) incorporated in Hong Kong should be a well-established bank or other supervised financial institution in good standing in the financial community and with appropriate experience. In considering applications from persons who do not fulfil this requirement, the HKMA's primary concern will be to ensure that any risks that may be posed to the existing or proposed bank by the applicant, and any other members of the corporate group of which the applicant is a member, are understood and well contained, and can impose additional conditions to achieve this. If the applicant is incorporated outside Hong Kong or the applicant is a locally incorporated company that is neither a financial holding company nor a subsidiary of a financial holding company, the applicant will generally be asked to establish a holding company incorporated in Hong Kong, whose sole purpose will be to hold the shares in the existing or proposed locally incorporated authorised institution (the holding company may however conduct other business or activities if they are for the purposes of providing support to the business or activities of the existing or proposed authorised institution).

In general, the majority of countries do not have additional requirements related to the parent and/or group structure of a branch/subsidiary being established. There are exceptions, however, with additional requirements for prudential purposes; for example, undertakings (e.g. covering access to information on the corporate group), potential group organisational restructurings, and additional financial requirements (e.g. Canada), or a very high level of assurance regarding resolution of the undertaking, as indicated earlier, by the UK.

In Hungary, the authorisation procedure for the establishment of a third-country branch requires information related to group structure, such as a certificate from the home supervisory authority, a detailed description of the ownership structure and of the circumstances under which the majority shareholder is considered to belong to the group of persons being affiliated with the entity; furthermore, the leading company's consolidated annual account for the previous year is needed if the leading company is required to prepare a consolidated annual account.

Other conditions on establishment could include the possibility of requiring financial guarantees, possible restrictions on intra-group exposures (e.g. Switzerland), cases in which the laws and other regulations of a third country governing one or more persons in close relationships with a bank or difficulties in implementing the aforementioned laws and other regulations prevent the effective supervision of the bank in question (e.g. Slovenia). In South Africa, the Registrar of Banks has the option to grant or refuse the relevant application or grant the application subject to conditions determined by the Registrar, after considering all information, documents and reports furnished for the application.

Nationality/residency requirements

Where non-resident banks are allowed to establish branches, a small majority of respondents impose nationality/residency requirements on the representative or senior management of the branch (Figure 6). For example, in Australia, a foreign bank branch must have a resident in Australia as senior

manager responsible for the branch's operations in Australia. Separate from this residency requirement, a foreign bank branch must nominate a senior officer outside Australia, with a delegated authority from the board of the bank, who is responsible for overseeing the Australian branch operation. Other jurisdictions imposing residency requirements on the chief executive, principal officer, or on a number of members of the leadership include Canada, Greece, Hungary, Japan, and Hong Kong, China. Only one country (Hungary) indicated a nationality requirement for at least one senior executive of the branch of a non-resident bank, while another (Russia) requires the majority of board members to be Russian citizens.

In Switzerland, there is no explicit requirement for residency apart from the need to be domiciled in a place where the management function may be exercised in a factual and responsible manner. Other jurisdictions also do not impose an explicit requirement of residence (e.g. Belgium, France), but require senior managers to commit sufficient *time* in order to allow them to effectively exercise executive functions within an institution and to be in charge of its day-to-day management.

The majority of the board of directors of a banking institution, regardless of being domestic or foreign, must be Mexican nationals or legal residents in Mexico, with the managing director being a legal resident in Mexico for tax purposes.

According to the Russian Banking Law, the Bank of Russia may have additional nationality requirements for credit organisations with foreign investments *inter alia* to the management and staff of the credit organisation. If the executive of a subsidiary of a non-resident bank is a non-resident (or stateless person), at least 50% of the managing body of the bank should be Russian citizens. The ratio of Russian employees in a subsidiary of a non-resident bank should be at least 75%.

In the U.S., state-level requirements generally vary by state. In addition, if a non-resident bank has combined U.S. assets of \$50 billion or more, the non-resident bank is required to employ a chief risk officer (U.S. CRO) located in the United States to oversee the risks of the bank's combined U.S. operations. In most circumstances, the U.S. CRO is not required to be employed by the branch, but if the U.S. operations are only branch operations, the U.S. CRO would be required to be employed by the branch.

Self-regulatory body in the banking sector

In most jurisdictions, there is no self-regulatory body in the banking sector (Figure 6). In all jurisdictions where such a body is said to exist, non-resident banks/credit institutions are allowed to become members of the body or association.

Reciprocity requirements

Reciprocity requirements are situations in which the granting of permission to provide a good/service by one country is based on the other country permitting the same or in kind good/service. Pursuant to Articles 8 and 9 of the Codes providing for MFN, a Member's or Adherent's right to benefit from others' liberalisation commitments should not be conditioned by reciprocity. However, reciprocity measures which were in place in 1986 and concerned inward direct investment were "grandfathered" and listed in Annex E of the Capital Movements Code. MFN is also a general obligation in the GATS and reciprocity requirements cannot be applied unless a provision to that effect has been included in the Member's MFN exemption list⁸.

⁸ For instance, the exemption lists of the EU do not include reciprocity requirements in financial services with the exceptions of direct non-life insurance for the benefits of Switzerland and licensing of branches or subsidiaries of foreign financial service suppliers in Austria.

That said, a few jurisdictions do apply a reciprocity requirement as a condition for the establishment of a branch (Figure 7). Canada notes in this context that the requirement only applies if the applicant foreign bank is from a country that is not a member of the WTO. In Hong Kong, China, other jurisdictions are required to allow Hong Kong, China banks to establish a presence and do business under terms similar to those applied to its own institutions in Hong Kong, China. In Switzerland, the theoretical and practical possibility for Swiss banks to establish branches in a foreign jurisdiction, subject to the same conditions that apply to banks from that respective foreign jurisdiction, is required for a non-resident institution seeking to establish a branch in Switzerland. In Spain, the Spanish supervisory authority (*Banco de España*) may reject the application for the authorisation of the establishment of a non-EU bank branch if the home country does not allow the establishment of branches of EU banks within their jurisdiction, even if there is compliance with all other requirements. Italy has also indicated that they have reciprocity requirements for non-EU banks. It is worth noting that, in light of obligations under the Codes and the GATS, whether these measures are applied in practice is another matter.

In Brazil, there are no specific requirements for the licensing of subsidiaries in Brazil by non-resident banks, except for the fact that participation in the capital of financial institutions, by individuals or entities resident or domiciled abroad, depends on international agreements, reciprocity agreements, or issuance of presidential decree stating that the operation is in line with the government interest, in accordance with constitutional provisions.

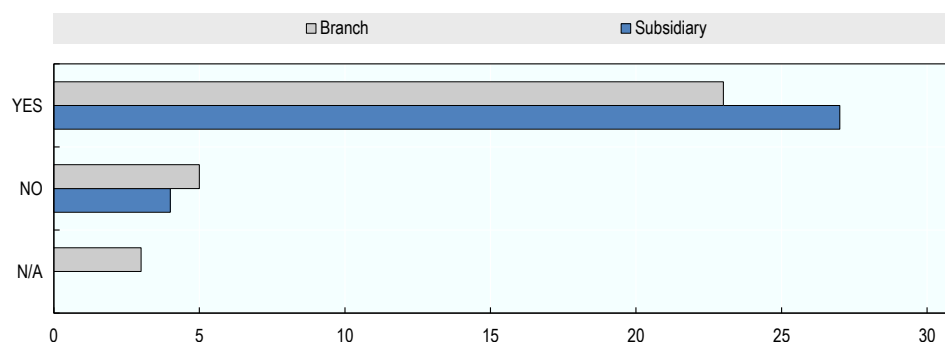
Authorisation procedure for a subsidiary/branch

As conditions for authorising establishment, the Codes allow for information exchange and other cooperative agreements which the host country supervisory authorities may require of their home country counterparts, in order to be satisfied that equivalent or comparable standards of supervision apply in the home country as relevant, provided that equal opportunities are accorded to interested countries to enter into such agreements. The arrangement for information exchange under the Codes is consistent with the Basel Committee on Banking Supervision's recommendations (Basel Concordat) on information sharing.

The survey explored authorisation procedures for a subsidiary or branch in some detail, including in terms of whether there are differences between the requirements imposed on non-resident institutions as compared with their domestic counterparts. While such differences could be grounds for an assessment of equivalence under the Codes, the measures need not be non-conforming if deemed to be no more burdensome than necessary (see again the excerpt in Box 1). For example, measures that stop short of mutual recognition and call for a host authority to exercise a non-trivial level of discretion may be found to be "sufficiently equivalent" that they do not raise issues under the Codes equivalence test. In any event, Codes provisions call for authorities to be transparent as to the reasons for any refusal or regarding requests for modification of an application for authorisation and provide for an appeal mechanism.

Most authorities do in fact have available a written statement that fully sets out the documents and information necessary for obtaining authorisation of subsidiaries and branches (Figure 8). In the vast majority of cases, the relevant statement or materials are made available to the public in electronic form, typically through official websites or specific links.

Figure 8. Availability of written statement that fully sets out information required for authorisation

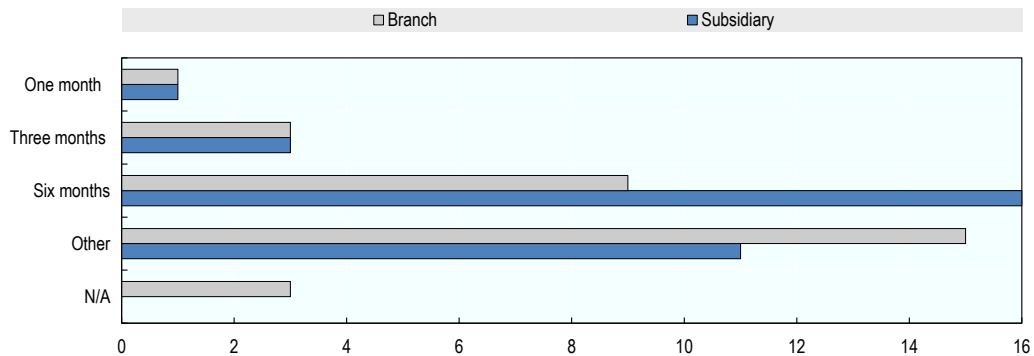


Source: OECD Survey on the Conditions for Establishment of Subsidiaries and Branches for the Provision of Banking Services by Non-Resident Institutions (2015).

The timeframe to respond to an application lodged for the establishment of a subsidiary of a non-resident bank/credit institution is within six months for most authorities, as is the assumed timeframe in the CLCIO (Figure 9), but there are exceptions. For example, in Australia, the guidelines of the Australia Prudential Regulatory Authority (APRA) provide an indicative timeframe for processing an application generally from three to 12 months. In a few other cases, no specific timeframe is given (e.g. Switzerland and Hong Kong, China), while a few others specify timeframes of 3 months or less to respond to an application. In Brazil, the timeframe may differ from that for domestic institutions on account of the time required by the President of the Republic to issue a decree recognising the national interest in opening the foreign bank in the country.

As regards applications by non-resident institutions to establish a branch, the basic patterns are similar as for applications for subsidiaries, with a typical response time within six months. In Singapore, there is no difference between the timeframes for authorising a subsidiary and a branch, but the opposite applies for EU jurisdictions. A number of EU jurisdictions indicate that the timeframe in the case of applications from EU-based institutions is two months, while for non-EU applicants the time to respond extends to six months. In other cases, as with establishment of subsidiaries (i.e. Switzerland, and Hong Kong, China), no specific timeframe is given. In Iceland, a foreign financial undertaking, which is established and licensed to operate in another member state of the European Economic Area (EEA), may establish a branch in Iceland two months after receipt by the Financial Supervisory Authority of notification of the proposed activity from the competent authority in the undertaking's home state. For banks outside the EEA, no specific timeframe is given.

Figure 9. Timeframe for authorities to respond to an application for the establishment of a subsidiary or branch



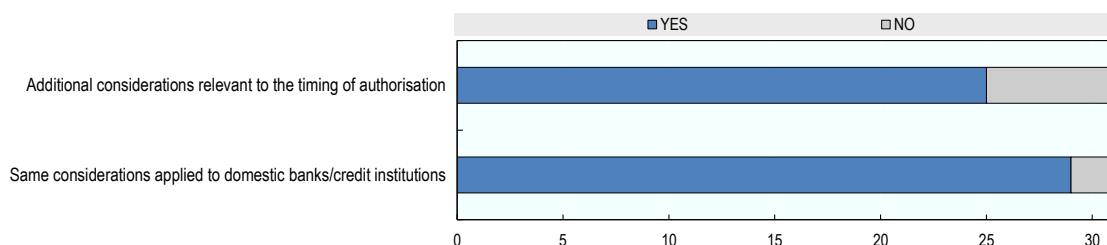
Source: OECD Survey on the Conditions for Establishment of Subsidiaries and Branches for the Provision of Banking Services by Non-Resident Institutions (2015).

Where differences exist between the timeframe for authorising a subsidiary and that for a branch, a number of explanatory factors are offered to explain the difference. The EU rationale, as outlined by Portugal, is that “[t]he timeframe is smaller for the authorisation of a branch of a EU-based credit institution, since the branch is managed directly by the credit institution (no legal personality), and both the branch and the (mother) credit institution are subject to the supervision of the competent home supervision authority within the EU, where the same/equivalent supervision rules and principles as the ones in force in Portugal apply – therefore the authorisation process is simpler and faster.”

Others note the importance of the difference in assessing management conditions of a subsidiary or branch because of the divergence in their legal status, ownership and risk management requirements for capital adequacy (e.g. Slovenia), and the fact that a subsidiary receives the same treatment as a domestic bank in that it is subject to the same regulation and supervision (e.g. Spain). Italy notes that the timeframe as set out by the Bank of Italy Regulation is proportional to the complexity of the assessment.

Other considerations are also relevant to the timing of authorisation, including possible refusal of authorisation or right for appeal of a refusal, of a subsidiary/branch of a non-resident bank/credit institution, such as what happens when additional information is requested (Figure 10). For example, the deadline for rendering a decision by the authority is mostly based on the date of provision of all required documents. In Hong Kong, China, the relevant timing of authorisation, including possible refusal of authorisation or right for appeal of a refusal, of a subsidiary/branch of a non-resident bank/credit institution is not statutorily set, but is dependent on the complexity of the application.

Figure 10. Considerations related to the authorisation of establishment of a branch or subsidiary



Source: OECD Survey on the Conditions for Establishment of Subsidiaries and Branches for the Provision of Banking Services by Non-Resident Institutions (2015).

Grounds for refusing an application and the timing of the refusal are in most cases laid out in relevant banking legislation. In Greece, for example, the Greek Banking Law holds that “[w]here the Bank of Greece refuses authorisation to commence activity of a credit institution, it shall notify the applicant of the decision and the reasons thereof within 6 months of the receipt of the application or, where the application is incomplete, within 6 months of receipt of all the necessary information for the decision.

A decision to grant or refuse authorisation, shall, in any event, be taken within 12 months of the receipt of the application.” In Iceland, in cases involving subsidiaries (resident or non-resident), if the Financial Supervisory Authority refuses an application, grounds must be given and the applicant informed thereof within three months of receipt of a complete application. A refusal must, however, always be received by the applicant within 12 months from the receipt of an application.

In Mexico, after the six months applicable term (180 calendar days) has elapsed in accordance with the Credit Institutions Law (LIC), it shall be understood that the request for a license is denied to the applicant. The LIC does not consider the right for appeal for a refusal for the establishment of a subsidiary. However, applicants have the right to file an *amparo* lawsuit (*Juicio de Amparo*).

In Portugal, by contrast, where there is the possibility/obligation of a decision refusing the establishment of a branch/subsidiary, there is always the possibility to appeal said decision. In the case of an application to establish a third-country (i.e. non-EU) branch, the Banco de Portugal may refuse the authorisation request if certain circumstances are identified, based on a list of grounds related, e.g., to the completeness of the authorisation procedure, the adequate supervision of the subsidiary, the fitness and properness of the members of the board/supervisory board and the sound and prudent management of the subsidiary.

In Russia, the grounds for refusing the state registration of a credit organisation and the issuance of a banking transaction licence are stated in the Banking Law and equally applied to domestic credit organisations and credit institutions with foreign participation (subsidiaries of foreign banks). The state registration of a credit organisation and the issuance of a banking transaction licence may be refused only on listed six grounds. A decision to refuse the state registration of a credit organisation and issue a banking transaction licence shall be made known to the shareholders of the credit organisation in writing, with the reasons underlying such a decision being provided. The refusal to grant state registration to a credit organisation and issue a banking transaction licence or the Bank of Russia's failure to adopt a relevant decision within the term can be appealed.

As the cases above suggest, in most cases, the same considerations are applied to the authorisation of non-resident institutions as for domestic banks/credit institutions (Figure 10). Iceland notes, in contrast, that additional requirements are placed on an application from a non-resident bank inside the EEA (European Economic Area) that wishes to open a branch, which includes the need for the home country supervisor to provide relevant information to the host country supervisor.

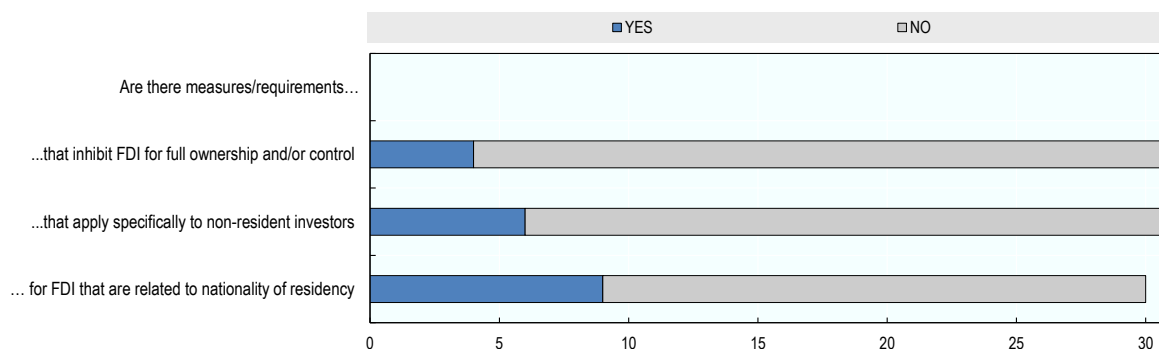
Licensing requirements for foreign direct investment in a bank/credit institution

In most jurisdictions, there are no measures that inhibit foreign direct investment for full ownership and/or control of domestic banks/credit institutions (Figure 11). Other requirements may apply, however. For instance, in Portugal, regardless of the origin of the investment, the Banco de Portugal assesses the project regarding the full ownership and/or control of the bank/credit institution (and all the information sent in that regard), and can oppose said project if it deems that the proposed buyer or sole shareholder does not meet the conditions that guarantee a sound and prudent management of the institution or if the information provided is considered incomplete. Foreign (third country) funds are assessed under the legal framework regarding prevention of money laundering and terrorist financing, and can also be cause for refusal.

Where limitations on direct investment exist, they are not necessarily based on nationality of the prospective acquirer. For example, in Australia, the government's Financial Investment Review Board (FIRB) vets certain kinds of foreign direct investment in Australia, including all investments by foreign government entities and investments over prescribed limits by foreign private investors. Additionally, FIRB requires that investments in banking institutions comply with the existing legal requirements for domestic institutions in the relevant acts and any relevant banking standards. Applications are assessed on a case-by-case basis. In addition, the law applies limits on the level of

voting interest and control of domestic authorised deposit-taking institutions (ADIs), which apply regardless of the nationality of the shareholders or controller.

Figure 11. Licensing requirements for foreign direct investment in a bank/credit institution



Source: OECD.

In Hungary, the shares held by any single person in the capital of a credit institution set up as a credit union, direct or indirect, may not exceed fifteen per cent, with the exception of the Hungarian State, MFB *Magyar Fejlesztési Bank Zártkörűen Működő Részvénytársaság* (MFB Hungarian Development Bank Private Limited Company), the Integration of Credit Unions Set Up As Cooperative Societies and the *Országos Betétbiztosítási Alap* (National Deposit Insurance Fund). This rule applies to any single person, regardless of nationality.

In South Africa, the South African Reserve Bank (SARB) will consider any actual or possible systemic implications and have possible requirements based on this. In case of foreign bank branches, the parent bank is required to provide its organisational structure and internal risk management, governance and internal control policies and processes. A comfort letter needs to be submitted by the parent bank, to provide confirmation from the home supervisor on of the home country to the Basel Core Principles, international minimum standards in respect of consolidated supervision of banking groups and cross-border operations, and international recommendations relating to the supervision of cross-border banking. The letter from the parent bank includes the requirement that the parent bank undertakes to safeguard the financial soundness and stability of the branch, including the maintenance of the branch's capital. These are evaluated by the SARB's Bank Supervision Department in assessing whether the application meets the criteria stipulated in the Banks Act.

Banks that fall under foreign control require additional authorisation in Switzerland (especially a guarantee of reciprocity, agreement of the foreign authority, for financial groups: adequate consolidated supervision by the foreign financial market supervisor, fitness and properness of the controlling shareholder).

Requirements for FDI in domestic banks/credit institutions related to nationality or residency

Many jurisdictions impose requirements related to the residency of non-resident banks or credit institutions (Figure 11). These measures are in some cases limited to anti-money laundering requirements such as under the FATF guidelines (e.g. Hungary). In Italy, there are no specific requirements set for FDI, but where a natural or legal person, regardless of its nationality, intends to acquire a qualifying holding (i.e. 10, 20, 50%, control or significant influence over it) in an Italian bank/banking group, authorisation is required. Based on required information, the competent authority assesses, inter alia, the reputation/integrity and the financial soundness of the applicant, including the chain of control and the source of the funds for the acquisition of the qualifying holding. A particularly careful evaluation is carried out for persons in countries which are black-listed in the context of the anti-money laundering rules.

In Mexico, the Credit Institutions Law (LIC) establishes that foreign governments are not allowed to participate in the equity of commercial banks, including subsidiaries of foreign banking institutions,

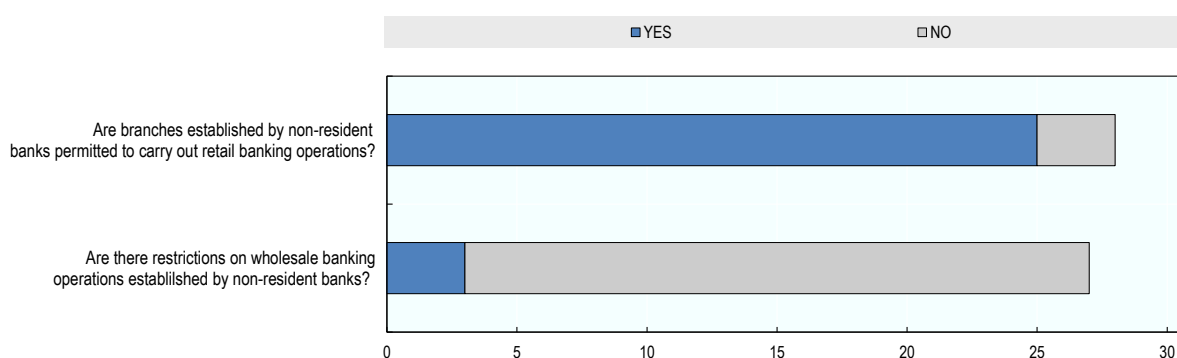
except as a temporary prudential measure, such as financial support or bailouts; when participation in the equity implies control over the financial institution and is carried out through official legal entities, such as funds and development governmental entities (prior discretionary authorisation by the corresponding financial authority is required to determine that such legal entities do not exercise governmental functions, and their managing boards are independent from the respective foreign government); and when the participation is indirect and does not involve the control of the financial institutions.

Scope of permitted retail banking operations for branches of non-resident banks/credit institutions

As indicated previously, the majority of jurisdictions allow non-resident banks/credit institutions to establish branches. Most jurisdictions allow these branches to carry out retail banking operations that do not differ in scope from that applying to domestic branches (Figure 12). The exceptions include threshold requirements related to the size of deposits (e.g. Australia, Canada, New Zealand), and systemic importance of the branch and subordination of local depositors to home jurisdiction depositors in a resolution (e.g. New Zealand).

While Brazil currently does not permit branches of foreign banks, four branches of foreign undertakings were *in situ* prior to the 1988 ban of branching, and their banking license was grandfathered, permitting them to carry out the same operations as a domestic bank.

Figure 12. Permitted retail banking operations for branches of non-resident banks/credit institutions



Source: OECD Survey on the Conditions for Establishment of Subsidiaries and Branches for the Provision of Banking Services by Non-Resident Institutions (2015).

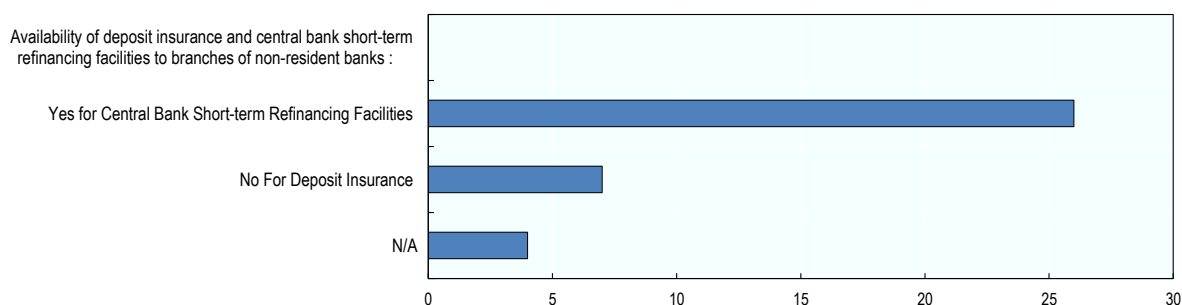
Note: If there are threshold or safety net conditions (e.g., eligibility to join the deposit insurance scheme) that prohibit the realistic provision of retail banking services, these countries have been counted as not permitting retail banking by branches.

Deposit insurance and central bank short-term refinancing facilities

Central bank short-term refinancing facilities (not lender of last resort) are typically available to branches of non-resident banks/credit institutions (Figure 13).

As for deposit insurance, it is not available to branches of non-resident banks in a few countries (e.g. Australia, Canada, Japan, and Poland). In the EU, deposits of branches of EU institutions are protected by their national deposit guarantee scheme, while non-EU banks and non-resident banks are obliged to insure their deposits through the host country deposit guarantee fund (e.g. Greece), in some cases if the level of protection offered to depositors in their home country is lower than the level offered in the host country (e.g. Spain). Deposits in a foreign branch of an Estonian credit institution which are guaranteed under a guarantee scheme of the host country of the branch to the same or a higher level than stated in Estonian law will not be guaranteed by the Estonian Guarantee Fund. Only the deposits in credit institutions which are members of the Estonian Guarantee Fund are guaranteed by the Estonian scheme. New Zealand and South Africa have not established a deposit insurance scheme although it is under discussion in South Africa.

Figure 13. Availability of deposit insurance and central bank short-term refinancing facilities to branches of non-resident banks



Source: OECD Survey on the Conditions for Establishment of Subsidiaries and Branches for the Provision of Banking Services by Non-Resident Institutions (2015).

Restrictions on wholesale banking operations of branches of non-resident banks/credit institutions

Similar to the case of retail banking operations by branches of non-resident banks/credit institutions, most jurisdictions allow branches of non-resident banks/credit institutions engaged in wholesale banking activities to conduct the same range of operations permitted to domestic banks. As a general rule, wholesale banks are not allowed to conduct retail banking activities or offer savings accounts, and in one jurisdiction, third-country branches are not permitted to issue negotiable credit tokens⁹ since 2013 (Hungary).

Governance requirements for branches

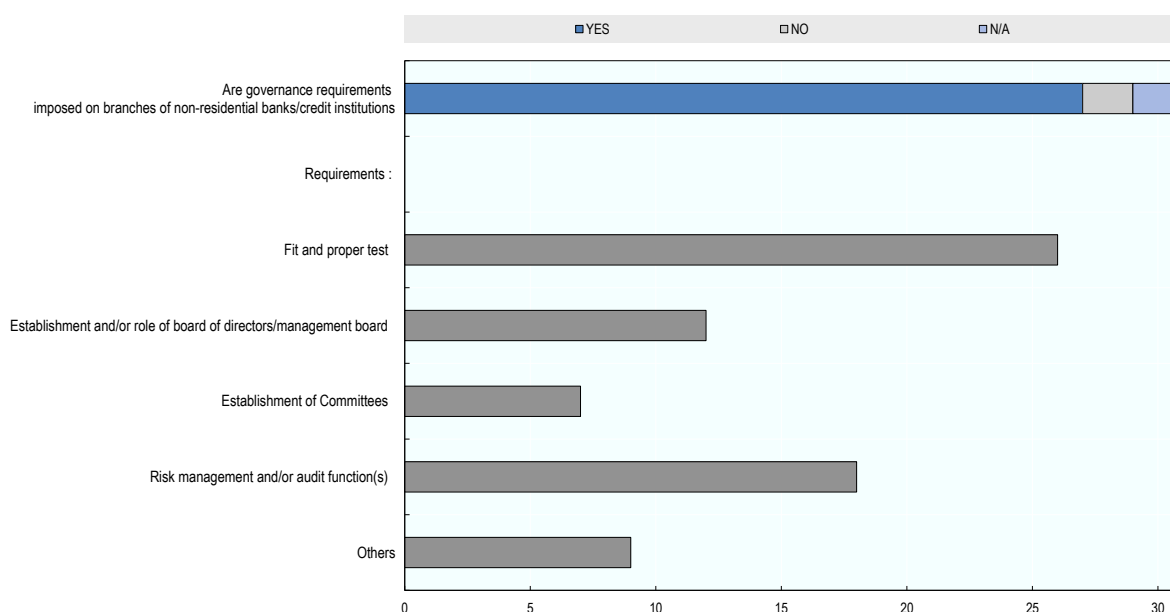
With one exception, all countries that permit the establishment of branches of non-resident banks impose some governance requirements in relation to the branch (Figure 14). Various provisions apply in this respect, including most commonly ‘fit and proper tests’, measures governing the establishment and/or role of the board of directors/management board, and requirements for the establishment of committees, especially for risk management and/or audit function(s).

For example, as noted in some detail by France: branches of third-country banks have to comply with governance requirements concerning executive functions (“*Dirigeants effectifs*”) and carry out an internal control system including a risk management function. To this end, branches have to communicate to the head office the necessary information to allow the head office, in particular to examine the required governance arrangement by periodically reviewing their efficiency and ensuring corrective measures have been taken to remedy potential failings; the bank’s head office is responsible for “determining the branch’s strategy as well as its risk appetite concerning both current and future risks”; and the branch’s senior management (*Dirigeants effectifs*) should inform the bank’s head office about all significant risks, risk mitigation policies as well as their evolution.

In the U.S., non-resident banking organisations with total consolidated assets of \$10 billion or more (if publicly traded) or \$50 billion or more (if not publicly traded) that maintain a branch in the U.S. are required to comply with certain risk committee requirements that vary depending on the size of the organisation. Greece notes that non-EU branches that operate in Greece must comply with the same governance requirements as domestic banks. Branches of EU banks that operate in Greece are not required to comply with the Greek governance requirements because they follow their EU Member State’s respective requirements.

⁹ Credit tokens, or more commonly vouchers, are paper-based, transferable and reusable means of payment that merely have to be produced in order to obtain goods and services. See: <http://www.hmrc.gov.uk/manuals/eimanual/eim16090.htm>.

Figure 14. Governance requirements of branches



Source: OECD Survey on the Conditions for Establishment of Subsidiaries and Branches for the Provision of Banking Services by Non-Resident Institutions (2015).

Financial requirements and prudential considerations

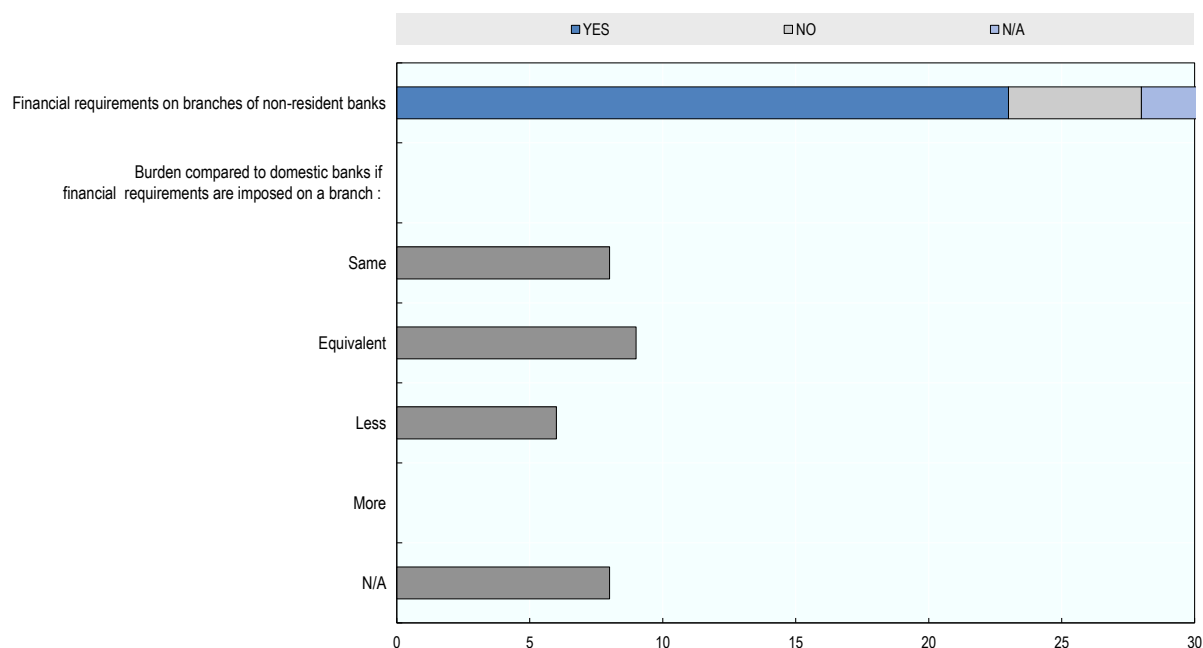
Various types of prudential measures may be imposed on banks/credit institutions, including financial requirements such as minimum capital requirements, financial guarantees and asset pledges. Under the Codes, such measures as applied to non-residents have been found to be conforming when equivalent to those required from domestic entities. Among EU jurisdictions, branches of EU-based banks are not subject to financial requirements in the host EU country, as the home country control principle applies.

The majority of jurisdictions do impose financial requirements on branches of non-resident banks/credit institutions (Figure 15). The requirements include, in addition to the types of measures listed in the paragraph above, liquidity requirements such as the Basel Liquidity Coverage Ratio requirement or alternatively the Minimum Liquid Assets requirement (e.g. Singapore). Branches of non-EU banks/credit institutions based in jurisdictions considered equivalent to the European banking regulation (i.e. Canadian, Japanese, Swiss, and the US) are not subject to the EU capital regulation requirement and directive (CRR/CRD4). Branches of non-EU banks/credit institutions established in countries other than those considered equivalent are subject to the banking regulation applicable to domestic banks (e.g. Italy).

In Turkey, a branch by a non-resident bank is subjected to the same conditions as establishment of a domestic bank. Financial requirements are not imposed on additional branches of the non-resident bank, on the condition that they comply with the provisions of the regulations and with the corporate governance and protective provisions set forth in the Banking Law and provided that the Banking Regulation and Supervision Agency is notified.

Among those jurisdictions imposing financial requirements on branches of non-resident banks/credit institutions, several indicate that the measures imposed are the “same” as for domestic banks/credit institutions. Other jurisdictions describe the financial requirements imposed as being “equivalent”, while five indicate that the requirements imposed are “less burdensome” than those imposed on domestic institutions.

Figure 15. Financial requirements imposed on branches of non-resident banks/credit institutions



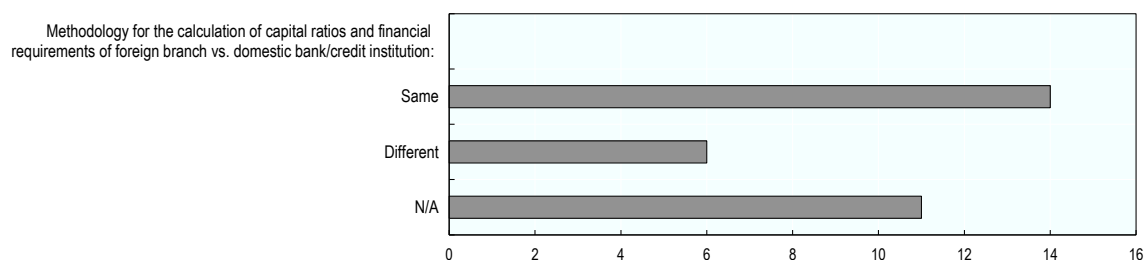
Source: OECD Survey on the Conditions for Establishment of Subsidiaries and Branches for the Provision of Banking Services by Non-Resident Institutions (2015).

Methodology for the calculation of capital ratios and financial requirements

Under the Codes, ratio measures used for prudential or other purposes should be no less favourable when applied to the branches or agencies of non-resident institutions than the ones applied to domestic institutions. Whenever a ratio or other measure is used for prudential or other purposes, full account should be taken of the total amount of any financial requirements that have been met in the establishment of branches or agencies and of any financial contribution of the same nature that has been provided in excess of such requirements.

In most cases, the types of ratio measures applied to branches of non-resident institutions were considered to be the “same” as for domestic institutions (Figure 16). For a few, the question itself is not applicable either because they do not allow branching by non-resident institutions or because they do not impose capital or financial requirements on branches of non-resident institutions (e.g., Australia, Estonia, New Zealand, Switzerland, UK), even when these measures may be imposed on domestic credit institutions. In Canada, a branch is not required to maintain capital ratios but they must maintain a deposit in Canada with a Canadian financial institution equal to at least 5% of their Canadian liabilities.

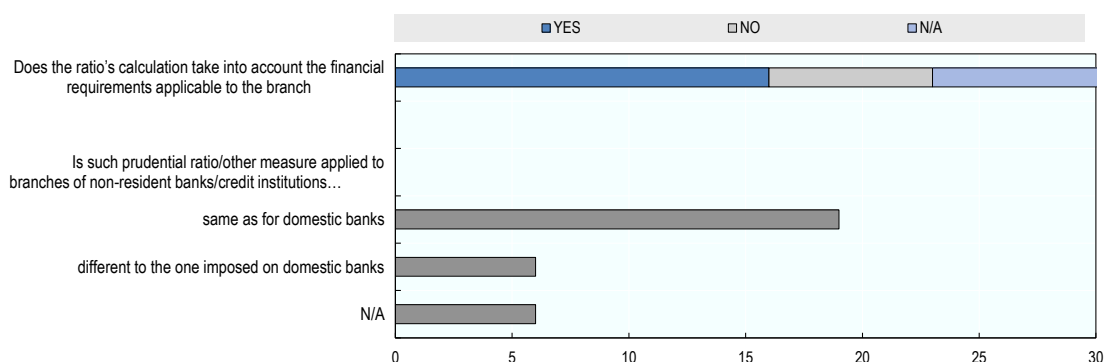
Figure 16. Methodology for the calculation of capital ratios and financial requirements of foreign branch vs. domestic banks



Source: OECD Survey on the Conditions for Establishment of Subsidiaries and Branches for the Provision of Banking Services by Non-Resident Institutions (2015).

Similarly, in most cases, a ratio or measure used in assessing liquidity, solvency or foreign exchange position of a branch takes into account the financial requirements applicable to the branch (Figure 17), but there are a few exceptions. In Australia, for example, branches of non-resident authorised deposit institutions (ADI) are subject to liquidity regulation. APRA can require a foreign ADI branch to satisfy either a Liquidity Coverage Ratio (LCR) ADI or a Minimum Liquidity Holding (MLH) ADI requirement, depending on the circumstances of the entity. APRA considers the ADI's size and complexity with respect to liquidity risk when deciding if it is an MLH or LCR ADI, and this decision is not directly influenced by the ADI's status as a foreign branch.

Figure 17. Calculation of ratios and financial requirements applicable to the branch

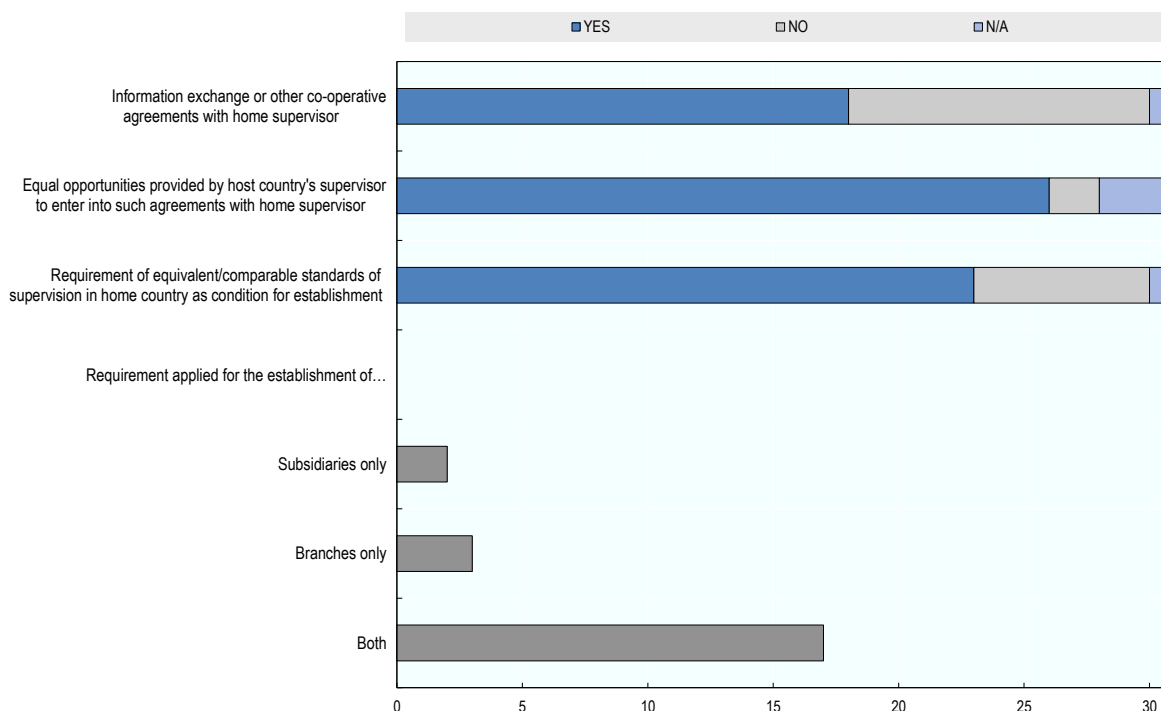


Source: OECD Survey on the Conditions for Establishment of Subsidiaries and Branches for the Provision of Banking Services by Non-Resident Institutions (2015).

Requirements for the home country supervisor of a non-resident bank to have an information exchange or other co-operative agreements

Requirements for home country authorities to adhere to international cooperation and information exchange standards as a prior condition for authorisation for establishment of subsidiaries/branches are conforming under the Codes to the extent that equal opportunities are offered for interested countries to enter into such agreements. The vast majority of jurisdictions indicate that their supervisory authorities provide such opportunities (Figure 18). The same degree of uniformity does not, however, apply as regards requirements for an information exchange or other co-operative agreement by the host country authorities (Figure 18) and there appears to be flexibility as to the formality of such an arrangement. As noted above, the requirements differ in some cases for establishment of subsidiaries versus branches.

Figure 18. Requirements by home country supervisors of non-resident banks



Source: OECD Survey on the Conditions for Establishment of Subsidiaries and Branches for the Provision of Banking Services by Non-Resident Institutions (2015).

Requirements related to home country standards of supervision

Under the Codes, host country supervisory authorities may take steps to ensure that equivalent or comparable standards of supervision apply in the home country as relevant. The majority of countries indicate that they impose such requirements (Figure 18), of which most apply the requirement to the establishment of both branches and subsidiaries; roughly a handful of jurisdictions apply it either to the establishment of branches or to the establishment of subsidiaries.

In practice, a number of factors are used to determine the equivalence or comparability of standards of supervision. In Japan, the Financial Services Agency conducts examinations to clearly understand and check the types of regulations applied to the main offices of the financial institution. This condition is not meant to inhibit foreign bank participation in the market, but to ensure equivalent treatment of domestic banks and branches of non-resident institutions. In Australia, for example, APRA requires that a foreign bank wishing to establish an authorised branch or subsidiary operations in Australia must be subject to adequate prudential supervision in their home country. In considering the standard of supervision, APRA requires the standard of the Core Principles of Banking Supervision promulgated by the Basel Committee on Banking Supervision to be applied in the home country. This includes whether the home supervisor supervises a foreign bank applicant on a consolidated basis in accordance with the principles contained in the Basel Concordat, and whether the home supervisor is prepared to co-operate (in terms of the Concordat) with APRA in the supervision of the foreign bank's operations in Australia.

Chile, the Czech Republic, Hungary, and South Africa also make reference to the Basel Core Principles for Effective Banking Supervision. In South Africa, membership of the Basel Committee on Banking Supervision (BCBS) and the outcome of BCBS's jurisdictional Regulatory Consistency Assessment Programme (RCAP) are taken into consideration. In the case of non-members, adherence to the Basel Core Principles for Effective Banking Supervision (Basel Core Principles) and reports issued by the International Monetary Fund (IMF) such as the Financial Sector Assessment Program

(FSAPs) are taken into account. South Africa requires a comfort letter from the parent bank, which requires confirmation of the adherence of the home country to the Basel Core Principles, international minimum standards for consolidated supervision of banking groups and cross-border operations, and international recommendations relating to the supervision of cross-border banking.

Similarly, in Canada, the Office of the Superintendent of Financial Institutions (OSFI) would consider whether the home country supervisor (specifically its financial sector regulators) complies with international standards established by the Bank for International Settlements and the International Organization of Securities Commissions. OSFI would also verify if the home country was the subject of a Financial Sector Assessment by the IMF.

The FSAP is also taken into account in Hong Kong, China. In considering the adequacy of supervision exercised by the home supervisor, the HKMA will have regard to the extent to which that supervisor has established, or is actively working to establish, the necessary capabilities to meet the Basel standards relating to the supervision of international banks. Among other things, the standards provide that all international banking groups and international banks should be supervised by a home country authority that capably performs consolidated supervision. In making this assessment, the HKMA will take account of (a) the legal and administrative powers of the home supervisor; (b) the supervisory framework of the home supervisor; (c) the method of supervision adopted by, and the resources available to, the home supervisor; (d) the information and analysis published by international organisations, such as the IMF country reports on the IMF's assessments of the home jurisdiction's compliance with the Basel Core Principles for Effective Banking Supervision carried out within the framework of the Financial Sector Assessment Program, and the reports issued by the Basel Committee on Banking Supervision in respect of assessment of the home jurisdiction's completeness and consistency of implementation of Basel II/2.5/III standards under the Regulatory Consistency Assessment Programme; and (e) past experience in dealings with the home supervisor.

In Austria, the equivalence or comparability of standards of supervision is assessed against the CRR and the CRD IV, also in cooperation with the European Banking Authority (e.g. with regards to the legitimacy of information exchange with non-EU countries). Assessments by European bodies such as the European Commission are also taken into consideration in other EU jurisdictions (e.g. Germany, Greece, Italy, Slovenia, and Spain).

In Switzerland, information examined includes that on the regulatory environment (especially authorisation requirements, financial aspects, anti-money laundering aspects, corporate governance, consolidated supervision, implementation of international standards, independence and supervisory approach of the supervisory authority).

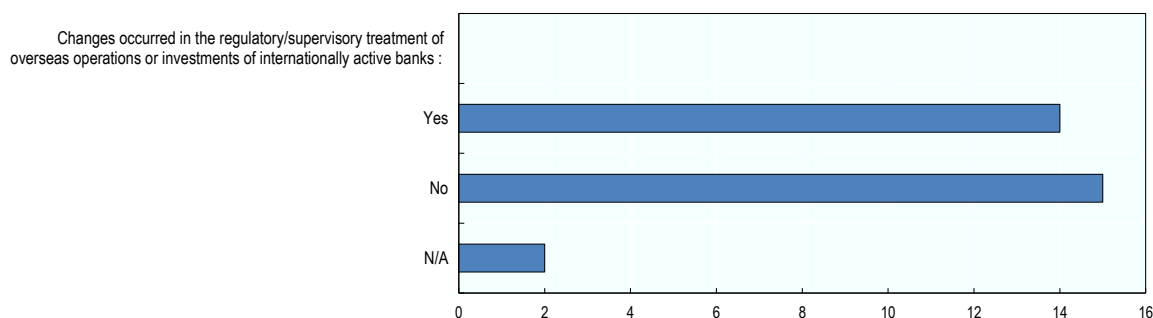
In New Zealand, reliance is placed on the disclosure of financial information, on accounting and auditing standards, and on licensing and supervisory standards.

Home country supervision experience

While many jurisdictions indicate that internationally active banks based in the jurisdiction in question have not experienced changes in the regulatory/supervisory treatment of their overseas operations or investments since 2008, almost as many indicated that their banks have seen such changes (Figure 19).

Figure 19. Home country regulatory/supervisory treatment of overseas operations/investments of banks

Since 2008



Source: OECD Survey on the Conditions for Establishment of Subsidiaries and Branches for the Provision of Banking Services by Non-Resident Institutions (2015).

Concluding summary

This report suggests a number of observations with regards to the conditions of establishment of subsidiaries and branches by non-resident banks, in light of regulatory reforms undertaken since the financial crisis. A range of measures having implications for non-resident banking or credit institutions were introduced or in force in the aftermath of the crisis. They include changes in the authorisation process or in the scope of permitted activities, as well as financial requirements, governance and risk management requirements, operational requirements, and ownership and control requirements. A larger number of jurisdictions have adopted measures that affect branches of non-resident banking institutions as compared with subsidiaries of non-resident banking institutions, but the margin of difference is not large in absolute terms as far as individual reform categories are concerned. This report has sought to assess these developments and the broad consistency of country requirements with the OECD Codes of Liberalisation.

There are some countries which do not permit establishment of branches by non-resident banks (Brazil, Mexico, and Russia) or only after incorporation (e.g. South Africa). Others do not permit branches of non-resident banks to operate in some banking services, mostly relevant to retail banking and/or deposit taking. There have been transitions from branches to subsidiaries in some jurisdictions and the reverse transition from subsidiaries to branches has also occurred, although sometimes only involving domestic institutions. There appears to be limited changes since 2008 in terms of the institutional structure of banks' foreign undertakings.

In terms of the possibility of requiring a non-resident bank to establish a subsidiary (or financial holding company) instead of a branch, in most cases the supervisory authority has the discretion to require this on a case-by-case basis and when certain conditions/thresholds are met. The survey results suggest that there has been some tightening since 2008 in regard to the conditions for non-resident banks to branch. For example, when the scale of deposit taking is significant, some countries will nudge non-resident banks towards the establishment of a subsidiary. For example, material or significant deposit taking requires the establishment of a subsidiary in Australia and Hong Kong, China. In South Africa, the parent undertaking's assets must be at least USD 1 billion to establish a branch. The UK will examine the equivalence of the home state supervisor's supervision as a central component of whether a branch can be established by a non-resident banking institution.

Many of the higher threshold requirements are also related to the possible systemic impact in terms of the size and complexity of the banking institution. Belgium can require the setting up of a subsidiary dependent on the size of the branch relative to the scale of the banking institution. The UK's approach to branches of non-resident institutions is centred on an assessment of the equivalence of the home state supervisor's (HSS) supervision of the whole firm, the branch's UK activities and the level of assurance the Prudential Regulatory Authority (PRA) gains from the HSS over resolution. In Hong

Kong, China, the majority shareholder of an authorised institution (whether a branch of subsidiary) should be from a well-established or well standing bank. The HKMA can require that a local holding company be established to hold the shares of an existing or proposed authorised institution. In the EU, a branch can be deemed “significant” depending on the market share or systemic liquidity and payment and settlement implications of the branch, and be subject to closer surveillance and disclosure.

Another observation that can be made is that there has been a convergence of various requirements for non-resident bank subsidiaries and branches. The conditions for the establishment of a branch and subsidiary are the same or equivalent as those for local banks in most cases, and there are no cases in which more requirements are made towards branches/subsidiaries. While this would be expected for the establishment of subsidiaries, under the principle of national treatment, and is mostly the case for branches operating solely in wholesale banking, branches operating in retail banking are in many cases subject to financial and governance requirements similar to locally incorporated banks.

Most jurisdictions indicate that financial or prudential requirements are imposed on branches of non-resident banks. A key issue that is being increasingly monitored since the crisis concerns liquidity and many financial requirements identified are liquidity related, some of which have been introduced since the crisis. There are exceptions to such requirements in the EU, such as among EU countries, and when the banking regulatory regime of a country is considered equivalent to the EU’s CRR/ARDC4 (regimes in Canada, Japan, Switzerland and United States). Australia, Estonia, New Zealand, Switzerland and the UK do not impose capital or financial requirements on branches, but Australia applies liquidity requirements. Most countries indicate that the financial requirement is the same or equivalent to that for local banks.

While financial requirements on branches have been common, governance requirements on branches are less well known, but are imposed by most jurisdictions on branches of non-resident banks and have increased in recent years since the crisis. The ‘fit and proper tests’ are the most common (indeed, all countries that have governance requirements on branches apply a fit and proper test) but many also require a risk management and/or audit function in the branch. Half of the jurisdictions require the establishment of a board of directors/management board, and some require the establishment of board committees.

National or equivalent treatment of subsidiaries is the norm, which signifies the importance of the concept as a basis for cross-border banking and its regulation. While branching by non-resident banks remains a widely available option, a number of countries have applied certain safeguards to ensure the safety of depositors or to prevent deposit insurance from being activated for a branch. In particular, the financial and governance requirements that are now being imposed, while the same or equivalent to domestic banks, may limit the attractiveness of branching going forward.

Annex 1

OECD Code of Liberalisations of Current Invisible Operations

Annex II to Annex A:

*Conditions for the Establishment and Operation of Branches, Agencies, etc.
of Non-Resident Investors in the Banking and Financial Services Sector*

General

1. Laws, regulations and administrative practices shall ensure equivalent treatment of domestic enterprises and of branches or agencies of non-resident enterprises operating in the field of banking or financial services (including securities dealing) so that the establishment of branches and agencies of non-resident enterprises shall not be subject to more burdensome requirements than those applying to domestic enterprises.

Authorisations

2. Where the establishment of banks, credit institutions, securities firms, or other financial enterprises is made subject to authorisations:

- a) The competent authorities shall make available to each non-resident enterprise applying for authorisation a written statement setting out fully and precisely the documents and information that the applicant must supply for the purpose of obtaining authorisation, and shall ensure that any procedures to be followed prior to the lodging of an application are straightforward and expeditious;
- b) Where in addition to legal, financial, accounting and technical requirements (e.g. requirements concerning the form of the undertaking, qualifications of directors or managers, etc.) authorisation is also subject to other criteria, the competent authorities shall inform applicant enterprises of such criteria at the time of their application and shall apply these criteria in the same way to both domestic and non-resident enterprises;
- c) The competent authorities shall decide on each application for authorisation from a non-resident enterprise not later than six months from the date of which the application has been completed in all particulars and shall without further delay notify the enterprise of their decisions;
- d) Where the competent authorities ask a non-resident enterprise for modifications to a completed application for authorisation, they shall inform the enterprise of the reasons for seeking such modifications and shall do so under the same conditions as for a domestic enterprise;
- e) Where an application for authorisation by a non-resident enterprise is refused, the competent authorities shall advise the enterprise of the reasons for their decision and shall do so under the same conditions as for a domestic enterprise;
- f) Where authorisation is refused, or where the competent authorities have not dealt with an application upon the expiry of the period of six months provided for under sub-paragraph c) above, non-resident enterprises shall have the same right of appeal as domestic enterprises.

Representation

3. An enterprise from one Member country operating in another Member country may appoint as its representative any competent person who is domiciled and actually resident in that other country, irrespective of his nationality.

Representative Offices

4. a) An enterprise from one Member country may establish a representative office in another Member country, subject to advance notification to the other Member country; b) A representative office shall be permitted to promote business on behalf of its parent enterprise.

Self-Employed Intermediaries

5. Members shall impose no restrictions upon the nationality of persons authorised to act as intermediaries in banking and financial services activities, to operate in any segment of the markets relating to those activities or to become members of institutions such as professional associations, securities or other exchanges or markets, self-regulatory bodies of securities or other market intermediaries.

Membership of Associations or Regulatory Bodies

6. Members shall be responsible for assuring that discrimination by nationality is not practiced in their jurisdiction as to conditions for membership in any private professional association, self-regulatory body, securities exchange or market, or other private association, membership in which it is necessary to engage in banking or financial services on an equal basis with domestic enterprises or natural persons, or which confers particular privileges or advantages in providing such services.

Prudential Considerations

7. Domestic laws, regulations and administrative practices needed to assure the soundness of the financial system or to protect depositors, savers and other claimants shall not prevent the establishment of branches or agencies of non-resident enterprises on terms and conditions equivalent to those applying to domestic enterprises operating in the field of banking or financial services.

Financial Requirements for Establishment

8. a) Where financial requirements of any kind are imposed for the establishment of a branch or agency of a non-resident enterprise to engage in banking or financial services, the total amount of such financial requirements shall be no more than that required of a domestic enterprise to engage in similar activities.
- b) Any financial requirement may be met by payment in the currency of the host country.
- c) Any financial requirement may be applied to more than one branch or agency of a non-resident enterprise, but the total of the financial requirements to be furnished by all the branches and agencies of the same non-resident enterprise shall be no more than that required of a domestic enterprise to engage in similar activities.
- d) Whenever a ratio or other measure is used for prudential or other purposes, for example, for assessing the liquidity, solvency or foreign exchange position of a branch or agency of a non-resident enterprise, full account shall be taken of the total amount of any financial requirements that have been met in the establishment of such branches or agencies and of any financial contribution of the same nature that has been provided in excess of such requirements.

- e) Whenever a ratio measure is used for prudential or other purposes, the ratio applied to the branches or agencies of non-resident enterprises shall be no less favourable than that applied to domestic enterprises, and shall not differ in any way other than in the replacement of paid-up capital for domestic enterprises by the total amount of any financial requirements that have been met in the establishment of branches or agencies of non-resident enterprises and of any financial contribution of the same nature that has been provided in excess of such requirements.
- f) Any other measures used for prudential or other purposes shall be no less favourable to the branches and agencies of non-resident enterprises than to domestic enterprises.

Annex 2

United Kingdom: New requirements for foreign bank branches assessment under the OECD Codes of Liberalisation

(Opinion adopted by the Advisory Task force (ATFC) on the OECD Codes of Liberalisation on 23 February 2015)

During its April 2014 meeting, the ATFC heard an update from the United Kingdom on a proposal by the Bank of England's Prudential Regulation Authority (PRA) to introduce new supervisory requirements for branches of foreign banks.¹⁰ The United Kingdom noted its commitment to ensure consistency of the new measures with Codes' provisions regarding establishment of foreign financial institutions. The ATFC asked the Secretariat to provide an assessment of the proposed new measures under the Codes and agreed that the United Kingdom should keep the ATFC informed on developments regarding the PRA's proposal.

The United Kingdom, in accordance with its obligations under Article 11 of the OECD Codes of Liberalisation, notified the Organisation of the introduction of measures having a bearing on the Codes following the publication of the PRA's *Supervisory Statement SS10/14: Supervising international banks: the Prudential Regulation Authority's approach to branch supervision* of September 2014.¹¹

This note provides an assessment of the PRA's new measures under the Codes obligations, in particular regarding conditions for establishment of branches of non-resident investors in the banking and financial services sector, as set out in Annex II to Annex A of the Code of Liberalisation of Current Invisible Operations which was examined by the ATFC at its meeting on 22 October 2014.

1. Introduction

The publication of the new supervisory statement for branches of foreign banks follows publication of *The PRA's Approach to Banking Supervision* in June 2014, which sets the overall framework for supervisory requirements, including for subsidiaries of foreign banks. The treatment of subsidiaries raises no issues having a bearing under the Codes, as the new framework maintains the general approach of setting the same supervisory framework for all banks incorporated in the United Kingdom.

For branches of banks benefiting from the European Union single passport rules (EEA-branches) the situation also is fundamentally unchanged, as in this case the Home state supervisor (HSS) continues to have the main responsibility for the supervision of the entire entity.

The new supervisory framework for non-EEA bank branches is described in Section 1. Section 2 presents an assessment of the United Kingdom's measure under the Codes provisions concerning establishment by means of branches for banks and financial institutions.

¹⁰ The PRA's public consultation document can be found at:
www.bankofengland.co.uk/pr/Documents/publications/cp/2014/cp414.pdf.

¹¹ The new measures can be found at:
www.bankofengland.co.uk/pr/Documents/publications/ss/2014/ss1014.pdf

2. The Prudential Regulation Authority’s new approach to non-EEA branches supervision

The PRA’s criteria for authorisation for a branch of a non-EEA bank are:

- i. Home state supervisor (HSS) equivalence;
- ii. the extent of critical economic functions undertaken by the UK branch;
- iii. the level of assurance the PRA has from the HSS over resolution; and
- iv. a clear and agreed split of prudential supervisory responsibilities with the HSS.

i. Home state supervisor equivalence

For a UK branch to be authorised to be established or to continue to operate, the PRA must be satisfied that the entity as a whole, and not just the UK branch, meets the UK’s minimum conditions for authorisation of a UK bank, namely the Threshold Conditions of the FSMA 2000.¹²

Furthermore, the PRA must deem the HSS to be “sufficiently equivalent” in relation to supervision and resolution and receive an “appropriate degree of assurance” that its actions will be aligned to delivering PRA objectives.

The PRA test regarding HSS equivalence falls short of full mutual recognition or home country control requirements. It gives the PRA scope to rely on others when it can satisfy itself that there are reasonable grounds for such reliance. International reviews such as IMF reviews and FSB peer reviews will form a large part of the basis of the supervisory authorities’ assessment, as well as the Bank of England and the Prudential Regulation Authority’s own experience and judgement. In assessing whether the HSS is “sufficiently equivalent” the PRA will consider the nature of the foreign bank’s activities in the United Kingdom, including whether the branch is to undertake critical economic functions (CEFs).

ii. Critical economic functions

For branches that provide CEFs (such as retail deposit taking and transaction accounts) the PRA focuses on requirements of continuity of service and minimising the risk that their disruption may pose to the United Kingdom’s financial stability.¹³ A very high level of assurance from the HSS over resolution will be requested by the PRA to authorise non-EEA branches to undertake retail banking activities beyond *de minimis* levels.

The PRA, in determining the *de minimis* levels of retail deposits, will take into account the value and type of account¹⁴, the number of customers¹⁵, the planned growth of retail deposits and the substitutability of the range of products provided. Furthermore, as non-EEA branches’ eligible deposits are covered by the UK’s Financial Services Compensation Scheme (FSCS), the PRA expects to exercise a greater level of supervisory oversight over those firms which could potentially cause a

¹² In broad terms, the Threshold Conditions require banks to have an appropriate amount and quality of capital and liquidity, to have appropriate resources to measure, monitor and manage risk, to be fit and proper, and to conduct their business prudently.

¹³ The PRA defines critical economic functions that firms provide to be — payment, settlement and clearing; retail banking; corporate banking; intra-financial system borrowing and lending; investment banking; custody services; life insurance; and general insurance. See: *The PRA’s Approach to Banking Supervision*, June 2014.

¹⁴ Non-EEA branches are expected to have under £100 million of retail/small and medium-sized enterprises (SME) covered transactional or instant access account balances.

¹⁵ More than 5,000 retail and SME customers per branch may be a concern.

liability to the FSCS, including an understanding of where the FSCS would rank in the creditor hierarchy in a home state's insolvency.

The PRA expects new non-EEA branches to focus on wholesale banking. For existing non-EEA branches which undertake CEFs, the PRA will work with the HSS to gain adequate assurance over the resolution plans of these functions, including retail banking.

iii. Resolvability

The key deciding factor in the PRAs assessment will be resolvability in case an entity fails. The PRA will assess the equivalence of the HSS's resolution regime, as well as the credibility of an individual bank's resolution plan, including whether the plan adequately covers the operations within the UK-branch.¹⁶

A higher standard will be demanded from branches undertaking CEFs that pose greater risks to UK financial stability and require continuity of service or require a significant time to wind down (including retail deposits, transactional accounts, and payment systems). The PRA expects the HSS to share the global resolution plan for global CEFs and to explain how this plan accounts for the activity in the UK branch. Furthermore, the minimum outcome the PRA seeks is to ensure that the branch's UK creditors and depositors are treated equally in the resolution process with their home state equivalents. This latter point could require further consideration of issues arising as a result of the interaction of the UK's requirements for protection of domestic creditors of foreign branches from jurisdictions, such as the US, for which the mandatory deposit guarantee schemes do not cover deposits in branches established abroad.

In forming its views the PRA will take into account international standards, notably those of the Financial Stability Board (FSB), and as international standards come into force the PRA expects the level of assurance on resolution it will require from HSSs to increase over time. In practice, the PRA will conclude written agreements with the home supervisory authorities, probably not as detailed as cooperative agreements, to clarify and understand how resolution will work.

iv. Clear and agreed split of prudential supervisory responsibilities

The PRA, in addition to conditions listed above, will seek to establish a clear acceptance from the HSS of its prudential responsibilities for branches in the United Kingdom, including confirmation that the whole firm meets the Threshold Conditions needed for PRA authorisation, and a firm-specific agreement on the split of responsibilities for prudential supervision of the branch and an appropriate level of information sharing.

3. Assessment of the United Kingdom's measure under the Codes

i. Relevant provisions of the Codes

The Codes' obligations regarding establishment and operation of branches and agencies in the banking and financial services sector are detailed in Annex II to Annex A of CLCIO (reproduced as Annex 1 to this note) call for measures for branches or agencies of non-resident enterprises to be equivalent to those applying to domestic enterprises, so that the establishment of non-resident enterprises shall not be subject to more burdensome requirements than those applying to domestic enterprises (paragraph 1). The equivalence test is also to apply to "domestic laws, regulations and

¹⁶ The United Kingdom will implement from 1 January 2015 the Bank Recovery and Resolution Directive of December 2013, which requires all EU Member States to ensure that authorities have wide-ranging resolution powers over non-EEA branches, including the power to resolve non-EEA branches on a stand-alone basis in certain circumstances.

administrative practices needed to assure the soundness of the financial system or to protect depositors, savers and other claimants” (paragraph 7) and to “financial requirements” (paragraph 8).

The equivalence test opens the scope for measures to be Codes conforming despite departures from strictly identical treatment between residents and non-residents, subject to assessment by the Investment Committee (see Box 1).

Box 1. The Codes equivalence test

As noted in the User's Guide to the OECD Codes of Liberalisation

“Measures which differentiate between residents and non-residents are, however, not always contrary to the obligations of the Codes. The Committee has accepted as equivalent treatment certain cases where a different regime applies to non-residents as compared to residents. The condition is that this does not exceed what is necessary, for prudential or other purposes provided in the Codes, to place residents and non-residents on an equal footing.

The principle of equivalent treatment has been developed in particular with regard to the establishment of branches or agencies by non-resident enterprises. When a foreign company establishes a subsidiary in the host country, the establishment takes place through incorporation, with the same guarantees and conditions (for example, minimum capital) as applies to resident investors. But where a foreign company decides to establish only a branch or agency, i.e. not to incorporate as a legal person, host country authorities may feel the need to impose special requirements for prudential reasons, which do not apply to branches of host-country enterprises. This need is recognised under the Codes, and differential treatment is accepted in such cases, but only if such requirements on branches of enterprises incorporated are not more burdensome than necessary for prudential or other purposes provided in the Codes.

The terms “burdensome” and “necessary” may involve a certain degree of subjective judgement. Member countries have attempted, wherever possible, to agree on minimum conditions under which treatment would be considered “equivalent”, and thus not constitute a restriction under the Codes. Examples are the areas of banking and financial services, as well as insurance and private pensions services. Detailed provisions are included in the Current Invisibles Code regarding authorisation procedures, representation, and prudential and financial requirements which may apply to the establishment of branches and agencies of non-resident enterprises.”

Source: OECD Codes of Liberalisation: User's Guide.

ii. Assessment of the PRA's criteria for authorisation for a branch of a non-EEA bank

With regards to the PRAs HSS equivalence criteria, these establish like conditions for establishment for the foreign bank requesting establishment of a UK branch and for a UK incorporated entity and raise no issues under the Codes equivalence test.

With regards to CEFs and the split of prudential supervisory responsibilities, the requirement that the PRA assess the HSS as being “sufficiently equivalent”, and there be in place a clear and agreed split of prudential supervisory responsibilities it should be noted that such requirements are directed to ensuring that all financial entities operating in the UK jurisdiction are subject to comparable supervisory standards. Furthermore, the PRA's “sufficiently equivalent” approach makes it possible to tailor requirements in specific cases to specific circumstances and fall short of a full mutual recognition requirement. Established Investment Committee practice has been to deem the requirement of home country standards for supervision that are comparable to host country standards, including mutual recognition arrangements, to be a conforming measure under the Codes. This understanding was last confirmed during the examination of Iceland's new requirements for the establishment of branches of foreign banks by the Investment Committee on the advice of the ATFC.

With regards to resolvability, the requirement of equivalence of the HSS’s resolution regime is setting the same standard of treatment for authorisation for all entities and do not raise issues under the Codes equivalence test. The PRA also seeks to ensure that the branch’s UK creditors and depositors are treated equally in the resolution process with their home state equivalents. This latter requirement does not amount to a financial guarantee requirement that would provide the same level of assurance to the UK as provided by separate capitalisation or liquidity requirements, which have been deemed by the Investment Committee to be conforming measures under the Codes. Thus, the PRAs approach is tailored to the specific circumstances of the branch and can be seen to be not more burdensome than necessary to “assure the soundness of the financial system or to protect depositors, savers and other claimants” (Cf. paragraph 7 of Annex II to Annex A of CLCIO).

iii. Implementation and expected impact of the measure

For all new non-EEA branches, the new policy will be implemented immediately. For existing branches, the PRA envisages the new policy to be implemented over time.

According to the PRA, there are currently 145 branches of international banks operating in the UK, mainly on wholesale banking activities. The PRA expects that non-EEA branches undertaking a CEF in the form of retail banking may be significantly impacted as the new supervisory approach is expected to require some branches to either exit the market or become a subsidiary. However, the majority of existing non-EEA branches will not need to change their United Kingdom legal entity to a subsidiary. With regards to a potential preference towards subsidiary versus branch for establishment in the UK, the United Kingdom’s authorities provided assurances that a neutral stance will be adopted in assessing how home state supervision frameworks and resolution outcomes combine with and meet the PRA’s objectives.

iv. Codes’ Article 16 protection at the stage of implementation

The new framework assigns a key role to the PRA’s assessment of activities undertaken by branches, of HSS supervisory standards and whether they are “sufficiently equivalent”. These assessments, necessarily on a case by case basis, inevitably entail a non-trivial level of discretion for the PRA.

The way in which the new PRA’s approach to branch supervision will be implemented will be a decisive element in ensuring equivalent treatment and conformity with Codes’ obligations. In particular, the Codes’ provisions (see Annex) call for authorities to be transparent regarding reasons for refusal or requests for modification of an application for authorisation and provide for an appeal mechanism.

In the event that members find that the implementation of the new framework by the PRA were to raise concerns regarding equivalent treatment issues, it should be noted that they may wish to avail themselves of the provisions of Article 16 of the Codes, which stipulates that:

“if a Member considers that the measures of liberalisation taken or maintained by another Member, in accordance with Article 2(a) are frustrated by internal arrangements likely to restrict the possibility of effecting transactions and transfers, and if it considers itself prejudiced by such arrangements, for instance because of their discriminatory effect, it may refer to the Organisation”.

4. Opinion of the Task Force

The ATFC agreed to advise the Investment Committee that in its opinion: the new requirements for foreign bank branches introduced by the UK Prudential Regulatory Authority conform to the obligations set out in Annex II to Annex A of the Code of Liberalisation of Current Invisible Operations regarding conditions for establishment of branches of non-resident investors in the banking and financial services sector.

Furthermore, the ATFC considers that given the significant amount of discretion granted to the UK supervisory authorities for the implementation of the measure, in particular with regards to development of assessments of “sufficient equivalence” of home state supervisor which under the new framework needed to be tailored to the scope of activities of a specific branch, United Kingdom authorities should report back to the Committee at an appropriate date in the future on their experience with implementation. The ATFC further notes that Article 16 of the Codes provides a means for any adherent to the Codes to raise issues before the Committee regarding the application of internal measures which may frustrate liberalisation commitments of another Code adherent.