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The Hidden European Investment Screening Mechanism –

The Banking and Insurance Sector

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Overview

European Banking and Insurance Supervision

- The European financial sector is heavily regulated, with different regulations concerning three sub-sectors
  - Deposit taking Credit Institutions (CRR-Credit Institutions) under the rules of the European Banking Union
  - Investment Banks / Securitites Firms
  - Insurance Companies
- Centralised supervision of all Eurozone CRR-Credit Institutions by the ECB (Single Supervisory Mechanism)

Investment Control Regulations

- Investments into European banks, securities firms and insurance companies are primarily regulated by
  - European banking, securities and insurance directives
    - CRD IV, MiFiD II and Solvency II
- Detailed requirements set by European Supervisory Authorities (EBA, ESMA and EIOPA)
  - E.g. Joint Guidelines on the prudential assesment of acquisitions and increases of qualifying holdings in the financial sector (JC/GL/2016/01)

Supervisory Investment Screening

- Shareholders/owners are screened and assessed throughout the lifecycle of companies
  - „Greenfield Investments“
    - Approval procedure related to new bank/insurer
  - „Brownfield Investments“
    - Ownership control proceedings related to shareholders
  - Ongoing Supervision

Supervisory aims

- Main supervisory aims, which guide investor screening:
  - Stability and safety of financial institutions
  - Stability and functioning of financial markets
  - Customer/consumer protection (individual and collective aim)
- Prevention of systemic risks
  - became prime target of supervision with 2008/2011 financial crisis

Ownership Control for Financial Institutions

Control of Qualifying Holdings

- Shareholders/owners are assessed by supervisors, in case of *qualifying holdings*
- Qualifying holding is a *direct or indirect holding*
  - of 10 % of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of the company;
  - Separate persons below the threshold, who are „acting in concert“ with others are treated as a single owner for control purposes.
- For indirect holdings notification requirements exist along the corporate control chain

Ownership Information Requirements

- Supervisors must be provided e.g. with information on the
  - Identity and participation of each natural and legal person, and other entities that have or will have a qualifying holding
  - Suitability and financial soundness of each named person
  - Details of the person‘s or entities intentions in respect of the acquired undertaking
- Approval/ownership control proceedings do not officially start, before applicants have provided all information explicity required by the supervisors

Ownership Control Criteria

- To acquire a qualifying holding a person must e.g.
  - have a good reputation,
  - be reliable and financially sound,
  - comply with all prudential requirements and
  - not be suspected of money laundering or terrorist financing.
- Third country investors
  - are allowed to acquire a qualifying holding, if they fulfill these requirements. No discrimination for reasons of origin;
  - are intensively scrutinized in case of complex and intransparent investment structures and doubtful sources of capital.

European Screening Mechanism

Current status: Fragmented EU Screening Mechanisms

- Historically the European Commission had a significant role in FDI Screening:
  - Competent Authorities of the Member States were required to inform the Commission on authorisations of subsidiaries governed by third country parent undertakings
  - The Commission was able to negotiate with third countries not granting effective market acces to EU companies
- In the area of insurance supervision the role of the European Commission remains prevalent:
  - Art. 176 and 177 Solvency II establish a similar mechanism as to the one described above with the difference that the Commission is not equipped with a mandate to negotiate anymore

EU Draft Regulation on a Framework for Screening Foreign Direct Investment

- Art. 4 stipulates that in screening foreign direct investment on the grounds of security or public order potential effects on, inter alia the financial infrastructure may be considered
  - To be determined, what is included in term *financial infrastructure*
    - *Broad interpretation could include all systemically important financial institutions (SiFis) on global, European and/or national level*
  - Financial Stability is implicitly adressed by the assessment criteria of ownership control proceedings
- Ownership control proceedings for financial institutions allow to determine clearly, whether a foreign investor is controlled by the government of a third country, though prudential supervision does not in general discriminate third country governments.