POSITION PAPER

ESBG response to EBA consultation on draft Guidelines on Ancillary Services Undertakings

ESBG (European Savings and Retail Banking Group)

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ESBG

EBA Questions

Question 1: Do you have any comments on the general provisions set out in Section 4.1?

The clarification set out in Section 4.1, Paragraph 11, is generally welcome.

However, it is unclear what 'other undertaking' Paragraph 12 of the same section refers to. It is open whether this remark refers only to institutions within the same group, or to any institution outside the group. In other words, would Bank B have to qualify an undertaking as an ASU in any case, provided that Bank A does so when both hold a participation in the same undertaking?

If so, we would argue against such an interpretation, as there may be cases where this doesn't make sense. This could be the case when, in the aforementioned example, Bank A includes its large participation in a common undertaking in its prudential consolidation, but Bank B only holds a tiny participation that is not subject to prudential consolidation (e.g. due to Art. 19 CRR). Here, it is not explainable why Bank B should not be exempted from the proposed rule in section 4.1 that it has to qualify that undertaking as an ASU though not being part of its prudential consolidation. The obligation to assess an undertaking as an ASU should be limited to cases of significant economic relevance for the individual institution.

Additionally, we would like to point out that institutions which are not part of the same group cannot be obliged or expected to exchange assessments relating to undertakings in which they hold a common participation.

Question 2: Do you agree with the criteria specified for identifying an activity as a 'direct extension of banking'? Do you believe that other criteria should be included to identify activities that should fall under this definition? If yes, please provide detailed proposals

In relation to Section 4.2, Paragraph 13.a., we understand that the term "banking" seems to be supposed to be understood as services pursuant to points 1, 2 and 6 of Annex I of the CRD. This clarification and limitation are welcome and agreeable.

However, the term "activities that are fundamental to the value chain of the core banking services" creates another layer of uncertainty. The term "fundamental" is vague and leaves a lot of room for interpretation. As an extreme example, it could be argued that HR services are "fundamental" in this sense because the provision of core banking services is impossible without the bank's staff. From the examples listed in Paragraph 14 we take that the example of HR services is probably not supposed to be covered. However, there will certainly be various other activities that won't be easy to classify as "fundamental" or not.

Against this background, we suggest replacing the vague terminology used in the draft guideline with a more concrete one, e.g. "activities that are an indispensable part of core banking services…". This would help distinguishing activities that deserve being considered as an extension of banking from those that are only ancillary to banking.

Question 3: Do you have any comments on the use of activities that are fundamental to the value chain of core banking services as a criterion for identifying activities that are a 'direct extension of banking'? In particular, do you find the definition of and link to core banking services, and the related list of activities sufficiently clear?

In our view, the criteria that qualify a business activity as a "direct extension of banking activities" must be closely aligned with the definitions in Annex I of the Capital Requirements Directive (CRD). In our view, a narrow definition is appropriate in order to clarify that not every business activity that banks are permitted to engage in, but which is not subject to banking regulation should be considered a "extension of banking activities."

In our opinion, the provisions in paragraph 13 a) and b) could in respect of the aforementioned ambiguity of the term "fundamental" probably meet this requirement. However, we consider the provision in paragraph 13 c) of the guidelines, which states that other activities that are (in some way) related to lending are also included, to be too vague to clearly define activities that constitute a "direct extension of banking activities."

We advocate strongly for the deletion of paragraph 13 c).

Question 4: Do you consider appropriate the inclusion of services and activities that involve maturity transformation, liquidity transformation, leverage or credit risk transfer – when conducted by shadow banking entities – as one of the criteria for identifying activities that are a 'direct extension of banking'?

It must be highlighted that Article 4(1) point (18) CRR makes a systematic distinction in letters a) and b) as to whether the principal activity of the undertaking is a direct extension of banking (letter a) or the undertaking performs an activity that is ancillary to banking (letter b). Although both points are inherently related to banking activities, this should not mean that a sharp distinction, where possible, is unnecessary. Otherwise, there is a risk that the definition of ASU will become too broad and ultimately ineffective.

In light of the aforementioned, we propose that the activities specified in Paragraph 14 a), b), f) and g) (namely, brokerage of loans and deposits, risk management, and services related to repossessed assets) be regarded as ancillary to banking. These activities are not intrinsic to the core banking operations (i.e. lending or deposit taking) but rather provide support at the

outset or in the aftermath. This is supported by the fact that Paragraph 23.a) of the consultation document names credit risk assessment as an example of an "ancillary service".

The activity of debt recovery, as outlined in Paragraph 14 d), should not be regarded as an extension of banking or an ancillary service at all, as it is not a specific activity of the banking sector and does not imply risks that require being covered by prudential supervision. In essence, all forms of commerce necessitate debt recovery, meaning that this should be excluded from the scope of the ASU definition.

Question 5: Do you consider appropriate the inclusion of 'other activities related to lending' as one of the criteria to identify activities that are a 'direct extension of banking'? Do you consider undertakings that perform one of these activities as their principal activity already qualifying as financial institutions within the meaning of Article 4(1)(26) of Regulation (EU) No 575/2013?

We object strongly to the inclusion of activities that are "related to lending." From our point of view, this term is too vague because it is unclear what would be covered by it.

Additionally, point a) of Article 4(1)(18) refers to an extension of banking. However, if a service does not pertain to an activity that requires a license under the CRD and is not subject to banking supervision, it should not be included under banking activities either. Otherwise, the term becomes blurred. Hence, a corresponding clarification should be made.

Question 6: Do you agree with the proposed criteria for identifying activities that are 'ancillary to banking'? Are the three main criteria specified for that purpose (i.e. support, complement and rely on banking) sufficiently clear? Are there any other criteria that should be included in that regard?

Overall, we agree with the criterion of a "supporting" characteristic, but not with the two relating to "complementing" and "relying on banking".

In the view of ESBG, the new definition of ancillary services undertaking is relevant for, inter alia, the inclusion in prudential consolidation. The objective of prudential consolidation is to enable indirect regulatory access to non-institutions. The scope of prudential consolidation only includes group entities operating in the financial sector – with the aim of identifying the bank-specific risks of a particular bank and its subsidiaries or undertakings in which it holds participation. This also includes ancillary services undertakings. However, businesses should only be classified under this term if their activity is associated with specific banking risks.

This means that not every activity can be meant as "ancillary", but instead only those that have a supporting relationship to banking activities, i.e. that enable or facilitate them. In particular, the wording of the English term 'ancillary'

suggests this, to the extent that this term means 'supporting or providing assistance' (synonym: 'auxiliary'). What is not meant, however, is that the term 'ancillary' covers any activity other than the banking activity defined above. Any such interpretation would go beyond the purpose of the consolidation provisions, which is to have regulatory access to non-banks that conduct or are involved in supervised business.

Including activities that "complement" banking may have the consequence of covering a very broad range of practices that do not comply with the background explained above. The explanation of the term "complement" in Paragraph 21 of the Draft Guideline also does not contribute to the required delimitation: In our understanding, the specific issue referred to in Paragraph 21 a) is that the undertaking introduces a new group of customers to the bank. This activity itself does not imply bank-specific risks, which are only associated with the bank's own activities and products and are already covered by banking supervision. Regarding Paragraph 21b), it should be noted that this would indirectly include the provision of non-banking services and products by a non-bank into banking supervision. This scenario, however, does not imply additional bank-specific risks and does not require inclusion into prudential supervision.

A similar line of argumentation applies to the term "relying on banking". Here we see the following additional problems: In relation to Paragraph 23, it is not conceivable why the reliance on banking products, services or funding by a credit institution would trigger the activity to be considered as "ancillary to banking". This view only focuses on the undertaking's relation to an institution but completely disregards the nature of activity of the undertaking in question. In our opinion this is a wrong focus that is not intended by the definition. It is also not covered by the common understanding of the term "ancillary".

Moreover, we would like to highlight that the current draft appears to focus solely on *financial reliance*. In practice, reliance may also manifest through operational or personnel dependencies. In several cases, the company's management is identical to that of the institution or its division managers. In other instances, while the management may differ, the company has no employees of its own and relies entirely on staff from the institution to perform its activities. These examples indicate a broader form of reliance on the institution. Against this backdrop, we *would like to suggest that such operational and personnel dependencies be considered as part of the assessment of "reliance on the bank".*

Additionally, the terms "relies on banking products or services" and "funding" are too broad. They may encompass a wide range of relationships that are not necessarily associated with the risk addressed by the ASU definition. In any case, any form of equity capital should be excluded from the term "funding."

Finally, it is very common for a credit institution to provide funding to its subsidiary or an undertaking in which it holds a participation, but this common circumstance does not qualify the activities provided by the undertaking in any

way (which should, however, be the core element of the ASU definition). Ultimately, this could result in nearly all subsidiaries or undertakings in which institutions hold a participation being qualified as ASUs – regardless of the nature of their business.

With regard to the provision of banking-related services by an entity to an institution, the draft does not specify whether a one-time service is sufficient for classification or whether the service must be ongoing. Additionally, it remains unclear whether the significance of such activity within the entity's overall operations should be taken into account. We thus propose that the criteria be clarified to reflect whether the frequency and relevance of the service provision are factors in the classification process.

Question 7: Do you agree with the approach envisaged in Section 4.3, which limits the assessment of an activity as 'ancillary to banking' only to undertakings that may have to be included in the scope of prudential consolidation or are collectively held by institutions belonging to the same IPS?

We welcome the limitation of the assessment of an activity as 'ancillary to banking' to undertakings that have to be included in the scope of prudential consolidation, as this reduces bureaucracy in other cases.

However, we are of the opinion that this limitation should not only be made in relation to point b) of the definition of an ASU, but also to point a) (i.e., activities that are a direct extension of banking). There is no obvious reason for distinguishing between the two categories in this regard.

Additionally, we suggest clarifying that an institution which generally does not have to perform prudential consolidation of its subsidiaries and participations is also not required to assess the status of an undertaking in which it only holds participation. This should be the case where there is a general lack of subsidiaries which qualify as institutions or financial institutions, or where there is no obligation to consolidate due to Art. 19 CRR or due to the absence of an authority's determination pursuant to Art. 18(5) CRR. This clarification is needed because paragraph 18(a) of the draft guidance also refers to 'any other situations specified in paragraphs 3, 5 … of Article 18' of the CRR, which could be misconstrued as meaning that an institution must perform the ancillary assessment even if it is generally exempt from prudential consolidation.

The same applies to companies that are subject to the equity method in accordance with Article 18(5) CRR. Clarification is needed here, as Article 18(5) CRR expressly states that the equity method does not result in the companies concerned being included in supervision on a consolidated basis.

In general, we see a risk of circular reasoning in paragraph 18(a) of the draft guidelines, as it refers to companies that "must or may be included in the scope of regulatory consolidation." In view of the above concerns, we fear that ultimately all participations in companies providing relevant services would

have to be classified as AvN, as there is a risk that they could be included in regulatory consolidation. We therefore propose deleting the phrase "or may."

Finally, we reject the special provisions for companies jointly owned by IPS members. There is no reason why these companies should be treated differently from those owned by non-IPS institutions. In particular, the argument put forward in footnote 5 of Part 3 of the consultation paper that "such companies could have a close operational and functional relationship with the banking activities of IPS institutions" also applies to companies outside the IPS sector. Within the IPS sector, joint holdings are generally of very little financial significance to the individual institution and are held solely for collective strategic purposes. If there is no obligation to consolidate these holdings due to their low significance for the individual institution, it does not make sense to require the determination of their status as AvN.

Therefore, imposing stricter rules on IPS members would constitute unjustified unequal treatment.

Question 8: Do you have any comments on concept of 'banking' specified in Section 4.3, which includes all relevant services or activities provided by institutions or financial institutions?

In our understanding, Section 4.3 establishes a different concept of banking than Section 4.2 which only refers to points 1, 2 and 6 of Annex I to the CRD. It is not understandable why the same term "banking" should be understood differently in points a) and b) of Sec. 4 No. 18 CRR. Such a distinction was certainly not intended by the legislator – if that would have been the case the legislator would instead have chosen different terms. Therefore, we suggest sticking to the interpretation laid down in Section 4.2 which is plausible.

The new definition of ancillary services undertaking is relevant for, inter alia, the inclusion in prudential consolidation. The objective of prudential consolidation is to enable indirect regulatory access to non-institutions. The scope of prudential consolidation only includes group entities operating in the financial sector – with the aim of identifying the bank-specific risks of a particular bank. This also includes ancillary services undertakings. However, businesses should only be classified under this term if their activity is associated with specific banking risks of the bank.

This means that not every activity can be meant as "ancillary", but instead only those that have a supporting relationship to banking activities, i.e. that enable or facilitate them. In particular, the wording of the English term 'ancillary' suggests this, to the extent that this term means 'supporting or providing assistance' (synonym: 'auxiliary'). What is not meant, however, is that the term 'ancillary' covers any activity other than the banking activity defined above. Any such interpretation would go beyond the purpose of the consolidation provisions, which is to have regulatory access to non-banks that conduct or are involved in supervised business.

Question 9: Do you have any comments on the specifications provided for the activities explicitly referred to in Article 4(1)(18)(b) of Regulation (EU) No 575/2013? In particular, are the illustrative examples provided therein adequately defined?

Regarding operational leasing, it would be worth considering whether the significance of services provided to institutions or financial institutions— whether within or outside the group— should influence the assessment of ASU classification. For example, if a leasing company leases a single asset to an institution, while the remainder of its business is unrelated to institutions or the group, it raises the question of whether it should still be classified as an ASU, even though such activity does represent a material part of its operations.

We recommend aligning the definition of operational leasing in the EBA Guidelines with the concept of finance leasing under the IFRS framework. This alignment is especially relevant for publicly listed companies across Europe, where IFRS is widely applied. Users are familiar with IFRS rules and interpretations and having different regulations for different stakeholders within the same business creates unnecessary complexity and burden for those applying them.

In relation to the ownership or management of property, we are of the opinion that the interpretation of this legal example should be limited to the case that is mentioned in Paragraph 26 a) i), i.e. cases where the properties owned or managed are used to support the operations of banking business.

It is unclear to which cases the second example in paragraph 26(a)(ii) refers. In our view, it would be correct to include cases of realized collateral managed by the company, as this supports banking business. To this end, we propose specifying the owner of the property (e.g., "the institution's ownership of the properties arises as a direct result of banking business").

Otherwise, paragraph 26(a)(ii) could be misunderstood to also cover cases where a customer of the institution is the owner of a property managed by the company in question and finances the ownership with a loan. In such a case, however, the company only provides its services to a third party (the customer) and not to the institution, so there is no element that could be considered a secondary activity.

In terms of real estate management, the Guidelines proposes that such activity should be considered reliant on banking when property ownership is financed by the institution. However, we believe this interpretation may not always be appropriate. For example, if a property is acquired using institutional financing but is managed by a property management subsidiary and used for non-banking purposes (e.g., a shopping center), classifying the entity as an ASU solely based on the financing aspect appears inconsistent – assuming there are no other factors that would support an ASU classification.

Similarly, we disagree with the classification in paragraph 26 b) iv) and v), as these cases concern real estate that is not owned by the institution but only by customers and other investors. Here, the recipient of the management service is only the customer and not an institution. The connection to banking business is too remote and there are no bank-specific risks. The example given in paragraph 26 b) iii) refers to marketing and should not be dealt with at all in the context of the specific example of "ownership or management of real estate." It would be going too far to include the marketing of banking products and services in the activities of ownership or management of real estate. With regard to paragraph 26(c), we refer to our general criticism of the inclusion of the aspect of "relying on banking" in the interpretation of the term "ancillary." With regard to the provision of data processing services, we consider it necessary to limit this activity to services associated with banking-specific risks. This applies to examples such as the establishment and operation of core banking systems and KYC and credit application tools. However, services that can be used by any company, such as the operation of data warehouses or HR applications, should not be included here. A corresponding clarification should be added in paragraphs 27a and 27b. We propose deleting paragraph 27c, as sole dependence on a banking product or service should not be a relevant criterion (see above).

Question 10: Do you have any comments on the process envisaged for the determination of activities to be considered similar to points (a) and (b) under Article 4(1)(18)(c) of Regulation (EU) No 575/2013?

We consider the suggested process for implementing Article 4(1)(18)(c) CRR to be ineffective. In practice, this means that national supervisory authorities repeatedly submit new use cases to the EBA. In our view, the guideline must provide a clear definition that can be applied unambiguously by all European institutions and national supervisory authorities and allows for a final case-by-case review and assessment.

Question 11: Do you have any comments on the clarification of the principal activity of an ASU? Do you consider the definition of this concept useful for the application of Article 4(1)(18) of Regulation (EU) No 575/2013?

We reject the concept that the EBA intends to apply to determine whether an AvND is engaged in a significant activity. In particular, the EBA should not introduce a rule whereby the sum of the business activities carried out that correspond to the provisions of Article 4(1)(18)(a), (b) or (c) CRR is decisive in determining whether the company qualifies as an AvND. As in previous supervisory practice, activities should be assessed individually and used as the basis for classification as an AvND.

Question 12: In general, is there any other activity or criteria not explicitly mentioned in these guidelines that should be considered to identify activities as either a 'direct extension of banking' or 'ancillary to banking'?

About ESBG (European Savings and Retail Banking Group)

ESBG represents the locally focused European banking sector, helping 32 savings and retail banks in 27 European countries strengthen their unique approach that focuses on providing service to local communities and boosting SMEs. Advocating for a proportionate approach to banking rules, ESBG unites at EU level some 859 banks, which together employ 620,000 people driven to innovate at 37,000 branches. ESBG members have total assets of € 6,35 trillion, provide € 3,72 trillion in loans to customers, and serve 163 million Europeans seeking retail banking services. ESBG members commit to further unleash the promise of sustainable and responsible 21st century banking.

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