VÖB german public banks

Current Positions on the regulation of banks and the financial markets

NOVEMBER 2018

VÖB in Europe

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

BONN
- Regular exchange of views with BaFin
- Registered office of VÖB-Service GmbH subsidiary

BRUSSELS
- Eight local employees
- Regular contact with the European Parliament and the European Commission
- Member of the European Association of Public Banks (EAPB)

FRANKFURT/MAIN
- Regular exchange of views with Deutsche Bundesbank, the German Federal Financial Supervisory Authority (BaFin), and the European Central Bank (ECB)
- Five press conferences per year
- Eight member institutions represented locally

LONDON
- Liaison office
- Regular contact with the European Banking Authority (EBA) and the International Accounting Standards Board (IASB)

PARIS
- Liaison office
- Regular contact with the European Securities and Markets Authority (ESMA)
- VÖB representatives to ESMA's Stakeholder Group

Current VÖB positions on the regulation of banks and the financial markets

NOVEMBER 2018

IRIS BETHGE | EXECUTIVE MANAGING DIRECTOR

Dear readers,

If you expect appropriate decisions, you will have to make your point – clearly and concisely. As the voice of German public-sector banks – and therefore one of the top associations of the German banking sector – we are thus committed to providing comprehensive, transparent and factual information. Our mission is to inform readers about the most important legislative initiatives as well as regulatory requirements, on a regular and timely basis. Yet we also clearly voice our views and opinions, in order to successfully represent the common interests of our 61 member institutions, on a national and international level – and to support decision-making by politicians and regulators in a results-oriented and hands-on manner. We want to play our part in ensuring that Germany's financial markets are client-focused, powerful, and competitive.

This vision of who we are also characterises our “Current Positions on the regulation of banks and the financial markets”, where we cover the ongoing discussion on regulation in Germany and Europe as well as regulatory requirements for outsourcing, for example. We also advocate to continue the successful European Structural Fund aid and support for small and medium-sized businesses beyond 2020, during the EU's next budget period.

I hope you will find our current positions interesting reading. Together with my colleagues at our Berlin head office, I will be happy to answer any questions you may have.

Yours sincerely,

Iris Bethge
Executive Managing Director

OUR TOPICS

1 Regulation in Germany and Europe

Revision of the EU Capital Requirements Regulation (CRR II) and of the Capital Requirements Directive (CRD V)

Delay the implementation of new trading book rules – recognise capital instruments even where a profit and loss transfer agreement is in place – refrain from lowering the threshold for remuneration rules – ensure reasonable implementation of Basel IV in Europe – apply a sense of perspective when implementing the Leverage Ratio.

The European Commission submitted legislative proposals for a revision of the Capital Requirements Regulation (“CRR II”) and the Capital Requirements Directive (“CRD V”) in November 2016. The main purpose of CRR II is to implement requirements set out by the Basel Committee on Banking Supervision (“BCBS”). Moreover, the EU Commission proposes to reduce capital requirements for qualified infrastructure financings by a quarter. The so-called SME Supporting Factor, which reduces capital requirements for loans to small and medium-sized enterprises – also by about a quarter – is to be maintained.

The EU's Economic and Financial Affairs Council (“ECOFIN”) agreed upon a “general approach” for both dossiers at the end of May 2018. The ECON Committee of the European Parliament (which is responsible for this issue) adopted its report on the EU Banking Package in June 2018; trilogue negotiations are expected to be concluded before the end of the year.

Implementation of Basel IV in Europe

Given the advanced stage of revisions to the CRR and CRD IV, European legislators will no longer pick up the standards for finalising Basel III (so-called Basel IV), as published by the Basel Committee in December 2017. According to current planning, the EU Commission will present a proposal for Basel IV implementation in the beginning of 2020. Is is therefore uncertain as to whether these rules will be able to come into force in the EU as at 1 January 2022. The EU Commission has already called upon the European Banking Authority (EBA) to analyse – September 2019 at the latest – the impact of Basel IV. According to a first EBA estimate, based on data provided by the Basel Committee,

OUR POSITION EU BANKING REGULATION

- **We** advocate recognising common equity tier 1 instruments even where a profit and loss transfer agreement is in place. Even though under such agreements (commonly used in Germany), a subsidiary is under a general profit-transfer obligation, it is nonetheless able to recognise reserves, in accordance with commercial due diligence, and to withhold capital to fulfil regulatory requirements. Hence, there is no restriction on strengthening the required regulatory capital base.
- **We** believe that a credit conversion factor (CCF) of 20 per cent should be applied to minimum value commitments for investment funds. The EBA's proposal to apply a CCF of 100 per cent to such commitments would dramatically increase capital requirements for these commitments, especially in connection with so-called “Riester” pension plans. This would threaten the overall profitability of this state-supported private pension sheme.
- **We** call for a significant increase in the proposed thresholds for remuneration levels; we oppose any requirements for remuneration systems which are not directly related to a bank's operations.

banks within the EU will need to increase common equity tier 1 capital (CET1) by 16.7 per cent on average. Likewise, an impact study carried out by Deutsche Bundesbank for German institutions estimates a significant 23.7 per cent increase in CET1 capital. This means that the Basel Committee has missed its own objective of preventing a significant increase in capital requirements – at least for Europe. The increased capital requirements are driven in particular by the so-called output floor, which is designed to restrict the benefits of internal models.

Introduction of the Leverage Ratio

The non-risk-related Leverage Ratio, expressed as the ratio of a bank's tier 1 capital to the aggregate of all on-balance sheet and off-balance sheet items, serves to supplement the risk-related capital requirements. A minimum of 3 per cent was set for the Leverage Ratio. Discussions regarding the question as to whether domestic or other systemically important institutions should fulfil a higher Leverage Ratio are yet to be held. Certain items, such as pass-through promotional loans, guaranteed export credits and intra-group claims may be exempted from this risk measure – this also applies to public investment finance, provided that a development and promotional bank's criteria are fulfilled. One such criterion is the exclusion of accepting covered deposits, as defined in the EU Deposit Guarantee Scheme Directive (DGSD). The Council has proposed to specify this criterion, to the extent that non-acceptance of fixed-term deposits and savings deposits of private individuals would qualify for exemption – an adjustment also supported by the European Parliament. Besides the exemption of intra-group claims, the Parliament is discussing whether exposures within institutional protection schemes should be treated in the same way (as they are regarding risk-weighted assets). However, this is rejected by some member states in the Council. The frequency of calculating the Leverage Ratio is yet to be decided upon: the Commission as well as the Council suggest to calculate this on a quarterly basis. The Parliament proposed to introduce a daily calculation for assets, in order to prevent the ratio to be influenced for a given reporting date.

IMPLEMENTATION OF BASEL IV IN EUROPE

- We advocate a moderate implementation of Basel IV in the EU. In particular, the output floor should be adjusted. To mitigate its impact, standardised approaches should be re-calibrated in a risk-sensitive manner; increased capital requirements due to the output floor should be capped.
- We advocate postponing implementation of the Fundamental Review of the Trading Book (FRTB) until work on this issue has been concluded. Furthermore, the Committee has proposed a re-calibration of the standardised approach for market risk. A premature implementation of FRTB rules would restrict legislative scope. Moreover, it is essential that FRTB rules be implemented across all major financial markets, especially in the US.
- We hold the view that numerous well-justified EU exemptions for the banking sector should be maintained, even after Basel IV implementation: examples include the SME supporting factor as well as loan splitting and the 'hard test' for residential and commercial real estate loans.

LEVERAGE RATIO

- We advocate the exemption of pass-through promotional loans from the Leverage Ratio, retaining the Commission's CRR proposal.
- We demand that reference to the DGSD be deleted from the deposits criterion, and that a clarification be added that accepting covered deposits is only prohibited regarding deposits from private individuals. it would be virtually impossible to comply with a full legal exclusion, given the very broad definition.
- We oppose any add-on to the Leverage Ratio for domestic or other systemically important institutions (D-SIBs and O-SIIs, respectively), to prevent further restrictions being imposed on low-risk business models.
- We advocate the exemption of claims within IPS, in order to prevent discrimination against those structures.
- We consider a daily calculation to be inappropriate and advocate sticking with the Commission's proposal. Implementation would cause additional costs, and would diverge from the Basel Framework as well as from the calculation of other ratios – in the absence of any proof of the benefits of such a regulation.

2 Tailor-made regulation for development and promotional banks

Development and promotional banks should not be impeded by unduly stringent regulatory requirements concerning their economic policy activities. They should be exempted from EU financial market regulations; appropriate domestic supervision takes their special situation into account.

German development and promotional banks support their public-sector owners in fulfilling their socio-political goals. Because of their low-risk business models and extensive public-sector guarantees, development and promotional banks do not pose a threat to the stability of the financial markets.

Yet as the past has shown, European banking regulation does not take sufficient account of the special features of development and promotional banks. These regulatory requirements place heavy burdens on institutions, increasingly preventing them from fulfilling specified objectives in terms of economic, structural, and social public policy.

For this reason, and as part of the ongoing revision of the EU Capital Requirements Directive (CRD), the EU Commission has proposed that, subject to certain conditions, European development and promotional banks with a total assets of less than €30 billion can be exempted from CRD application by way of a Commission Delegated Act.

The ECOFIN Council has rejected an exemption by means of a Delegated Act, and has proposed to specify – by name – the development and promotional banks to be exempted in the CRD text. The Council wishes to exempt all independent German development and promotional banks from the CRD, regardless of their size. The ECON Committee of the European Parliament has argued for the possibility of also exempting larger development and promotional banks from the CRD, provided that their liabilities are fully guaranteed by their public owners. In the event of an exemption from the CRD, the development and promotional banks would be subject to a tailor-made domestic supervisory regime, and would be supervised by the German Federal Financial Supervisory Authority (BaFin) and Deutsche Bundesbank.

OUR POSITION

- **We** are in favour of exempting all legally independent German development and promotional banks from the CRD, and applying tailor-made domestic supervisory regulations.
- **We** aim to establish a domestic supervisory regime which will be established and refined as and when required, through dialogue between the German legislator and the supervisory authorities, as well as the development and promotional banks and their public-sector owners.
- **We** advocate that development and promotional banks should be exempted, regardless of their size. What sets them apart from commercial banks is not their size, but their low-risk business model, which focuses on a specific region. The size of a development and promotional bank is determined solely by the territory of its owner, and the public-sector development mandate awarded to the bank. Large economies therefore naturally have large development and promotional banks.
- **We** wish to point out that the financial and personnel burdens arising from supervisory and regulatory requirements tie up funds required to fulfil the development mandate.

3 Focus on sustainable financing in the Capital Markets Union

Sustainable or 'green' finance has evolved into the central project of the European Capital Markets Union. The idea is to increasingly direct capital flows to ecological and social investments, and to emphasise long-term thinking, through the sustainable orientation of the financial sector. The management of risks that are relevant to climate and environmental issues is to be enhanced, and environmental, social and governance (ESG) aspects given more weight in decision-making processes.

In March 2018, the EU Commission published an action plan on sustainable financing on the basis of its High-Level Expert Group. The first legislative proposals followed in March 2018. The key issues of the proposals are to introduce an EU-wide sustainability classification system (taxonomy), and to integrate ESG factors in the investment process as well as in risk management, including corresponding disclosure. Similarly, provisions for taking ESG aspects into consideration during the investment advisory process, and the structure of sustainability benchmarks, were also discussed. Proposals on 'green bond' standards and labels for 'green' financial products are expected to follow in 2019, and greater consideration should be given to ESG criteria in the rating process.

Definitions and the disclosure of sustainability risks, based on ESG criteria, and a corresponding extension of the Supervisory Review and Evaluation Process (SREP) are being critically reviewed at present. The EBA, which will likely assume responsibility, has called for caution, proposing to focus initially on an assessment of ESG factors. BaFin will soon also look into the issue as to how ESG risks can be appropriately taken into consideration in banks’ risk management systems.

We consider it essential to continue promoting market-based solutions in a European context – applying a pragmatic taxonomy for Green Finance products, and ensuring a sense of perspective concerning integration into risk management.

The recommendations of the FSB Task Force on Climate-related Financial Disclosures (FSB TCFD) on integration, management and disclosure of climate-relevant data also represent far-reaching changes that the EU Commission should address in the course of adjusting the CSR Directive. Disagreement exists about whether a 'green' supporting factor should be incorporated in the capital requirements applicable for duly qualified financial instruments.

OUR POSITION

- **We** welcome the objectives of Capital Markets Union, as well as the fact that the Commission recognises the material importance of bank financing for the economy. Moreover, the Commission does not restrict its scope to regulation as the only true guideline, but has expressed an interest in promoting market-based solutions.
- **We** are convinced that the common classification and standards for green and sustainable financial products will increase transparency for investors, reduce uncertainty among issuers, and contribute to market growth in the long term.
- **We** think it is right to focus, first and foremost, on the ecological dimension when developing a taxonomy. We are in favour of taking market initiatives into account and oppose excess regulation, allowing this nascent market segment to develop well, and to flourish. However, any capital relief may only be granted on the basis of measurably lower risks for 'green' loans.
- **We** think that the proposal put forward by the EBA to approach this topic on a step-by-step basis is the right way to go: only when a uniform approach concerning ESG factors has been adopted should consideration be given as to whether it makes sense to introduce the provisions for the SREP. The integration of ESG factors in risk management and disclosure will require a longer transformation period for banks. Moreover, such rules may also be applied to new business only.
- **We** believe that an ESG-based and non-product-specific disclosure to stakeholders should be made, in a transparent and harmonised manner, in the annual Non-Financial Statement. We find it premature to revise disclosure requirements after only one CSR reporting period.
- **We** are convinced that a sector-specific transition period, together with economic, environmental and fiscal policy support, are necessary to bring about a lasting change in the economy.

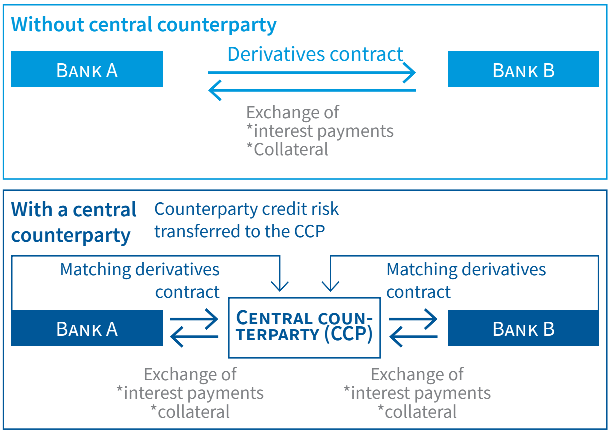
4 Brexit and the financial sector

Reach fair negotiation results – for the EU and the United Kingdom; move derivatives clearing to the euro area; strengthen the Frankfurt financial marketplace

The UK's exit from the EU is set to be completed by 29 March 2019. Since the conclusion of a comprehensive agreement governing the future relationship by March 2019 is unlikely, given the short negotiation period, and since both the UK and the EU want to avoid failure, both parties have agreed on a potential transition period until the end of 2020, during which the status quo should be largely maintained. It is currently being discussed whether this should in fact be extended until the end of 2021. The UK would thus continue to be fully subject to EU law, but it would no longer have any co-decision powers since non-member states are not allowed to take part in the decision-making process of the EU. The fact that this temporary solution is part of the exit agreement continues to pose a problem. Accordingly, it will only come into force if the exit agreement is negotiated and ratified by both sides.

From a capital markets perspective, the issue of euro derivatives clearing – which mainly takes place through the UK clearing house LCH at present – has evolved as one of the key topics of Brexit negotiations. The importance of derivatives clearing is driven by the obligation to clear standardised derivatives via a central counterparty, pursuant to the European Market Infrastructure Regulation (EMIR) which came into force in 2012. In case of a "hard" Brexit, UK clearing houses such as LCH would lose their status as eligible central counterparties – leaving unilateral recognition by the EU as the only solution. The EU Commission also proposes that, in the course of Brexit, supervisory authorities be given greater rights in the future for systemically-relevant central counterparties from non-member states. If these fail to adequately address the risks, another solution would be to refuse the admission of central counterparties from non-EU states. Whilst the EU and the European Parliament are unlikely to oppose these proposals, refusal to grant admission would be a measure of last resort. The political will to attract euro-based derivatives clearing to the EU remains unchanged.

CLEARING INTEREST RATE DERIVATIVES



Source: Bundesverband Öffentlicher Banken Deutschlands, VÖB

OUR POSITION

- **We** support the adoption of an exit agreement, allowing a transitional phase until the end of 2020 (or even the end of 2021) to come into force. This would guarantee legal certainty and considerably extend the timeframe for negotiations.
- **From** a regulatory perspective, we recommend moving derivatives clearing into the EU, to safeguard the stability of financial markets in the EU, even during times of crisis. Specifically, the transfer of existing derivatives portfolios requires the establishment of clear legal and technical provisions in order to maintain market stability – failing that, grandfathering rules will be required. The transfer of new business may require transitional provisions.
- **We** believe that a cooperation with the UK on the basis of (third country) equivalence regimes should provide the opportunity to ensure durable legal and planning certainty – in order to enable a solid business foundation on the one hand, and investments for an improved market infrastructure on the other. With regard to the timeframe and the previous negotiations, the development of appropriate regulations appears questionable.

5 Discussions concerning the European Deposit Insurance Scheme (EDIS)

In November 2015, the European Commission submitted a proposal for establishing a European Deposit Insurance Scheme (EDIS) as a third pillar of European Banking Union. The plan is for EDIS to be introduced in three stages; starting with a reinsurance scheme, it will be developed into a co-insurance and ultimately a full insurance system. In Germany, this would apply to deposit guarantee schemes and their associated credit institutions. Moreover, the proposal calls for the establishment of a Deposit Insurance Fund (DIF), to be funded from contributions of credit institutions. In the event of a payout, or where national deposit guarantee schemes are involved in a restructuring or resolution, EDIS is supposed to cover liquidity shortfalls, or to cover against losses.

In June 2016, the Economic and Financial Affairs Council (ECOFIN) decided to only commence concrete negotiations on a political level once sufficient progress had been made concerning risk mitigation measures. In November 2016, a draft report was presented to the EU Parliament's Committee on Economic and Monetary Affairs (ECON), which is chiefly responsible for this issue. The draft report suggests a significant dilution of the Commission's proposal. Given the wide variety of positions held by ECON members, to date the issue has not been put to vote. In early October 2017, the European Commission published a communication for the completion of the Banking Union by 2018, in order to help facilitate a compromise in the Parliament and the Council. Compared to its original proposal, the Commission proposed a slightly modified approach, based on a two-phase model: during the reinsurance phase, which is scheduled to commence in 2019, gradually increasing liquidity support would be provided on a loan-by-loan basis, whilst EDIS would cover increasing losses during the co-insurance phase only after certain conditions are met. The Commission's goal remains unchanged: to fully "communitise" deposit guarantee schemes, with a roadmap intended to be agreed upon by the end of 2018. However this roadmap is only set to specify certain prerequisites that must be fulfilled before political negotiations can commence. The report is not expected to be adopted in the European Parliament during this legislative period.

> No European deposit guarantee scheme without prior risk reduction – no communitisation of risks.

OUR POSITION

- **We** maintain our objections to the EU Commission's proposals for a European Deposit Insurance Scheme. Whilst a deepening of the Banking Union is only conceivable after successful implementation of risk-reducing measures, it must not threaten the viability of tried-and-tested German deposit guarantee schemes. Regardless of how a European Deposit Insurance Scheme is specified, the prerequisites to be fulfilled before such a scheme can be established are crucially important. We therefore reject any mutualisation of national deposit protection schemes at a EU level.
- **We** do not see a legal basis for the EU Commission's draft regulation: it constitutes a breach of the subsidiarity principle, and it is not in line with the principle of proportionality. No comprehensive impact assessment has been published, thus breaching the principle of 'Better Regulation'.

6 Reduction of non-performing loans in Europe

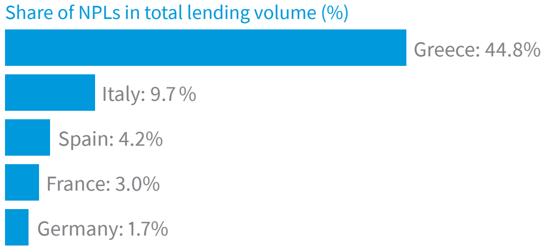
Longer realisation periods and no complete write-off for non-performing loans, within the scope of a prudential provisioning backstop.

In March 2018, the EU Commission published a comprehensive package of measures to tackle non-performing loans (NPLs) held by banks. The Commission's action plan proposes a regulation on amending the EU Capital Requirements Regulation (CRR), a policy on credit servicers and the realisation of collateral, and a non-binding blueprint for establishing national asset management companies (AMC). Going beyond the action plan, the ECB has issued its expectations within the scope of Pillar 2, shortly after publication of the legislative proposals, as a final addendum to its NPL Guideline. The EU Commission's draft regulation as well as the ECB's requirements propose the introduction of a prudential provisioning backstop for NPLs. The EU Commission's legislative proposals are designed to prevent the risk of insufficient risk provisioning, and propose a minimum coverage level for newly-originated loans that are subsequently classified as non-performing. Progressive risk coverage should be established for secured NPLs over a period of eight years, and over a two-year period for unsecured NPLs. If the minimum cover required by the backstop is not met, the bank will be required to deduct the difference to the risk provisioning recognised from common equity tier 1 (CET1) capital. The proposals put forward by the EU Commission are currently being discussed in the EU Council and the EU Parliament. The Council Working Group discusses extending the coverage period for unsecured NPLs to three years, whilst reducing it to seven years for secured NPLs. The Council Working Group and the EU Parliament are also proposing amendments to limit the effects of the backstop. Specifically, partial write-offs are set to reduce the difference to the minimum coverage; any forbearance measures granted on the grounds of financial difficulties incurred by the borrower are set to extend the coverage period by another year. In addition, the introduction of transitional arrangements for NPLs with real estate collateral is also being discussed.

NON-PERFORMING LOANS IN THE EURO AREA

Second quarter of 2018

Share of NPLs in total lending volume (%)



Source: European Banking Authority, own presentation

OUR POSITION

- **We** generally welcome the NPL reduction measures. However, we have considerable concerns about the proposal as well as about the methodology of a backstop. The reasons for high NPL inventories are complex: besides macroeconomic factors, structural factors (whether on a national level or specific to the institution concerned) play a major role; these include, for example, inefficient insolvency and enforcement proceedings. It is doubtful whether the undifferentiated approach of the planned backstop is the right solution for the multifaceted reasons, or if other measures (such as harmonising insolvency law) would be more suitable to achieve the intended goals.
- **We** advocate, in particular, the introduction of a threshold based on the NPL ratio. The relevant regulations should only apply to banks exceeding this threshold – meaning that the risks will be reduced where they exist. Otherwise, the economy might be unjustifiably weakened.
- **We** demand longer realisation timeframes than those proposed by the EU Commission, in order to cover the usual restructuring period. We believe the period for covering the unsecured part of NPLs should be extended to five years, in line with the usual duration of restructuring proceedings. The backstop period for the secured part of NPLs should be raised by at least one year, to nine years.
- **We** argue in favour of reducing minimum coverage, to a level not exceeding 80 percent. Coverage of 100 percent, such as that proposed by the EU Commission, is not appropriate even for unsecured loans: practical experience in Germany has shown that banks generally always obtain proceeds.

NEW

7 Regulatory requirements for Outsourcing

The European Banking Authority (EBA) published its Draft Guidelines on Outsourcing arrangements, aimed at replacing the 2006 guidelines. Comments were invited up until the end of September 2018. The recommendation published by the EBA in December 2017 on outsourcing to cloud service providers has been integrated into the current draft. The new guidelines are aimed at credit institutions, investment firms, payment institutions and e-money institutions. The aim is to create a more harmonised framework for outsourcing agreements among all financial institutions, as the member states have implemented existing regulatory requirements in very different ways.

The current draft defines the concept of outsourcing, and provides assessment criteria for determining whether an outsourced activity, service, process or function is deemed critical or important. Current requirements for outsourcing were tightened at domestic level in the October 2017 version of BaFin's Minimum Requirements for Risk Management (MaRisk) and the latest September 2018 revision of the Supervisory Requirements for IT (BAIT). In comparison, the EBA guidelines are much more detailed and in some instances go beyond domestic requirements. For example, EBA requirements are not limited to activities and processes related to the provision of services typical of an institution. In addition, the EBA calls for the establishment of a register of outsourcing arrangements, which must be submitted to supervisory authorities.

> Allow institutions sufficient flexibility, focus on principles-based rather than rule-based requirements, focus on institution-specific services, provide sufficient time for implementation.

Outsourcing is particularly suitable for an institution if it entails cost benefits, process optimisation, the use of product innovations, or quality improvements. It also enables banks to concentrate more on their core business by reducing the depth of value added. Excess regulation of outsourcing – in accordance with the EBA's specifications – is contrary to this objective. In practice, this poses problems for institutions and jeopardises cooperation with specialised service providers – in this age of digitalisation, it can also affect cooperation with FinTechs.

OUR POSITION

- **We** reject an excessively rules-based framework, since this unnecessarily restricts the flexibility of institutions and runs counter to the very objective of outsourcing. EBA should therefore make its guidelines broadly principles-based.
- **We** believe that the risks of outsourcing – such as inadequate service levels by the service provider, excessive dependencies, or loss of internal know-how – should be kept to a minimum by means of appropriate contractual arrangements.
- **We** call for the proposed definition of outsourcing to be amended. EBA should limit itself to activities and processes related to the provision of services typical of the institution. The activities and processes that go beyond this are rightly treated less strictly at domestic level than other outsourcing of services.
- **We** are committed to ensuring that the requirements take greater account of the principle of proportionality, and that the requirements distinguish more clearly between essential and non-essential outsourcing, as is the case with MaRisk. The EBA uses the terms “critical and important functions” for this purpose.
- **We** believe the specifications for the outsourcing register to be far too detailed. The documentation on outsourcing should instead be based on material aspects. In addition, we do not see the point of having to report to the supervisory authorities.
- **We** propose that the first application of the EBA Guidelines be postponed from 30 June 2019 to 1 January 2020, in order to allow institutions sufficient time for implementation.

8 Digitalisation and innovation

Ensuring legal and planning certainty for new and established providers within the financial sector facilitates digital innovation and safeguards customer interests.

A well-founded and carefully considered digitalisation process offers great opportunities for Germany's competitiveness. At the same time, it holds major challenges for our society. The way in which Germany and Europe are able to position themselves in the face of global competition depends to a large extent on how they manage to deal with these challenges. Digitalisation is happening everywhere; it is progressing at an enormous pace – with increasing automation of value-creation chains, implementation and networking of digital products, services, platforms and systems. This also has major implications for financial services providers and their customers. Legislators and regulators across Europe are in the process of developing an appropriate legal and regulatory framework that must promote digital innovation and support fair competition and stable financial markets. To this end, major projects and goals were laid out in Germany's coalition pact.

The EU Commission published the "FinTech Action Plan" at the beginning of March 2018: by spring 2019, European-wide foundations will have been laid for the implementation of business and database models based on Blockchain/distributed ledger technology, regulation of cryptocurrencies, outsourcing to cloud service providers and the handling of licensing and approval requirements, as well as relaxation of innovation development requirements for FinTech companies. In order to create a future "open banking ecosystem" in Europe, technical standards for FinTechs need to be developed further, especially as regards interfaces that enable non-banks to access bank accounts and banking services, thereby largely opening up the banking infrastructure to third parties. The first step towards this has been the implementation of the Second Payment Services Directive (PSD2), which – for the first time – has created a legal framework for providers of legally-defined payment initiation and account information services. This will not only boost competition, but also cooperation between banks and FinTechs, in the context of new digital solutions for payment transactions and accounts. The role that global internet giants such as Google, Amazon and Facebook will play in all of this remains to be seen. We expect other new services to enter the market.

OUR POSITION

- In our view, fair competition is essential. We thus demand a risk-adjusted supervision which oversees market participants, following the principle of 'same business, same risks, same regulation'.
- We advocate that innovation-enhancing technologies such as Blockchain be internationally in an open and opportunity-driven manner.
- We believe an access charge to be necessary when access to infrastructure is opened up. This is the only way to ensure fair competition. Infrastructures require ongoing investment, which must be appropriately compensated. Technology providers and internet giants with significant market positions must also provide access to their interfaces.
- We support transparent rules regarding data and consumer protection, in particular relating to obligations and liability issues for market participants. We reject any softening of existing regulations.
- We are committed to cross-sector interoperability by complying with European standards, such as real-time payment systems (instant payments) and the PSD2 interface for third-party services.
- We advocate the banking sector retaining responsibility for maintenance, further development, and orderly implementation of technical procedures. In this way, the standards for data protection, banking secrecy and IT security, which banks have established for their online banking services, are safeguarded.
- Over the long term, we envisage instant payments to have profound implications for the settlement of payment transactions in Europe, and for the integration of payment solutions into digital offerings for consumers and businesses alike.

9 Supervisory Requirements for IT

Several legal initiatives and implementation regulations have tightened the requirements for IT security requirements applicable to critical infrastructure, as well as reporting duties and the requirements for banks' IT systems. Most recently, the legislative process for adoption of the revised Regulation Determining Critical Infrastructure (Verordnung zur Bestimmung Kritischer Infrastrukturen – "BSI-KritisV") was concluded, as part of the implementation of the German IT Security Act (IT-Sicherheitsgesetz – "IT-SiG"). When it comes into force, this will also implement the EU Directive concerning measures for a high common level of security of network and information systems into German law.

Pursuant to the BSI-KritisV, banks as well as technical service providers and IT centres may be considered as 'operators', provided they have material involvement in the planning and design of the IT infrastructure. Operators of critical infrastructure are obliged to establish a contact for reporting IT faults or disruptions to the German Federal IT Security Authority (BSI), and to conduct audits regarding state-of-the-art security. The German Federal Financial Supervisory Authority (BaFin) has set out Supervisory Requirements for IT (BAIT), thus specifying the requirements set out in the German Banking Act (KWG) and the Minimum Requirements for Risk Management in Banks (MaRisk), focusing on key aspects of IT governance, management and operations. BaFin's BAIT rules are also designed to implement concrete requirements set out by the European Banking Authority (EBA), including those from the ICT (information and communications technology) risk review, as part of the Supervisory Review and Evaluation Process (SREP), or governing outsourcing of cloud-based services. EBA's Guidelines on Outsourcing might trigger adjustments to the MaRisk, and to the BAIT (concerning requirements for (IT) outsourcing – cf. chapter 7). Moreover, BSI and BaFin are discussing the extent to which BAIT (plus detailed related IT security requirements) can be seen as a sector-specific standard within the meaning of the IT-SiG. This direction is supported by the new BAIT module published in September 2018, which operators of critical infrastructure may use to provide evidence.

BAIT to combine the requirements for IT infrastructure and IT security.

OUR POSITION

- **We** generally welcome the more detailed specification – and hence, improved transparency – concerning requirements for banks' IT security and infrastructure.
- **We** strongly request a continuous review of whether existing regulations on a European as well as national level are in fact appropriate. Any potential relief that is available to banks must be consistently pursued.
- **We** will continue to advocate clearly-worded and simplifying requirements – at a European and national level – for IT outsourcing.
- **We** expect that additional efforts for banks be prevented – for example, due to dual or even multiple regulation on a European and/or national level. For instance, reports concerning IT faults or restrictions which operators of critical infrastructure are required to report to the BSI overlap with the regulatory reporting requirements under the Second Payment Services Directive (PSD II), as well as with evidence to be submitted to BaFin and BSI concerning the fulfilment of requirements.
- **We** welcome the active involvement of banks and their associations during discussions on BAIT, and recommend continuing this dialogue in order to ensure regulation that is practicable.
- **We** demand that the principle of proportionality, as set out in MaRisk and BAIT, be applied throughout, with a corresponding harmonisation and review of the auditing practice.

10 EU Funding Policy post-2020

In May 2018, the EU Commission submitted its budget proposal for the Multiannual Financial Framework (MFF) for the 2021-2027 period. This sets the expenditure ceiling for the EU's annual general budgets. With a budget increase to €1,135 billion, current investment priorities in the area of funding policy will continue, and new challenges – such as managing migration, protecting the EU's external borders – will be financed. For many years German promotional banks have been the main players implementing European development objectives in Germany. Proposals for the full legislative package in the next EU funding period include reducing the number of funding programmes, respecting rule of law, and achieving more flexibility and efficiency by simplifying administrative procedures. With regards to the European Structural Funds investments, the European Union tends to emphasize the "European Added Value" criteria. The relative GDP per capita should remain the most important factor in determining which regions are eligible for assistance. Other factors such as climate change and unemployment should also be taken into account. As part of this new legal framework, the Commission seeks to ensure more effective links with other EU programmes. Administrative costs will be reduced as a result of greater synergies and aligning implementation rules across all funds, while at the same time simplifying management and control systems for individual programmes. As a successor to the current European Fund for Strategic Investments (EFSI), the new InvestEU fund will bring together centrally-managed EU financial instruments from different programmes and mobilise additional investment in the areas of sustainable infrastructure, of research, innovation and digitisation, financing of small and medium-sized enterprises, and social investments.

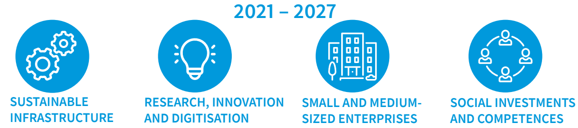
Investments with European Structural Funds and support to small and medium sized enterprises should continue post 2020.

FINANCING INSTRUMENTS UNDER THE UMBRELLA OF InvestEU:

2014 – 2021

- European Fund for Strategic Investments
- CEF Debt Instrument
- CEF Equity Instrument
- COSME Loan Guarantee Facility
- COSME Equity Facility for Growth
- InnovFin Equity Facility
- InnovFin SME Guarantee Facility
- InnovFin Loan Facility for R&I
- Private Finance for Energy Efficiency instrument
- Natural Capital Financing Facility
- EaSI Capacity Building Investments
- EaSI Guarantee Instrument for Microfinance and Social Entrepreneurship
- Student Loan Guarantee Facility
- Cultural and Creative Sector Guarantee Facility

2021 – 2027



Source: European Commission, own presentation

OUR POSITION

EU STRUCTURAL FUND AID

- **We** committed to support a broad approach respecting subsidiarity at a maximum, also beyond 2020.
- **We** are convinced that in order to achieve the best possible funding outcomes, we need to be able to use development instruments in a flexible manner. In order to take account of the specific regional particularities, support programs need to be tailor made. This can only be achieved by using a mix of instruments including grants, loans, guarantees, equity capital and other financial instruments, in order to account for specific regional structural features.
- **We** advocate a general simplification to the eligibility criteria for Structural Funds investment. We support the EU Commission's intention to introduce simplified management and control systems for programmes with a "good track record".

EUROPEAN SME SUPPORT

- **We** are committed to ensuring that our member development and promotional banks, with the help of EU guarantee facilities, will continue to provide regional and domestic support programmes beyond 2020. The EU Commission must ensure continuity and reliability in its support.
- **We** are in favour of making available the option of direct and non-discriminatory access to the EU budget guarantee.
- **We** advocate that the burden of governance, the selection process and the criteria for implementing partners, should not lead to unnecessary bureaucratic hurdles. The products envisaged within the framework of "InvestEU" must follow uniform and simple design principles, and therefore be more practical and workable.

NEW

11 New anti-money laundering measures

Against the background of the latest money laundering scandals, uncovered in the first half of 2018, European legislators concluded that the measures taken thus far are insufficient. In September 2018 the EU Commission therefore proposed to significantly extend the anti-money laundering authority of the European Banking Authority (EBA). Specifically, it is planned to grant the EBA the authority to issue instructions to the national competent authorities, and even to individual enterprises under certain circumstances. Furthermore, the EBA is supposed to collect information about risks and trends in combating money laundering, and to demand the exchange of such information amongst national competent authorities. The measures are expected to be concluded within this legislative period, within the scope of revising the competencies of the EU supervisory authorities.

The terrorist attacks in Brussels and Paris prompted the EU Commission to present a proposal for the Fifth EU Anti-Money Laundering Directive (AMLD5) even before the Fourth EU Anti-Money Laundering Directive (AMLD4) was implemented in July 2016. The legislative procedure at European level has been concluded, and the countries are now required to transpose the new regulations into national law by January 2020 at the latest. The legislative changes propose, among other things, to extend the scope of obligated parties, specifying customer due diligence requirements with respect to countries with increased risk, public access to the transparency register, and extending the powers of the authority to whom suspicions must be notified.

> Strengthen an exchange of views and information amongst the supervisory authorities; guarantee legal security.

Legislators and supervisory authorities in Germany and Europe have tightened the requirements of money laundering prevention through the Fourth EU Anti-Money Laundering Directive. The European directive was transposed into German law when it came into force in June 2017. The German Federal Financial Supervisory Authority (BaFin) substantiated the legal requirements by publishing draft interpretation and usage advice. A consultation process involving banks and the German Banking Industry Committee was launched in early 2018. After conclusion of the consultation, publication of the final version is currently awaited, and it is hoped that many open issues will be clarified.

OUR POSITION

- **We** advocate the national supervisors specifying the requirements of the banks’ measures for the prevention of money laundering.
- **We** welcome the involvement of the banks and associations in the consultation on the interpretation and usage advice, and furthermore demand that a continuous dialogue be maintained with the supervisory authority, to ensure practical implementation of new legal and regulatory developments.
- **We** are opposed to hasty decisions. We thus demand removal of the ambiguities that still exist in relation to the implementation of the Fourth EU Anti-Money Laundering Directive, and recommend waiting to gauge the impact of the changes already agreed upon within the scope of the Fifth EU Anti-Money Laundering Directive.
- **We** support clearer rules for the exchange of information between the supervisors and the authorities responsible for the fight against money laundering.
- **We** advocate that existing competencies remain with the national competent authorities, in the event that a new EU authority is created for the purpose of centralising money laundering supervision. NCAs should retain their responsibilities to the obliged parties and should also continue to be available as a point of contact.

12 New EU standards for securities issues

Exploit opportunities for avoiding bureaucracy – provide legal and planning security for issuers

One prospectus approved by supervisory authorities is required for securities to be offered publicly, and to be admitted for trading on a regulated market. The prospectus must contain minimum legal details that provide investors with comprehensive information concerning the security in question, and the issuer. The objective of the new EU Prospectus Regulation is to structure securities prospectuses in a simpler and more flexible way. As part of European Capital Markets Union, the Prospectus Regulation should also make it easier for small- and medium-size enterprises – in particular – to access the capital markets.

The European Securities and Markets Authority (ESMA) published its recommendations for a first set of implementation measures (Level 2). Specifically, ESMA makes proposals on core areas of new issues business:

- prospectus content and formats;
- the EU Growth Prospectus; and
- prospectus review and approval.

ESMA has forwarded its recommendations to the EU Commission, which will draw up the formal Delegated Acts by June 2019 at the latest, and commence the related European legislative procedure. The European Parliament and the EU Council have a right to raise an objection in this respect. The new European Prospectus Regulation will come into effect on 21 July 2019, replacing the existing EU Prospectus Directive and the German Prospectus Act (Wertpapierprospektgesetz – "WpPG") which is based on it.

From a regulatory perspective, a common understanding of the topic of plain language – in other words, the reader-friendly and linguistically understandable presentation of prospectuses' contents – is currently being hotly debated. This also concerns Level 3 measures, such as ESMA's Guidelines on risk factors under the Prospectus Regulation, for which a consultation process ran until October 2018.

OUR POSITION

- **We** welcome the EU Commission's approach, whereby the new Prospectus Regulation will place greater emphasis on ensuring uniform regulatory requirements for the issue and listing of securities throughout Europe. This will facilitate the broader-based financing of banks as well as SMEs. The first part of the implementation measures that has now been published forms a generally reasonable regulatory framework.
- **We** are disappointed that the provisions for the EU Growth Prospectus are too extensive and detailed to facilitate easier access for small companies to the capital market. A summary prospectus – for example, in question-and-answer format – would be a constructive and pragmatic alternative.
- **We** criticise the fact that ESMA is generally planning very detailed Level 2 regulations. Further 'purging' would have been possible here to facilitate issuing activity.
- **We** demand legal and planning security. Securities issuers require clarity about the regulations at Level 2 of the Prospectus Regulation as early as possible. Material implementation activities of securities issuers cannot start until the regulations are definite.
- **We** advocate that the contents and language of an issuer's disclosure documents are coherent for liability reasons – for example, with regard to the linguistic representation of risk factors in the prospectus and the financial reporting. The communication of contents at securities level could be presented in a more targeted manner if there were separate prospectuses for retail and institutional investors.

Room for your notes and questions

Development and promotional banks in Germany

1 Landesförderinstitut Mecklenburg-Vorpommern – Division of NORD/LB*
Total assets: €1.757 billion (2016)
→ www.lfi -mv.de

2 Investitionsbank des Landes Brandenburg
Total assets: €13.332 billion (2016)
→ www.ilb.de

3 Sächsische Aufbaubank – Förderbank
Total assets: €7.640 billion (2016)
→ www.sab.sachsen.de

4 Investitionsbank Schleswig-Holstein (IB.SH)
Total assets: €19.003 billion (2016)
→ www.ib-sh.de

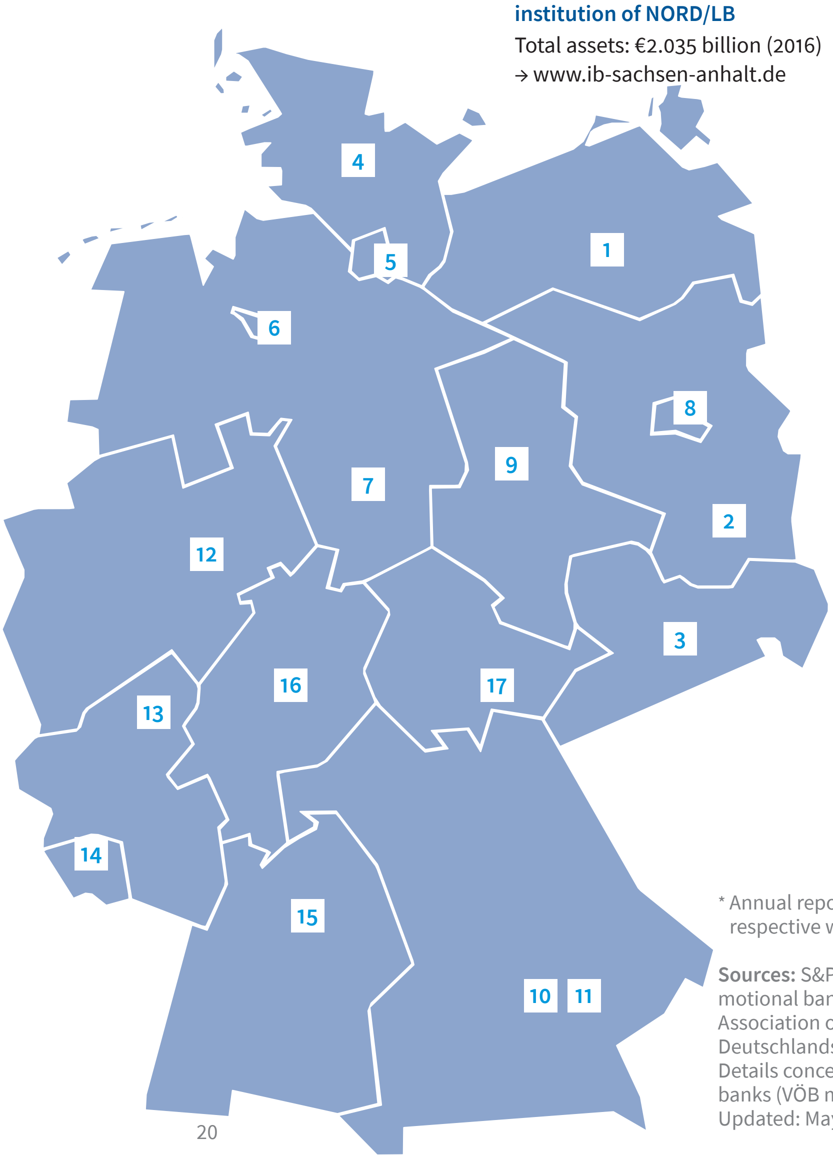
5 Hamburgische Investitions- und Förderbank
Total assets: €5.144 billion (2017)
→ www.ifbhh.de

6 Bremer Aufbau-Bank GmbH
Total assets: €1.164 billion (2016)
→ www.bab-bremen.de

7 Investitions- und Förderbank Niedersachsen – NBank
Total assets: €3.905 billion (2016)
→ www.nbank.de

8 Investitionsbank Berlin
Total assets: €17.893 billion (2017)
→ www.ibb.de

9 Investitionsbank Sachsen-Anhalt – institution of NORD/LB
Total assets: €2.035 billion (2016)
→ www.ib-sachsen-anhalt.de



10 LfA Förderbank Bayern
Total assets: €21.475 billion (2017)
→ www.lfa.de

11 Bayerische Landesbodenkreditanstalt
Total assets: €23.068 billion (2017)
→ www.bayernlabo.de

12 NRW.BANK
Total assets: €147.584 billion (2017)
→ www.nrwbank.de

13 Investitions- und Strukturbank Rheinland-Pfalz (ISB)
Total assets: €10.18 billion (2016)
→ www.isb.rlp.de

14 SIKB Saarländische Investitionskreditbank AG
Total assets: €1.485 billion (2016)
→ www.sikb.de

15 L-Bank, Baden-Württemberg State Bank
Total assets: €70.670 billion (2017)
→ www.l-bank.de

16 Wirtschafts- und Infrastrukturbank Hessen – legally-dependent institution within Landesbank Hessen- Thüringen Girozentrale
Total assets: €17.627 billion (2017)
→ www.wibank.de

17 Thüringer Aufbaubank
Total assets: €3.99 billion (2016)
→ www.aufbaubank.de

Development and promotional banks at Federal level

KfW Banking Group
Total assets: €472.347 billion (2017)
→ www.kfw.de

Landwirtschaftliche Rentenbank
Total assets: €95.046 billion (2016)
→ www.rentenbank.de

* Annual report of the development and promotional bank (as published on the respective website)

Sources: S&P Global Market Intelligence; annual reports 2017 of development/promotional banks (consolidated financial statements in accordance with local GAAP)
Association of German Public Banks (Bundesverband Öffentlicher Banken Deutschlands – VÖB)
Details concerning promotional lending volumes: development and promotional banks (VÖB member institutions)
Updated: May 2018

Landesbanken and DekaBank

HSH Nordbank AG
Total assets:
€70.382 billion
→ www.hsh-nordbank.de

NORD/LB Norddeutsche Landesbank Girozentrale
Total assets:
€165.379 billion
→ www.nordlb.de

DekaBank Deutsche Girozentrale
Total assets:
€93.740 billion
→ www.deka.de

Landesbank Hessen-Thüringen Girozentrale
Total assets:
€158.349 billion
→ www.helaba.de

SaarLB Landesbank Saar*
Total assets:
€14.417 billion
→ www.saarlb.de

Landesbank Baden-Württemberg
Total assets:
€237.713 billion
→ www.lbbw.de

BayernLB
Total assets:
€214.521 billion
→ www.bayernlb.de

* Consolidated financial statements in accordance with the German Commercial Code (local GAAP – "HGB")

Sources: Handelsblatt, own representations
S&P Global Market Intelligence; consolidated financial statements as at 31 December 2017 in accordance with IFRS; Association of German Public Banks (Bundesverband Öffentlicher Banken Deutschlands – VÖB)
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PO Box 11 02 72, 10832 Berlin, Germany

Phone +49 30 8192-0
Fax +49 30 8192-222

www.voeb.de

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Association of
German Public Banks

Lennéstrasse 11,
10785 Berlin, Germany

Phone +49 30 8192 0
Fax +49 30 8192 222

presse@voeb.de
www.voeb.de