Current positions on the regulation of banks and the financial markets

JUNE 2023

VÖB in Europe

BERLIN
- Main lobbying office, with close to 80 staff members
- Professional support for members
- Positioning and exchange of views in expert committees and working groups
- Contact with Germany's Federal Government, and with both chambers of the German parliament (Bundestag/Bundesrat)

BONN
- Regular exchange of views with the German Federal Financial Supervisory Authority (BaFin)
- Registered office of VÖB-Service GmbH subsidiary

FRANKFURT
- Regular exchange of views with BaFin, the Bundesbank and the European Central Bank (ECB)
- Five press conferences per year
- Eight members represented locally

BRUSSELS
- Eight local employees
- Regular contact with the European Commission, the European Parliament, the Permanent Representations of the Member States and other banking industry associations
- Member of the European Association of Public Banks (EAPB)
- Member of the European Banking Federation (EBF)

PARIS
- Regular contact with the European Banking Authority (EBA) and the European Securities and Markets Authority (ESMA)

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IRIS BETHGE-KRAUSS | EXECUTIVE MANAGING DIRECTOR

Dear readers,

In recent months, the financial community has once again been thrust into the spotlight, with both sides of the Atlantic hit by turbulent times in the banking sector. Ultimately, however, our banks have proven to be robust and resilient. The mechanisms put in place in the aftermath of the financial crisis are bearing fruit and put us in a stronger position than before.

At the same time, we are still faced with major challenges. The after-pains of the pandemic are having an impact in the long term, and the Ukraine war is also associated with serious implications. Both factors have played a significant role in driving high inflation, which forced the European Central Bank to take considerable action to keep price increases in check. This obviously has a knock-on effect on the economy, where growth is dwindling as the monetary policy reins are tightened and cost pressure mounts. These circumstances will remain our constant companion throughout 2023.

And while we need to find answers to the crises currently facing us, setting the right course for our future is another key task on the agenda. The aim is to drive a process of transformation to create a digital, sustainable and competitive economy. This is a political challenge that calls upon all sectors to do their bit to turn the ambitious transformation vision into a reality. Public-sector banks are more than aware of this responsibility. They have proven to be reliable partners in times of crisis. And they are now demonstrating their ability to act as a driving force for transformation. We could describe our promotional banks as socially, economically and environmentally sustainable institutions. The subsidies they provide range from start-up financing to support for digital transformation within schools, affordable housing and measures to ramp up the use of renewable energies – meaning that they are more broadly positioned than ever before. This allows banks to create the right incentives for business and society at large to forge ahead with the transformation process. But in order to implement these incentives successfully, we need constructive overall conditions to facilitate the necessary investment. Additional requirements, intricate regulations and capital buffers could cast a shadow over a forward-looking funding environment. Consequently, it is all the more important to create the sort of political environment that not only facilitates, but also encourages, investment.

The “Current positions on the regulation of banks and the financial markets” offer an extensive insight for inform policymakers, regulators, members and other stakeholders concerning our take on key legislative initiatives and regulatory requirements.

Let us join forces to rise to the challenges that 2023 will bring. My colleagues and I will be happy to answer any questions you may have.

Yours sincerely,

OUR TOPICS

1 Sustainable finance

Integrate market-based solutions in a European context – implement a pragmatic taxonomy for green finance products, embedding this into risk management using a measured approach.

The aim of sustainable financial management is to further channel capital flows into social and environmental investments, to better manage sustainability risks and to integrate environmental, social and governance (ESG) aspects more effectively into decision-making processes:

to this end, an EU-wide sustainability classification system – the taxonomy – has been deployed to ensure such integration is conducted on a uniform basis. The Delegated Act on the first two climate-related environmental objectives and details on the disclosure of taxonomy KPIs (Article 8) were published in December 2021. Credit institutions currently publish their taxonomy eligibility ratio and will be disclosing their green asset ratio (GAR) for the first time as at 31 December 2023. The additional Delegated Act incorporating economic activities that include fossil gas and nuclear energy followed in July 2022.

The draft Delegated Act on the four remaining environmental objectives (Taxo 4) was published on 5 April 2023 together with an amendment to the Article 8 Delegated Act and an additional Delegated Act setting out legislative proposals to expand climate-related economic activities. The European Commission is anticipated not to take up the social taxonomy before the next legislative period starting in 2024. Voluntary guidelines on transition activities are reportedly still planned for 2023.

Requirements for disclosure of ESG factors, including their integration into the investment process (SFDR), have been applicable since March 2021; however, numerous details are still pending. Due to the interdependencies of the thirteen published regulatory technical standards (RTS) under the SFDR, the European Commission bundled them in one Delegated Regulation in April 2022. The RTS came into force on 1 January 2023. On 12 April 2023, the European Supervisory Authorities (ESA) published a consultation paper aimed at achieving a review of the RTS to simplify the calculation of existing PAI indicators, introduce additional – primarily social – indicators and disclose product information on decarbonisation targets. The aim is also to improve the DNSH disclosures for sustainable investments. The revised RTS are not, however, expected to be published before the first quarter of 2024.

In order to further promote the growing green bond market

OUR POSITION

- **We** explicitly support taking sustainability considerations into account in long-term economic stimulus programmes launched to reinforce Germany's position as an economic hub against the background of the COVID-19 PANDEMIC, THE WAR IN UKRAINE AND THE ENERGY CRISIS. This applies especially to strengthening healthcare as well as the establishment of climate-friendly infrastructures and key industries.
- **We** believe that sector-specific transition periods, together with economic, environmental and fiscal policy support, are necessary to bring about changes in the economy to make it fit for the future.
- **We** are convinced that common, science-based standards for sustainable financial products will increase transparency for investors, reduce uncertainty among issuers, and contribute to market growth in the long term. Our stance on the introduction of the European Green Bond Standard is a very positive one. In particular, we welcome the voluntary nature of the standard, as well as the flexibility pocket approach, which allows up to 15% of the issue proceeds to be used to finance economic activities not yet covered by the EU Taxonomy.
- **We** advocate consideration of the special characteristics of the German credit market when developing transparency obligations that banks will have to fulfil. Due to methodological weaknesses, the mandatory taxonomy ratios currently offer only limited informational value. We therefore believe a timely revision to be necessary.
- **We** are convinced that a broad sustainability approach is necessary, which is why we welcome the development of the Taxonomy, especially with regard to the inclusion of social aspects. Before that, however, the methodological weaknesses of the green asset ratio should be remedied.
- **We** welcome the EBA's position of gradually approaching

and to create a reliable framework for investors, the Regulation for an EU Green Bond Standard (EuGBS) is expected to come into force starting in the fourth quarter of 2024 – after a twelve-month transition period. Use of the "EuGB" label, which is linked to the EU Taxonomy and is designed to serve as the gold standard in this market segment, will be voluntary.

In addition, the Delegated Regulation on MiFID II was published in August 2021. ESMA consulted on the details in 2022, with the final rules set to apply in Germany in the summer of 2023.

How to define ESG risks – and their inclusion within the capital adequacy regime and the Supervisory Review and Evaluation Process (SREP) – is still the subject of intensive discussion. In the draft CRD VI/CRR III banking package currently being coordinated, the European legislator is defining ESG risks for the first time. EBA was also tasked with developing guidelines for factoring in ESG risks. 2022 saw the ECB concentrate on climate-related and environmental risks in its thematic review and conduct its first major climate risk stress test (CST) at all major EU banks (significant institutions – SIs).

19 December 2022 marked the publication in the EU Official Journal of the Implementing Technical Standard (ITS) on ESG disclosure in the regulatory Pillar 3 report, according to which large listed CRR credit institutions have to disclose information on ESG risks every six months. The CRR III is likely to expand the scope of application. Further regulatory requirements were announced by the European Banking Authority in its Roadmap on Sustainable Finance on 13 December 2022.

The Corporate Sustainability Reporting Directive (CSRD) was published in the EU Official Journal on 16 December 2022. Detailed reporting standards (European Sustainability Reporting Standards, ESRS) are under development to accompany the Directive. The International Sustainability Standards Board (ISSB) will also be finalising the first set of sustainability reporting standards in the near future.

ESG-related financial instruments are increasingly gaining importance within financial reporting. Based on the current requirements stipulated in the International Financial Reporting Standard IFRS 9, a large part of these financial instruments runs the risk of no longer being able to be measured at amortised cost. This would require fair value measurement, with corresponding earnings volatility. Last but not least, the European Commission also published the draft EU Corporate Sustainability Due Diligence Directive (CSDDD) at the end of February 2022. The European Commission has announced a legislative initiative on ESG rating providers, which is due on 13 June 2023.

the topic of ESG risks; we particularly advocate longer implementation periods, as appropriate procedures and methods still have to be developed. In addition, we advocate that the regulatory capital requirements for credit risk be based solely on the default risk associated with a loan. There is no empirical evidence at present to suggest that "green" loans entail a lower, and "brown" loans a higher default risk.

- **We** support a Federal Government guarantee framework for sustainable financing.
- **Taking** into account the level of detail and needs for adjustment of internal processes, we consider the timeline for CSRD and ESRS implementation to be ambitious. In addition, a stronger alignment with international initiatives should continue to be sought. We strongly support the calls made by European Commissioner McGuinness to prioritise the guidelines for existing requirements and prevent overlapping consultation processes.
- **We** demand harmonisation of the requirements for sustainable products under the SFDR and the Delegated Regulation on MiFID II. The varying structures are complicating uniform disclosure and product design, and the differing application dates for the individual regimes should be brought closer into line with each other, particularly since it is still the case that not all relevant ESG data is available.
- **We** call for a separate International Accounting Standards Board (IASB) project to take up ESG topics for financial instruments as soon as possible. We propose applicable accounting provisions to be amended to the extent that recognition at amortised cost is also permissible for ESG-related financial instruments under certain criteria yet to be defined.

2 Promotional business in the midst of the energy crisis

In 2022 it became apparent that the Ukraine war would result in significantly higher energy prices for both businesses and consumers. To relieve pressure on businesses and private households, the Federal Government capped prices for electricity and gas, and created a special aid package for cases of hardship. A total of €3.8 billion is available for support payments to small and medium-sized enterprises (SME), cultural institutions and consumers. Strict criteria apply to any payments: companies have to demonstrate that their energy prices have gone up by a factor of three, for instance, and that their business is particularly energy-intensive. Consumers who heat their homes with oil or pellets must provide evidence of how much their energy expenses have risen year on year, and the difference is then subsidised.

> Promotional banks again prove to be strong partners, but still need backing from the Federal government and states.

Out of the 17 state-owned promotional banks, 13 have currently been mandated by their state governments to dispense energy subsidies to companies experiencing hardship (€1 billion total volume). Many of the federal states have also defined additional funding criteria, such as negative cash flow, in order to be sure that the companies are really suffering hardship. The number of applications has been significantly lower than originally forecast as a result. At the same time, the banks have spent a great deal of time and money to program IT systems for logging and processing the applications in digital form. To avoid this, the VÖB had repeatedly called on the Federal Government to provide a standardised, nationwide IT solution for implementing the hardship subsidies. In addition, and in contrast to the situation for companies, the promotional banks are expecting large numbers of applications by private households (€1.8 billion total volume), ranging from several hundred thousand to two million applications depending on the federal state. Coming after the COVID-19 support payments, this could represent another programme of mass subsidies. As of today, five of the 17 state-owned promotional banks will be processing the support payments to consumers on behalf of their Federal State.

Finally, some promotional banks are also responsible for disbursing the federal subsidies for the culture sector (€1 billion total volume). In almost all federal states the promotional banks are also busy with the time-consuming final audit of the federal COVID-19 support payments.

OUR POSITION

- **We** appeal to the Federal and state governments to join forces and give the promotional banks all the support they need. This is the only way that all policymakers will continue to be able to rely on the promotional banks as strong partners for the implementation of future emergency aid programmes.
- **We** call for the creation of centralised IT solutions at the federal level whenever programmes of mass payments are set up to cope with crises. Otherwise, the promotional banks should receive support to maintain the kind of responsive IT structures that are also capable of managing programmes set up by individual federal states.
- **We** demand uniform nationwide audit principles and standards for auditing the final federal COVID-19 support payments. This is the only way in which the promotional banks can cope with the work within a reasonable period of time and at the same time invest in capacities to disburse the energy subsidies. The VÖB and the promotional banks have drawn up a joint proposal for such standards. The Federal and state governments should actively support the promotional bank’s harmonised approach. Furthermore, the federal task force for COVID-19 support payments at the German Federal Ministry for Economic Affairs and Climate Action could support the promotional banks with the group audit.
- **We** advocate a digital archival solution, provided by the Federal Government, for all documents relating to COVID-19 support payments, for the period of ten years for which by law they must be kept on file. The promotional banks must have legal certainty in this area, since follow-up work related to the federal COVID-19 support payments (recovery, appeals, litigation, fraud) will be required at the same time as the work to distribute energy subsidies, and may continue until 2026/2027.

NEW

3 Green Bond Standard

While green bonds have become more attractive in recent years, they only represent a fraction of the total bonds issued in the EU (4% in 2020). According to the European Commission, this is due primarily to the lack of harmonised, legally binding criteria that green bonds have to meet. This situation is now set to change with the establishment of an EU-wide Green Bond Standard (EuGBS) to serve as the very highest seal of quality in this market segment. The Standard aims to create a reliable framework for investors and, at the same time, to combat greenwashing by having an external reviewer monitor compliance with the stringent requirements.

A brief overview of the main characteristics of the EuGBS is provided below:

- Bond issuers remain responsible for deciding whether to use the EuGBS label, meaning that other market standards – like the ICMA Green Bond Principles – can continue to apply alongside the EuGBS.
- The standardised reporting formats that the Standard provides for are also to be available to other sustainability-oriented bonds that are labelled "green" but do not meet the EuGBS (e.g. sustainability-linked bonds).
- In contrast to the European Commission's original proposal, issuers are to be able to use up to 15% of the issue proceeds to finance economic activities not yet covered by the EU Taxonomy (flexibility pocket approach).
- The EuGBS is only to apply after a twelve-month transition period starting at the time of publication in the EU Official Journal.
- A seven-year grandfathering period will apply to green bonds that have already been issued.

The establishment of the EU Green Bond Standard is designed to heighten investor interest in sustainable investments.

The trilogue negotiations proved particularly difficult due to various differences of opinion regarding key features of a EuGBS label. The provisional agreement reached on 28 February 2023 marked the conclusion of these negotiations. The final version of the EuGBS Regulation still has to be (formally) adopted by the European Parliament and the European Council. The provisional date for the first plenary debate in the European Parliament is 12 June 2023. We currently do not expect the EuGBS Regulation to be published in the EU Official Journal before the fourth quarter of 2023.

OUR POSITION

- In general, our stance on the introduction of an EU-wide green bond label is a very positive one. It remains to be seen how much interest capital market investors will show once the new EU label has been introduced.
- We support the voluntary nature of the standard. We believe that the introduction of a mandatory EuGBS would trigger a flight into other bond formats with less stringent quality criteria (e.g. ESG-linked bonds, which would undermine the objective of a greater standardisation of green bonds.
- Throughout the legislative process, we repeatedly advocated for full grandfathering to ensure that investors can rely on bonds that are issued as green bonds keeping this green labelling for their entire term, irrespective of any subsequent adjustments to the taxonomy criteria. While the compromise reached, namely a seven-year grandfathering period, does not comply with our request in full, it does represent an improvement on the European Commission's original proposal.
- We consider 100% compliance with the EU taxonomy to be an unrealistic goal, particularly right after the EuGBS introduction. As a result, we welcome the flexibility granted, namely the option of investing up to 15% of the proceeds from a EuGBS in sectors not yet covered by the EU Taxonomy.
- We will advocate for further necessary details and practical solutions at Level 2.

4 Implementation of Basel III in the EU

In October 2021, the European Commission adopted its legislative proposal on the implementation of Basel III in the EU. The new regulations are currently being discussed between the European Council and the Parliament as part of the trilogue negotiations; they are to apply as of 1 January 2025. The Commission's proposal is recognisably marked by the intention to limit negative implications of the new rules upon institutions – and thus on the real economy. Specifically, it is intended to mitigate the negative implications of the output floor by allowing model banks to make use of certain relief measures when calculating capital requirements according to the regulatory standardised approaches. The Commission plans to retain many existing specifics in place from the implementation of earlier Basel standards in the EU. Specific capital buffers which, according to the Basel Committee, do not have to be included in the output floor, are not set to increase as a matter of principle. Last but not least, the Commission wants to grant institutions more time to implement regulations which impose a burden upon them.

Ensuring that European specifics are taken into account when implementing Basel III.

OVERVIEW OF BASEL III

Credit risk	▪ Revision of the Credit Risk Standardised Approach (CRSA) ▪ Revision of the Internal Ratings-Based Approach (IRBA)
Operational risk	▪ Introduction of a newly developed standardised approach ▪ Abolition of all alternative approaches
CVA risk	▪ Revision of the standardised approach ▪ Introduction of a basic approach ▪ Abolition of the internal model approach (IMA-CVA)
Market risk	▪ Revision of the standardised approach ▪ Revision of the internal model approach
Output floor	▪ Under the standard approaches, model banks must observe the 72.5% output floor for their RWAs ▪ Gradual introduction over a five-year period
Leverage Ratio	▪ Introduction of an add-on for global systemically important banks (G-SIBs) ▪ Revision of the framework

Source: Bundesverband Öffentlicher Banken Deutschlands, VÖB

According to Deutsche Bundesbank's calculations, the new regulations would still increase capital requirements for German banks by more than 10% after the transitional rules expire. This is likely to disproportionally hit banks that use internal models for calculating their capital requirements. Abolition of the ‘country of domicile' principle may pose a significant threat to exposures of promotional banks to credit institutions which are passing through loans. This could negatively impact the promotional business in Germany.

OUR POSITION

- **We** welcome the EU Commission’s proposed package of measures, which significantly reduces the increase in capital requirements compared to a non-modified implementation of Basel III. To avoid burdens for the real economy and banks, it is crucial not to dilute the proposed relief measures in the forthcoming legislative process.
- **We** advocate that the new regulations concerning treatment of exposures from banks should not impede the promotional business. As a result, the transposition process should keep the current risk weight for exposures of promotional banks to other banks that do not have an external rating.
- **We** are convinced that environmental aspects should only be taken into account in capital requirements where there is a sufficient empirical basis for doing so. In this respect, it will be interesting to read the corresponding report of the EBA. The link proposed by the European Parliament between the infrastructure supporting factor and the Taxonomy Regulation would increase the financing costs for key infrastructure projects and create competitive disadvantages compared with insurance companies.
- **Our** view is that the sharp increase in capital requirements for securitisation due to the output floor should be lowered until the planned revision of the securitisation rules has been completed. With this in mind, we support the European Parliament’s proposal, namely that the “p factors” be halved when calculating the output floor.

5 MiFID Review/Retail Investment Strategy

The review of the Markets in Financial Investments Directive (MiFID II) is going to be resumed in May 2023, when the European Commission presents its first proposals for legislation as part of its Retail Investment Strategy (RIS). However, talks about the substance of individual topics such as the possibility that commissions will be banned have been ongoing for some time now.

In practice, since the last MiFID review some of its provisions have repeatedly prompted private customers and institutional clients to complain about the abundance and redundancy of information, which has led to overly complex processes in the securities business overall.

In order to mitigate the consequences of the COVID-19 crisis, the "MiFID Quick Fix" removed some initial bureaucratic requirements, particularly for the product governance area and securities transactions executed with professional clients and eligible counterparties. The comprehensive MiFID II review was originally intended to provide further relief, but there is currently a risk of new requirements that could make the securities and capital markets business significantly more complicated. The Commission could tighten the rules on commissions, for instance, or even propose a complete ban on commissions in the context of MiFID. In connection with its RIS the Commission is also discussing further proposals like the Personal Investment Plan or the value-for-money approach.

The MiFID II review is an important issue for investors and the financial industry alike. It should cut through red tape, however, and not introduce more.

In view of the ESG regulations, some MiFID provisions have already been added in advance, which are applicable as of August and the end of November 2022 respectively. Rules for investment advice and asset management have been amended, as have the product governance requirements for issuers. Issuers now have to identify sustainability factors in their processes and also assign corresponding information on their products to a target market, which must then be communicated to the sales units. In addition, the ESMA recently revised the details of general product governance requirements, such as the definition of target markets, which may call for adjustments in practice.

OUR POSITION

- **We** advocate continuing along the path that began with the MiFID Quick Fix, and providing further relief for the securities business in the course of the MiFID review.
- **We** caution against the introduction of wide-ranging new rules. This particularly relates to stricter rules on commissions or the introduction of a value-for-money approach. The latter would further complicate the securities business and the related back-office processes. Commissions, by contrast allow a vast range of investment services, such as investment advice, to be offered to retail clients – so also to people on low and middle incomes – across the board. The rules currently in place ensure very high levels of transparency and avoid conflicts of interest. Any tightening or even bans in this area could mean that investment advice can only be offered on a very limited scale. This would be highly regrettable, since the ESG regulations and the capital markets union are actually intended to bring more investors into capital markets, for which investment advice is an urgent requirement.
- **With** a view to the ESG provisions, we oppose excessive detail on the secondary legislation level regarding the product governance provisions and rules for advisory services. At present, clients are already obliged to gather a plethora of information and make a lot of decisions. In our opinion, further requirements would increase the risk of leaving clients behind. The general product governance rules should not be overloaded any further either, since they have performed well in practice.

6 EU Listing Act

European companies often choose to go public outside the EU due to the complex and time-consuming listing processes. This preference indicates that European capital markets are utilized less compared to the capital markets of some of their main international counterparts. In response to this issue, the EU Commission introduced the Listing Act on December 7, 2022. The purpose of this wide-ranging package of measures is to simplify and streamline the rules governing initial public offerings and the public listing of European companies.

> The European Commission has proposed reforms to simplify aimed at simplifying listing requirements to enhance European companies access to capital markets.

The Listing Act comprises inter alia two directives and one regulation, which propose various amendments to the Prospectus Regulation. These amendments encompass several key aspects, including the introduction of exceptions for share issuances without a prospectus, the adoption of a standardized format for prospectuses and summaries, the implementation of a more efficient review and approval process, and the replacement of the EU recovery prospectus with the EU growth issuance document. Furthermore, the Act proposes replacing the simplified disclosure regime for secondary issuances with the EU follow-on prospectus. Overall, the proposed changes to the Prospectus Regulation appear to be broader in scope than initially anticipated.

In addition, the Listing Act includes amendments to the Market Abuse Regulation (MAR). These amendments address various areas such as the scope of application, treatment of inside information, maintenance of insider lists, conduct of market soundings, and reporting of directors' dealings.

OUR POSITION

- **We** believe the EU Listing Act goes well beyond the minimally invasive approach that we advocate, even if the general thrust of many of the proposed changes to the Prospectus Regulation is correct. A complete overhaul of the tried and tested EU prospectus regime could result in additional costs for issuers.
- **We** support the additional planned exemptions from the obligation to produce a prospectus. The same applies to the proposal to turn transitional rules for the obligation for financial intermediaries under Article 23 of the Prospectus Regulation to notify investors if a supplement is published into a permanent regulation, although we believe that modifications are required here.
- **We** are critical of the Commission's "one size fits all approach" in attempting to largely standardise prospectuses without considering the specifics of each issuer. Prospectuses are documents for which issuers are liable. Thus, we believe that issuers should be generally allowed to design and structure at their discretion. Otherwise, additional liability risks and costs could emerge.
- **We** welcome simplifying EU rules on curbing market abuses as well as clarifications on the scope of the obligation to publish inside information. However, further alleviations might be needed.

NEW

7 Future Financing Act

With the publication of the draft bill for a Future Financing Act (Zukunftsfinanzierungsgesetz – ZuFinG) on April 12, 2023, the two coordinating German federal ministries, the Federal Ministry of Finance (BMF) and the Federal Ministry of Justice (BMJ), have initiated a comprehensive set of measures aimed at modernizing the capital market and facilitating access to capital markets for companies. In addition to specific capital markets legislation, the proposed changes also affect national corporate and tax law. The following proposals are particularly relevant for capital markets:

- Certain licensable financial transactions between banks are to be exempt from the fairness test of the general terms and conditions used. This is important because the terms and conditions used by one business entity in its dealings with another are also subject to the fairness test. The sector-specific exemption aims to promote the use of standard contractual clauses.
- German securities law shall now also open up for electronic shares. Public limited companies will have the choice in future of issuing shares as either paper-based or electronic shares under the Electronic Securities Act (Gesetz über elektronische Wertpapiere – eWpG). In the case of electronic shares, the registration in an electronic securities register replaces the paper certificate. However, according to the draft bill, only registered shares can be issued in both forms – as a central register entry and as a crypto security. The second option is not available for bearer shares: they can only be issued as electronic bearer shares in central registers and not as crypto securities. This is justified by concerns related to money laundering.
- A segregation of assets requirement will be introduced for crypto custody and the possibility of ringfencing crypto assets held in custody in the event of the custodian's insolvency will be legally established.

According to cabinet planning, the Future Financing Act is scheduled to come into effect by the end of 2023.

> Financing the future or how to improve possibilities for futureproof investments. With the new Future Financing Act, Germany's Federal Government sets ambitious targets for capital markets regulation.

OUR POSITION

- **We** welcome the exemption of general terms and conditions certain used in certain licensable financial contracts from the fairness test. However, this can only be the first step towards greater legal certainty. The personal, substantive and temporal scope of the exemption can lead to practical application problems. The proposed rule is not sufficient for bonds either.
- **We** fully support the extension of the Electronic Securities Act (eWpG) to include electronic shares. It may be necessary to reconsider the ban on issuing bearer shares as crypto securities.
- **We** welcome the proposed changes to safeguard customer rights in the insolvency of crypto custodians. Until now it has only been possible to achieve the same level of legal certainty by analogously applying the rules on fiduciary duties. The proposed statutory provisions establish a clear legal basis for claims and eliminate the need for recourse to analogy and the associated examination steps

8 Combating money laundering in the EU

On 20 July 2021, the EU Commission presented a package of measures to harmonise and strengthen the fight against money laundering at EU level. The package comprises four legislative measures.

> EU package of measures to harmonise and strengthen the fight against money laundering and the financing of terrorism.

Plans include the creation of a new European supervisory authority to combat money laundering and the financing of terrorism, to be known as the Anti-Money Laundering Authority (AMLA). AMLA is intended to directly supervise credit institutions with significant cross-border activities and a higher risk profile.

The draft AMLA-regulation stipulates for example, that institutions to be supervised by AMLA have branch offices in at least seven member states. In these cases, European supervision would replace national supervision. Aside from that, AMLA is intended to provide indirect supervision by coordinating and monitoring the activities of the national authorities. Another task will be the provision of regulatory standards and guidelines.

A Regulation on Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT Regulation) is intended to tighten up the rules, especially regarding customer due diligence, and make them directly applicable in all member states. However, Level-2 measures are pending in many regulatory areas, which need to be devised by the AMLA. The sixth Anti-Money Laundering and Countering the Financing of Terrorism Directive will primarily include rules on national supervisory authorities and Financial Intelligence Units (FIUs).

Finally, the existing Transfer of Funds Regulation is amended and provisions on crypto transfers added. The Council has adopted a (partly preliminary) common position on the drafts of the AMLA Regulation, the AML Regulation and the AML Directive. A preliminary agreement has already been reached between the European Parliament and the European Council on the Transfer Regulation.

OUR POSITION

- **We** generally consider the creation of a European Anti-Money Laundering Authority and the associated harmonisation of standards as positive, as long as responsibilities are clearly defined and duplicate payment obligations avoided. National authorities must remain capable to act. From our point of view, it is important that credit institutions which operate primarily at the national level are supervised by national authorities.
- **We** advocate an urgent efficiency review of the new requirements. A series of stricter requirements would lead to significantly increased expenditure without improving the fight against money laundering and terrorist financing.
- **We** welcome the fact that the Council has spoken out in favour of the wider possibility of outsourcing.
  Any ban would deprive smaller institutions of drawing on the services of specialised third parties.
- **We** support the Council's principle of using the 25% ownership threshold as a basis for identifying the beneficial owner. However, we are critical of the complexities involved in identifying beneficial owners. Insofar as bearer instruments are viewed critically, we welcome the fact that the Council regards bearer instruments as permissible provided they are held via a depositary or are admitted to trading on a regulated market.
- **We** caution against waiting for AMLA to further specify the AML/CMF Regulation's provisions through regulatory standards, as this would counter a swift implementation of the issued by new rules.

9 Revision of the macroprudential framework

Banking regulators have numerous macroprudential instruments at their disposal to prevent potential stability risks in the financial system: first and foremost, capital buffers such as the capital conservation buffer, the countercyclical capital buffer, and the capital buffer for systemic risks, which strengthen banks' equity capital base.

The macroprudential framework was introduced in 2013 as a reaction to the financial markets crisis, and is now being revised for the first time. The European Commission is to review whether the applicable selection of instruments is effective and sufficient, or whether further instruments are required. Other aspects to be examined include the interaction of capital buffers with other regulatory requirements, such as the leverage ratio, and the question of how to make better use of buffers, and associated challenges.

Last but not least, the Commission is to review whether the macroprudential instruments would be suitable to address further risks such as climate or cybersecurity risks. The Commission will discuss matters with the European Banking Authority (EBA), the European Systemic Risk Board (ESRB), and the European Central Bank (ECB). The European Commission had originally planned to present its legislative proposal at the end of 2022. The revision of the macroprudential rules is now being postponed until the next legislative period. As a first step, a report on the review of the framework is to be presented in the second half of 2023.

> The revision of provisions should be comprehensive and capital-neutral; it should not be accompanied by increased capital buffer requirements.

As a result, the European Commission plans to incorporate selected aspects into the ongoing legislative process for the EU Banking Package (CRR III/CRD VI). In particular, the proposals include the option of setting a "positive cycle-neutral countercyclical capital buffer (CCyB) rate" on a voluntary basis. This is designed to create a situation in which the buffer, which was originally designed to be cyclical, can be set at up to 2.5% in the long term, irrespective of the actual economic cycle. It remains to be seen whether the European Commission will succeed with its endeavours given how advanced the negotiations are.

OUR POSITION

- **We** support the review of the applicable macroprudential framework. In our view, it is important that the focus lies on the instruments' methodological weaknesses, instead of the imposition of higher capital requirements upon banks.
- **We** advocate that the revision of provisions be comprehensive and capital-neutral. A more flexible buffer release or potential cover of further risks must not be associated with higher capital buffer requirements. This also applies, in particular, with a view to the European Commission's proposed option of setting a positive cycle-neutral countercyclical capital buffer rate on a voluntary basis. This would be tantamount to an increase in capital requirements across the board.
- **We** advocate a simpler and more flexible macroprudential framework.
- **We** are also in favour of the number of capital buffers being reduced. The capital conservation buffer should be combined with the countercyclical capital buffer to form a new releasable capital buffer.
- **We** furthermore call for elimination of European special requirements such as the capital buffer for systemic risks, and for application of uniform provisions for determining the buffer height for otherwise systemically relevant institutions in the EU.

10 The digital euro firmly establishes a sovereign payment method

The European Central Bank (ECB) intends to conclude the digital euro (D€) project in autumn 2023, which will provide specific details about the digital euro including a specific digital euro payment method. The digital euro not only goes well beyond the original objectives but also harbours substantial risks.

The ECB has been investigating a digital euro since the end of 2021. The project is scheduled to run for two years and should facilitate a fundamental decision about a digital euro at the end of 2023. The ECB wants to establish a sovereign digital euro payment method with the digital single currency. In doing so, it goes way beyond introducing an additional form of central bank money and wants to compete with the payment methods currently offered by the private sector. At the same time, the EU Commission will make a proposal for supporting all forms of legal tender, which will probably make it mandatory for all banks and traders to support the digital euro and digital euro payment method. This statutory obligation would massively distort competition between the sovereign digital euro and private sector payment methods. The ECB does not take sufficient account of the risks of the digital euro and trivialises them to a certain extent. A study shows that an average of 500 digital euros held on deposit already leads to a shortfall in cover among the first banks, while an amount of 3,000 digital euros spreads the shortfall across a great many small and medium-sized banks. BaFin will therefore have to deal with liquidity bottlenecks because of the digital euro. However, this does not replace the need for an analysis by the ECB about possible disruptive effects on the European economy. The ECB is vehemently in favour of the digital euro, which will lead to a substantial change in the monetary and banking system. The central banks were always cautious in the past about making changes, to avoid creating any unwanted distortions. This principle apparently does not apply to the digital euro, as the political pressure to introduce this payment method is huge. The central banks are seeking constructive dialogue with the banking industry. However, what is needed is a broad, public debate about the benefits of a digital euro, not least because of the possible risks involved. In addition, the digital euro will create huge costs for the European economy. There is currently no evidence of a business case, which counteracts investments in innovative projects. Conversely, industry is specifically asking for token-based payment methods that can be integrated in their distributed ledger technology (DLT). This is why the banking industry is exploring the concept of tokenised commercial bank money (CBMT) that meets the needs of the market.

OUR POSITION

- **We** are calling for a broad public debate about the actual benefits of the digital euro, in which the impact on and the costs for all market participants, and not least for consumers, are considered.
- **We** caution against establishing a sovereign digital euro payment method and not just providing a payment instrument as with cash, which skews competition with private sector payment methods. The absence of a level playing field weakens the position of European financial institutions among their global competitors.
- **We** are concerned that ultimately a digital euro will have a macro-economic impact, arising from disruptive consequences for banks and savings bank with regard to liquidity, lending opportunities and stability. We therefore believe it is imperative for the ECB to have an independent third party conduct an analysis of the disruptive effects of a digital euro.
- **We** demandstrict compliance with the ECB's current monetary policy mandate as a top priority. Policymakers and the ECB must create the conditions for the digital euro that will facilitate rather than hinder innovations in the financial market.
- **We** deem it necessary for the ECB to issue a digital euro as a "raw material" that payment services providers can refine in line with market standards. Payment services providers must be able to freely design wallets and services, which is why it is vital to separate the roles of central banks and commercial banks.
- **We** expect the digital euro to facilitate business models for all market players and not be restricted by free basic services. This is the only way of creating services that are in line with market requirements.
- **We** support a maximum deposit limit in a low triple-digit million euro range. We reject the concept of offering a positive interest rate as an incentive to deposit euros in the digital euro wallet. On the other hand, we do not consider it necessary to impose a transaction limit.

11 Regulation of instant payments

The EU Commission wants instant payments to become the new normal and a driver of innovation for the EU economy. But interest among market participants is muted. In the absence of any market failure, there is no legitimate basis for regulatory intervention. While there are areas in which instant payments can open up new potential, it is up to the market to choose the appropriate payment instruments. Institutions are being forced to be reachable for instant payments and make instant payments available to their customers across all channels that offer SEPA standard credit transfers.

Limiting the obligation to banks that already offer credit transfers for payment account holders makes sense as it avoids unnecessary expenses at banks that offer a different business model, such as promotional banks. The exemption applies where no payment accounts are maintained for customers.

The regulation of instant payments constitutes a significant intervention in the right to set prices freely, since the fees for instant payments may not exceed those for SEPA transfers. This runs contrary to the need for investment in new infrastructure. The transitional deadlines of six months (passive) and twelve months (active) for the introduction of instant payments are much too tight and do not allow adequate time for the regulation to be effectively implemented. In order to prevent fraud, banks are required to check whether the beneficiary's name and IBAN match. Yet this cross-check only serves to reduce a particular kind of scam and has no effect in the majority of fraud cases. Since there is no EU-wide system in place, legislation must grant significantly longer deadlines to apply the new rules.

The EU Commission put forward a legislative proposal on instant payments in October 2022 requiring banks to actively and passively support instant payments.

In view of allegedly high fraud rates with instant payments, the European Commission wants to restrict the sanctions check to the payer. According to the draft, payees may not be checked for sanctions and the payments may not be filtered. Not filtering instant payments eliminates an essential check that has proven to be necessary in practice.

OUR POSITION

- **We** demand that banks are not forced to offer active and passive instant payments. There is no market failure that would justify regulation.
- **We** welcome that the obligation to support instant payments will not apply to banks that do not offer payment accounts or credit transfers to their customers. This typically applies to promotional banks.
- **We** believe it is necessary for customers to be able to choose their payment instruments themselves, because instant payments are not suitable in all cases. The market has in fact already found a solution. In particular, the bulk processing of instant payments only makes sense with special processes and is not generally economically or environmentally viable.
- **We** believe that applying the same pricing as for standard credit transfers is unreasonable, because it does not reflect the effort and expense involved in instant payment methods. A one-size-fits-all pricing model curtails banks' freedom to define their own products and prices. It also discourages investment and price transparency.
- **We** demand that the transitional periods of six months (passive) and twelve months (active) be increased to 36 months. This is the only way to ensure that the regulation is implemented effectively.
- **We** reject a statutory obligation to check whether the IBAN matches the name. Providing customers with an opt-out option is not sufficient. At best, only a small percentage of the fraud being committed today can be prevented. The effort and expense involved are disproportionately high compared with the benefits. Besides, there are unresolved legal questions about data protection that need to be answered. If the general obligation is maintained, the transitional periods must be extended significantly.
- **We** are calling for banks to be allowed to apply sanctions lists from other jurisdictions. This applies to payees in particular. The penalties must be significantly reduced and brought into line with similar legislation.

12 Requirements for banks' IT systems and EU regulation of DORA

> The Digital Operational Resilience Act (DORA) entered into force in early 2023.

High levels of cyber resilience and information security are central supervisory and legal requirements for ICT infrastructures in the financial sector. The Digital Operational Resilience Act (DORA), a legislative proposal put forward back in autumn 2020 to strengthen the digital operational resilience of the financial sector, affects almost all financial entities, not just banks.

The regulation entered into force via a lex specialis exemption in January 2023. All elements will apply from the beginning of 2025. The European Supervisory Authorities (ESAs) are currently developing draft Level-2 regulatory technical and implementation standards and guidelines. The drafts are expected by the middle of this year. The EU regulation includes a wide range of regulatory areas, in particular for ICT (information and communication technology) risk management, ICT incident reporting and impact analysis, cyber security testing, ICT third party risk management, and cyber threat information sharing and incident reporting.

It also stipulates a supervisory framework for critical ICT service providers, such as major cloud providers. DORA has assigned the European Supervisory Authorities (ESAs) with providing specific (technical) regulatory standards (ITS/RTS) for some of the requirements. These will also serve as an important prerequisite for their implementation at banks and service providers.

OUR POSITION

- **We** would like to emphasise that the principle of proportionality embedded in the proposed regulation DORA must be fully taken into account in all the supervisory standards to be implemented. In the absence of such an action, the planned regulations would apply equally to all banks – and without sufficient consideration of individual circumstances – thus incurring disproportionate additional burdens.
- **We** advocate DORA as a "lex specialis" for the financial sector, so that the existing burdens resulting from dual and multiple regulation, such as the planned harmonisation of the reporting system, can be eliminated in the future. This will be achieved when, for example, reports on significant security incidents only have to be sent to one supervisory authority in future. Smaller banks must also have the option of conducting cyber-resilience assessments in-house so as to minimise the huge administrative burden this entails.
- **We** are in favour of clearly-worded requirements that provide simplification in the handling of ICT security risks and IT outsourcing, while adhering to the principle of proportionality. We see the potential to relieve the banking industry of some of its critical responsibilities by providing optional certification for selected IT products and services (for example, cloud services in the case of outsourcing).
- **We** support the European Commission's plan to define a supervisory framework for critical ICT service providers, especially for major international cloud service providers. It is imperative that this goes hand in hand with regulatory relief for financial institutions, by requiring service providers, for example, to provide proof that in rendering their services they comply with the requirements.

Promotional banks in Germany

1 Landesförderinstitut Mecklenburg-Vorpommern – Division of NORD/LB
Total assets: €1.0 billion (2021)
→ www.lfi-mv.de

2 Investitionsbank des Landes Brandenburg
Total assets: €14.9 billion (2021)
→ www.ilb.de

3 Sächsische Aufbaubank – Förderbank
Total assets: €9.0 billion (2021)
→ www.sab.sachsen.de

4 Investitionsbank Schleswig-Holstein (IB.SH)
Total assets: €21.4 billion (2021)
→ www.ib-sh.de

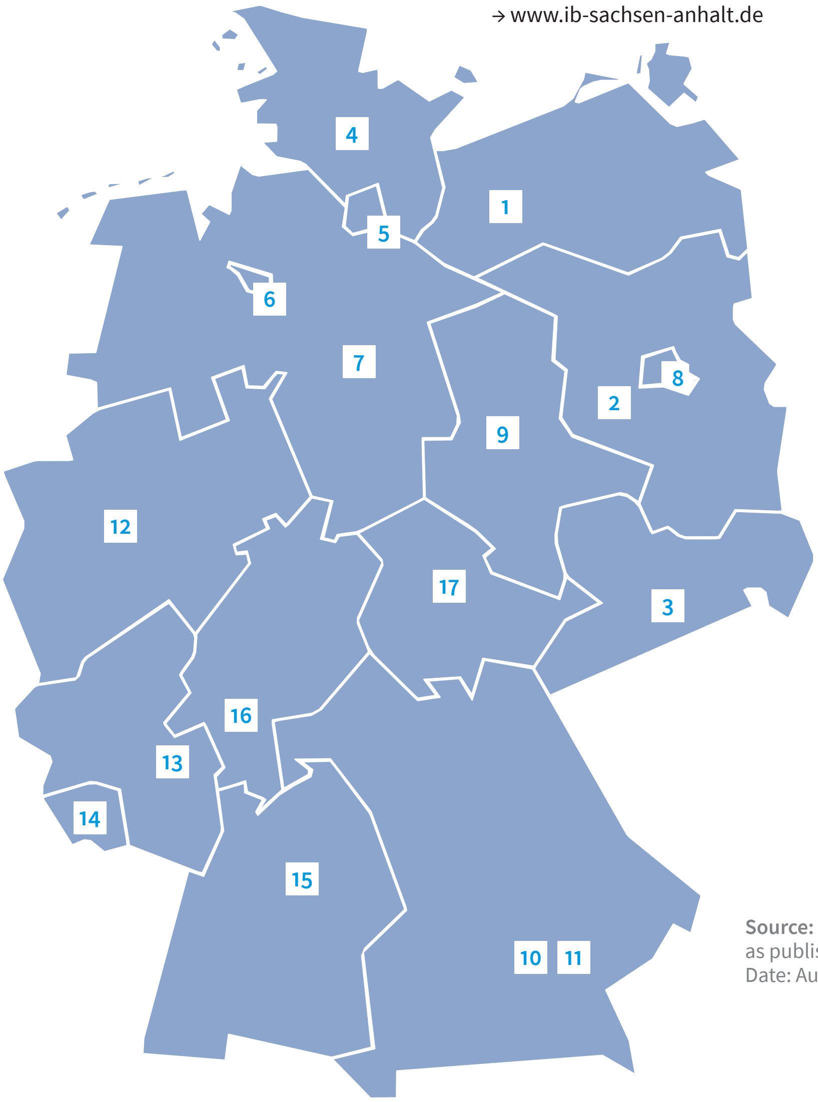
5 Hamburgische Investitions- und Förderbank
Total assets: €6.3 billion (2021)
→ www.ifbhh.de

6 Bremer Aufbau-Bank GmbH
Total assets: €1.0 billion (2021)
→ www.bab-bremen.de

7 Investitions- und Förderbank Niedersachsen – NBank
Total assets: €5.0 billion (2021)
→ www.nbank.de

8 Investitionsbank Berlin
Total assets: €20.8 billion (2021)
→ www.ibb.de

9 Investitionsbank Sachsen-Anhalt – Anstalt der NORD/LB
Total assets: €1.6 billion (2021)
→ www.ib-sachsen-anhalt.de



10 LfA Förderbank Bayern
Total assets: €23.6 billion (2021)
→ www.lfa.de

11 Bayerische Landesbodenkreditanstalt
Total assets: €21.1 billion (2021)
→ www.bayernlabo.de

12 NRW.BANK
Total assets: €153.1 billion (2021)
→ www.nrwbank.de

13 Investitions- und Strukturbank Rheinland-Pfalz (ISB)
Total assets: €9.2 billion (2021)
→ www.isb.rlp.de

14 SIKB Saarländische Investitionskreditbank AG
Total assets: €2.0 billion (2021)
→ www.sikb.de

15 L-Bank, Staatsbank für Baden-Württemberg
Total assets: €89.6 billion (2021)
→ www.l-bank.de

16 Wirtschafts- und Infrastrukturbank Hessen – legally-dependent institution within Landesbank Hessen-Thüringen Girozentrale
Total assets: €26.4 billion (2021)
→ www.wibank.de

17 Thüringer Aufbaubank
Total assets: €3.5 billion (2021)
→ www.aufbaubank.de

Public-sector promotional banks at Federal level

KfW Banking Group
Total assets: €551.0 billion (2021)
→ www.kfw.de

Landwirtschaftliche Rentenbank
Total assets: €95.5 billion (2021)
→ www.rentenbank.de

Source: Annual reports of the promotional banks, as published on the respective websites.
Date: August 2022

Landesbanken and DekaBank

NORD/LB Norddeutsche Landesbank Girozentrale
Total assets:
€114.7 billion
→ www.nordlb.de

DekaBank Deutsche Girozentrale
Total assets:
€88.9 billion
→ www.deka.de

SaarLB Landesbank Saar*
Total assets:
€16.2 billion
→ www.saarlb.de

Landesbank Hessen-Thüringen Girozentrale
Total assets:
€212.3 billion
→ www.helaba.de

BayernLB
Total assets:
€266.6 billion
→ www.bayernlb.de

Landesbank Baden-Württemberg
Total assets:
€282.3 billion
→ www.lbbw.de

* Consolidated financial statements in accordance with the German Commercial Code (HGB).

Source: own representations
S&P Global Market Intelligence database: Consolidated financial statements (in accordance with IFRS) as at 31 December 2021;
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