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From:	Commission services
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Subject:	Non Paper on passporting regime and the division of home-host Member State competences
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Non-paper

Passporting regime and the division of home-host Member State competences

This non-paper concerns two issues: (i) the definition of a ‘host Member State’ and (ii) possible limitations to the functioning of the passporting regime for credit servicers.

1. DEFINITION OF THE ‘HOST MEMBER STATE’

Pursuant to the **Commission** proposal under Art. 3(1) Point 10 (line 109):

“‘host Member State’ means a Member State, other than the home Member State, in which a credit servicer has established a branch, has appointed an agent or where a credit servicer provides services.”

The **Council’s** negotiation mandate proposes the following amendments (line 109):

“‘host Member State’ means a Member State, other than the home Member State, in which a credit servicer has established a branch, has appointed ~~an agent~~ a credit service provider referred to in Article 10 or where ~~a credit servicer provides services~~ provides services, respectively where the borrower is domiciled or established.”

The Council has proposed two changes: (i) the introduction of the location of the borrower and (ii) replacing the “agent” by a “credit service provider referred to in Article 10”.

1.1. On the location of the borrower and cross-border services

The Council has included the location of the borrower as a criterion for determining the ‘host Member State’. This aims to ensure that the consumer protection law of the Member State where the borrower is located is applicable. The formulation using the word “respectively” is however not clear.

Moreover, it should be noted that the credit servicer provides a service to the creditor (credit institution or credit purchaser) and not to the debtor/the borrower. The Member State (...) in which a “credit servicer provides services” is not necessarily the same as the Member State in which the borrower is located.

The **EP** has proposed the following re-wording based on the Council’s text (line 109):

“‘host Member State’ means a Member State, other than the home Member State, in which a credit servicer has established a branch, has appointed ~~an agent~~ a credit service provider referred to in Article 10 or where ~~a credit servicer provides services~~ the borrower is domiciled or established at the time of concluding the credit agreement.”

The difference with the Council’s definition is that the EP has deleted the reference to the freedom of providing services and added instead a direct reference to the location of the

borrower. This approach is similar to the IORP (institutions for occupational retirement provision) directive, which defines the ‘host Member State’ not in relation to the location of the provision of services (see annex), but in relation to the Member State whose laws apply to the pension scheme (contract). The IORP directive makes a distinction between the host Member States on the one hand and the provision of cross-border services on the other hand, the latter being a service provided by the pension fund to the sponsoring undertaking (the employer) and not to the pension scheme member (the employee to be protected).

That three-way relationship is also present in the proposal at hand: the credit servicer provides the service to the creditor and the laws of the host Member State protect a third-party, i.e. the borrower. The enabling of the provision of cross-border services by the credit servicer on the basis of the freedom to provide services is contained in Article 11(1) of the Commission’s proposal: *“Member States shall ensure that a credit servicer having obtained an authorisation in accordance with Article 5 in a home Member State has the right to provide in the Union those services that are covered by that authorisation.”*

1.2. On the agent or the credit service provider

Both the Council and the EP propose to replace the “agent” by “a credit service provider referred to in Article 10”, the latter being a third party that the credit servicer uses to perform credit servicing activities. This proposal aims to specify what is meant by the agent in the Commission’s proposal. The inclusion of the “agent” in the definition of the host Member States is however not needed strictly speaking.

The definition in PSD2 (payment services directive) provides for an “agent” as an alternative to a branch (see annex) and this is needed, for example, for money remittance services which rely on very light structures (sometimes “corner shops”) in another Member States. Such agents are not used by credit servicers.

Co-legislators might therefore want to consider adopting a definition of the host Member State without reference to the agent nor to the credit service provider.

In conclusion, the co-legislators might want to consider the definition of the host Member State as proposed by the EP with a deletion of ‘has appointed a credit service provider referred to in Article 10’:

“‘host Member State’ means a Member State, other than the home Member State, in which a credit servicer has established a branch, ~~has appointed an agent~~ a credit service provider referred to in Article 10 or where ~~a credit servicer provides services~~ the borrower is domiciled or established at the time of concluding the credit agreement.”

2. PASSPORTING REGIME: COOPERATION BETWEEN HOME AND HOST

The Commission’s proposal, following the approach employed in other EU legal acts, provides a supervisory system whereby the authorisation and the ongoing supervision of a credit servicer is the responsibility of the home Member State, but that the authorities of the host Member States when it detects irregularities can request the home Member State to intervene. This is for example the case in the Solvency 2 Directive (article 155) in the

precautionary principles in the Prospectus Regulation (Article 37) and in the Crowdfunding Regulation (also Article 37).

In the proposal at hand this approach is specified as follows:

- The process of authorisation by the home MS is covered in Articles 4 to 6 of the proposal (lines 114-140). The process for the withdrawal of an authorisation by the home MS is covered in Article 7 of the proposal (lines 141-149).
- Ongoing supervision of the credit servicer by the home MS is provided in Article 20 and the powers of the home MS are specified in Article 21.

When the credit servicer services loan agreements from borrowers in a different Member States, the proposal foresees, for the on-going supervision, a system of cooperation between the home and the host Member States in the following articles:

- Article 11 (freedom to provide services) ensures that credit servicers authorised by the home MS can provide their services in another MS without additional authorisation (passport). The home Member State is required to inform the host Member State about that start of cross-border credit servicing by the credit servicer.
- Article 12 provides that the home MS is responsible for the supervision of credit servicers who provide cross-border services, but with several important safeguards for the host MS, notably:
 - a duty to cooperate closely between home and host MS, in particular for investigations and on-site inspections (lines 196-199) and more generally in Article 37 (lines 381-386);
 - an own initiative right for the host MS to conduct inspections (line 200), including the right of the host MS to take appropriate administrative penalties and remedial measures (line 203) and the Council proposes to add the right for the host MS to prohibit further activities where the home MS has failed to act (line 203). The EP provides a technical reformulation of the Council's text (lines 203a to 203e).
- Article 21(5) provides that the home and host MS should exchange information.

Against this background, the following points in more detail can be observed.

2.1. Granting of authorisation (Art. 5(1) – line 117 and Art. 5(2a) – line 126a)

Article 5 of the proposed directive concerns the granting of an initial authorisation to the credit servicer by the home MS authorities. The EP has proposed a new article 5(2a) which stipulates the following:

“Member States shall ensure that where competent authorities of the host Member State have determined that the applicant does not fulfil the conditions laid down in this Article, they shall send a communication containing all relevant information to the home Member State.”

At the moment of the authorisation, the credit servicer does not necessarily carry out cross-border activity. For this reason the Commission's proposal did not yet foresee a role for the host MS at that stage. As soon as a credit servicer conducts cross-border activity, the host MS acquires supervisory powers as explained above.

Accordingly, while the authorisation criteria for the home MS could be strengthened in accordance with proposals from the EP (notably lines 121, 121a, 121b and 125d) it could be envisaged not to introduce line 126a proposed by the EP.

The proposal by the EP to include language requirements (line 125a) could be considered for Article 11.

Additionally, in Art. 5(1) (line 117), the EP has proposed an amendment introducing *'minimum'* requirements for authorisation that Member States should lay down. While such requirements do not directly affect home-host MS competences, they could lead to regulatory arbitrage.

2.2. *Withdrawal of authorisation (Art. 7(1a) – line 148a)*

As regards the withdrawal of the authorisation from a credit servicer, the European Parliament has proposed the following new article:

“Member States shall ensure that where competent authorities of the host Member State have determined that a credit servicer acts in a way that falls under points (e) or (f) of the first paragraph, they shall send a communication containing all relevant information to the competent authorities of the home Member State.”

The decision to withdraw an authorisation from a credit servicer would affect its entire activity (domestic and cross-border). The Commission's proposal therefore does not provide an obligation for the home MS to withdraw an authorisation at the request of one host MS. As explained above, the Commission's proposal does provide an own-initiative right for the host MS to conduct inspections (line 200), including the right of the host MS to take appropriate administrative penalties and remedial measures (line 203). The Council proposes to add the right for the host MS to prohibit further activities where the home MS has failed to act (line 203).

The EP provides a reformulation of the Council's text (lines 203a to 203e) which could clarify the legal text (see section 2.3 below), without however including line 148a.

2.3. *Supervisory competences of home and host Member States (12(11a) – lines 203a-203e)*

The EP has proposed a streamlined version of Article 12(11) as follows:

“Where a credit servicer continues to be in breach of the applicable rules, including its obligations under this Directive, and after having informed the home Member State, Member States shall ensure that the competent authorities of the host Member State are entitled to adopt appropriate administrative penalties and remedial measures in order to ensure compliance with this Directive when any of the following apply:

- (a) no adequate and effective steps were taken by the credit servicer to rectify the breach in a reasonable time; or*
- (b) despite remedial measures already being taken by the competent authorities of the home Member State; or*
- (c) in an urgent case, where immediate action is necessary in order to address a serious threat to the collective interests of the borrowers.*

In addition, the competent authorities of the host Member State may prohibit further activities of a credit servicer that is in breach of its obligations under this Directive in that Member State until an adequate decision is taken by the competent authority of the home Member State or the credit servicer takes steps to remedy the breach.”

Considering that the reformulation includes all elements of the texts of the COM and the Council, a way forward could be to incorporate the EP’s above referenced version (lines 203a-203e) into the text.

In conclusion, the co-legislators might want to consider adopting the following lines in the compromise text:

Line	Article	Conclusion
117	5(1) requirements for granting authorisation	COM text
121	5(1)(b)(ii) compliance requirements	EP text
121 a	5(1)(b)(iia) cumulative effect of minor incidents	EP text
121 b	5(1)(b)(iib) good cooperation in the past	EP text not incorporated
125 a	5(1)(ea) sufficient language skills	EP text (could be incorporated in Art. 11)
125 d	5(1)(ed) no obstacles to effective supervision	EP text
126 a	5(2a) host MS competence regarding authorisation	EP text not incorporated
148 a	7(1a) host MS state withdrawal of authorisation	EP text not incorporated
203 a	12(11a) home-host MS state supervision	EP text
203 b	12(11a)(a) home-host MS state supervision	EP text
203 c	12(11a)(b) home-host MS state supervision	EP text
203 d	12(11a)(c) home-host MS state supervision	EP text
203 e	12(11a)(new) home-host MS state supervision	EP text

Annex 1: Definition of ‘Host Member State’ in other EU financial legal acts

1. IORP Directive

Article 6(11): ‘host Member State’ means the Member State whose social and labour law relevant to the field of occupational pension schemes is applicable to the relationship between the sponsoring undertaking and members or beneficiaries;

Article 11(1): Without prejudice to national social and labour law on the organisation of pension systems ..., Member States shall allow an IORP registered or authorised in their territories to carry out cross-border activity. Member States shall also allow undertakings located in their territories to sponsor IORPs which propose to or carry out cross-border activity.

Article 6(19): ‘cross-border activity’ means operating a pension scheme where the relationship between the sponsoring undertaking, and the members and beneficiaries concerned, is governed by the social and labour law relevant to the field of occupational pension schemes of a Member State other than the home Member State.

2. Other EU legal acts

PSD II:

‘host Member State’ means the Member State other than the home Member State in which a payment service provider has an agent or a branch or provides payment services.

CRR:

‘host Member State’ means the Member State in which an institution has a branch or in which it provides services.

Solvency II:

‘host Member State’ means the Member State, other than the home Member State, in which an insurance or a reinsurance undertaking has a branch or provides services; for life and non-life insurance, the Member State of the provisions of services means, respectively, the Member State of the commitment or the Member State in which the risk is situated, where that commitment or risk is covered by an insurance undertaking or a branch situated in another Member State.

MiFID:

‘host Member State’ means the Member State, other than the home Member State, in which an investment firm has a branch or provides investment services and/or activities, or the Member State in which a regulated market provides appropriate arrangements so as to facilitate access to trading on its system by remote members or participants established in that same Member State.

Annex 2: List of articles relevant regarding passporting and supervision

Arts. 4 and 5 – Initial authorisation by **home** MS

Art. 6 – Refusal to grant authorisation by **home** MS

Art. 7 – Withdrawal of authorisation by **home** MS

Art 11 – Cross-border credit servicing - Freedom to provide services:

- Documents that the credit servicer has to provide to the **home** MS authorities before the start of cross-border servicing;
- Duty of **home** Member State to verify the submitted documentation and to inform the host Member State about the start of cross-border credit servicing by the respective credit servicer.

Art. 12 – Supervision of cross-border servicing by **home** and **host** Member States

Including the right of the **host** MS to take appropriate administrative penalties and remedial measures as well as the right to prohibit further activities where the home member State has failed to act (Art. 12(11)).

Art. 20 – Supervision by competent authorities

Art. 21 – Supervisory powers of competent authorities of **home** MS (except 21(5) mentions home and host should exchange information).