

FACTS AND FIGURES
TRENDS **2017**
AND STRATEGIES

Facts and figures, trends and strategies 2017

PUBLISHER INFORMATION

Published by: Austrian Financial Market Authority (FMA)

A-1090 Vienna, Otto-Wagner-Platz 5

Phone: +43-1-249 59-0, Fax: +43-1-249 59-5499

E-mail: fma@fma.gv.at

Internet: www.fma.gv.at

Sources (unless otherwise stipulated): FMA

| | |
|---|----|
| Preface by the Executive Board | 4 |
| LEGAL DEVELOPMENTS | |
| Major changes in national and international financial market legislation | 6 |
| THE FMA'S DIGITAL ROADMAP | |
| Responses to the challenges posed by new technologies | 18 |
| THE NEW SUPERVISORY REGIME FOR TRADING IN LISTED SECURITIES | |
| MAR and CSMAD: Uniform rules EU-wide and more effective weapons for combating market abuse | 26 |
| THE FMA'S ROLE IN CONSUMER PROTECTION | |
| Collective consumer protection: How it works and how it protects consumers | 36 |
| LESSONS FROM THE 2016 FATF REPORT | |
| Austria is optimising its system for the prevention of money laundering and terrorist financing | 44 |
| THE INTEGRATED APPROACH TO SUPERVISION IN ASSET MANAGEMENT | 49 |
| RESOLUTION PLANNING | |
| Comparing and contrasting resolution and recovery planning for Austrian credit institutions | 55 |
| DISTRIBUTION OF LOSS-ABSORBING BANK SECURITIES – A CHALLENGE FOR SUPERVISION | |
| The new MiFID II & MiFIR regime provides new supervisory tools covering advice and distribution | 65 |

Preface by the Executive Board



The world's financial markets are becoming increasingly interdependent, while the boundaries between different products and sectors are becoming ever more blurred. Just as national borders are losing their relevance in the financial industry, supervision too must operate on a cross-border basis. Meanwhile, we also find ourselves living in a time of rapid technological development. Indeed, many regard the digitisation of financial services as a disruptive technology, turning the rules of the markets completely on their head.

Regulation and supervision must keep pace with these developments, always engaging with the markets on an equal footing and being developed accordingly.

The integrated approach to supervision, bringing the entire financial market under one roof, not only proved its worth during the challenges of the global financial crisis. It has also turned out to be particularly adaptable, learning the lessons from and keeping up with these dynamic developments on the markets.

In our capacity as an integrated national supervisor, we have been able to help shape the efficient and effective creation of Europe's new supervisory structure, with the establishment of the European Banking Authority (EBA), European Insurance and Occupational Pensions Authority (EIOPA) and European Securities and Markets Authority (ESMA). Meanwhile, the European banking union, comprising the Single Supervisory Mechanism (SSM) for the eurozone, the Single Resolution Mechanism (SRM) and the common deposit guarantee scheme that is set to be introduced, have all benefited greatly from the integrated approach to national supervision. Ultimately, banking supervision today is about more than supervising solvency, which encompasses market access, capital, liquidity and governance. Nowadays, banking supervision must also consider resolution, the prevention of money laundering, and investor and consumer protection, with just 50% of the FMA's work in banking supervision now relating to solvency supervision in the classic sense. A large portion of the risks potentially associated with banks' balance sheets relates to conduct supervision.

And these trends, if anything, are accelerating. The digital revolution has no respect for boundaries, be they sector-based or regulatory. FinTechs, those innovative companies developing new products and technological solutions, are frequently questioning established business models and not just in the case of banks but also with regard to insurance undertakings, investment firms and investment funds. And it is often difficult to know if and how the traditional rules apply. Yet regulation and supervision should not stand in the way of technical progress but must allow technology to develop unimpeded.

From the perspective of consumer protection, the same requirements must be made of economically equivalent financial services, regardless of whether, legally speaking, these are banking, insurance or investment products. Efforts to combat money laundering and terrorist financing must also focus on the risk inherent in the transaction and not on the legal form that the financial service takes.

European legislators are increasingly taking account of these developments. Many new rules are now designed to encompass a range of sectors, such as the Anti-Money Laundering Directive and the Regulation on packaged retail and insurance-based investment products (PRIIPs) or the new MiFIR and MiFID rules (Markets in Financial

Instruments Regulation and Markets in Financial Instruments Directive). The regulatory aspects are also being developed and applied across different sectors, such as the fit and proper requirements made of management and executive staff, or the requirements relating to controlling, compliance and risk management functions.

The more dynamically the markets develop, the more important it will be to create a level playing field for all, avoiding any form of regulatory or supervisory arbitrage. The integrated approach to supervision has proven particularly worthwhile in this regard, helping to show the “big picture” rather than a mere snapshot of a single sector.

Our annual publication “Facts and figures, trends and strategies” is designed to provide an overview of current developments on the markets and in the field of regulation and supervision. In light of the trends described, it is clear that the latest developments in particular focus on issues that require an integrated mentality, be it the challenges posed by the digital revolution, the challenges in investor and consumer protection, the challenges in the distribution of loss-absorbing bank securities, or the challenges of adopting an integrated approach to asset management supervision.

With this in mind, the subjects tackled in this publication have been selected to be of particular interest and benefit to you.

HELMUT Ettl, KLAUS KUMPFMÜLLER

Legal developments

Major changes in national and international financial market legislation

The financial markets are among the most creative and innovative areas of the economy. To be able to keep pace with these dynamic markets, laws and regulations must be continuously amended to reflect the changing requirements and challenges. The global financial crisis challenged the efficiency and effectiveness of the existing types of regulation in many areas, demanding a new legislative response. The “digital revolution” with its disruptive technologies also called for new regulatory responses. Accordingly, financial market legislation was fundamentally driven forward in 2016, at an international, European and national level. The following section provides a summary of recent major changes in legislation that falls within the FMA’s scope of enforcement.

NATIONAL LEGISLATION

CHANGES TO EXISTING LAWS

Amendment to the Federal Act on the Creation of a Wind-down Entity

(GSA; Bundesgesetz zur Schaffung einer Abbaueinheit), Federal Law Gazette I No. 11/2016

Income generated by the wind-down entity Hypo Alpe-Adria-Bank International AG through reducing liabilities by applying the bail-in tool referred to in Article 85 of the Bank Recovery and Resolution Act (BaSAG; *Bankensanierungs- und Abwicklungsgesetz*) is now exempt from corporate income tax.

Consumer Payment Accounts Act (VZKG; Verbraucherzahlungskontogesetz) and amendment to the Financial Market Authority Act (FMABG; Finanzmarktaufsichtsbehördengesetz) and others, Federal Law Gazette I No. 35/2016

This federal act implements Directive 2014/92/EU, the Payment Accounts Directive. The aim is to make consumer payment account fees transparent and comparable, to facilitate switching of accounts and to give consumers a legal right to a basic payment account. In enforcing the VZKG, the FMA is not just responsible for administrative penal matters but also for preparing and updating a list of the most representative services linked to a payment account and to submit this list to the European Commission and the European Banking Authority (EBA), as well as for handling complaints from consumers who were denied access to a basic payment account or whose payment account was terminated.

2016 Statutory Audit Law Amendment Act (APRÄG 2016; *Abschlussprüfungsrechts-Änderungsgesetz*), Federal Law Gazette I No. 43/2016

This federal act transposes Directive 2014/56/EU and specifies implementation details in relation to the directly applicable Regulation (EU) No 537/2014. The aim of this EU legislation is to allow for greater transparency and predictability of the requirements applying to statutory auditors and to enhance their independence and objectivity in the performance of their tasks. The maximum duration for a continuous appointment in the case of public-interest entities where the continuous appointment of the statutory auditor was made for the first time for a business year that started between 17 June 2003 and 15 June 2014 may be extended to a maximum duration of 20 or 24 years (no exception as laid down in Article 43 para. 1 no. 2 BWG). The APRÄG 2016 changes the internal rotation period from five to seven years and the cooling-off period from two to three years. In addition, there are changes related to the set-up of the audit committee and its extended duties.

Liability Act Carinthia (*Haftungsgesetz Kärnten*), amendment to the Financial Market Stability Act (FinStaG; *Finanzmarktstabilitätsgesetz*) and others, Federal Law Gazette I No. 69/2016

This federal act creates the legal basis for the composition with HETA creditors. Pursuant to the Liability Act Carinthia, the Federal Minister of Finance is authorised to assume liability for up to a maximum of € 11 billion in relation to credit operations of the Carinthian government's fund for compensation payments. In connection with this assumption of liability and the requisite raising of the FinStaG liability cover by € 1.5 billion, the Act on Federal Liability Caps (BHOG; *Bundshaftungsobergrenzungsgesetz*) also needed to be amended, resulting in an increase in the total amount of federal guarantees.

Federal Act implementing Regulation (EU) 2015/2365 on transparency of securities financing transactions (SFT-Vollzugsgesetz), amendment to the 2011 Investment Fund Act (InvFG 2011; *Investmentfondsgesetz*) and others, Federal Law Gazette I No. 73/2016

This Act aims at increasing the transparency related to securities financing transactions (SFTs) in the shadow banking system. The European SFT Regulation prescribes that details of SFTs must be efficiently reported to trade repositories, investment funds (UCITS – undertakings for collective investment in transferable securities and AIFs – alternative investment funds) must include detailed information on the use of SFTs and total return swaps in their periodical reports and pre-contractual documents, and it also lays down minimum transparency requirements for reuse of collateral. With regard to the InvFG 2011, amendments concerned clarifications of the FMA's supervisory powers and additions related to sanctions following Commission Delegated Regulation (EU) 2016/438.

Amendments to the Stock Exchange Act (BörseG; *Börsegesetz*), the 2007 Securities Supervision Act (WAG 2007; *Wertpapieraufsichtsgesetz*) and others (implementing MAD and MAR), Federal Law Gazette I No. 76/2016

This legislation implements Directive 2014/57/EU, the Market Abuse Directive (MAD), and establishes additional rules following Regulation (EU) No 596/2014, the Market Abuse Regulation (MAR). Insider law, ad hoc disclosure requirements, the ban on market manipulation and disclosure of directors' dealings are now all regulated by the directly applicable MAR. The group of issuers and other market participants affected by these regulations has been widened, and the penalties for market manipulation, insider dealing, etc. have been markedly increased. The FMA was given additional powers; specifically, it may search premises and obtain information on communications data. Where an ad hoc report is postponed, the FMA need only be informed of the postponement when the actual ad hoc report is being made, unless credit or financial institutions are postponing the report to secure the stability of the financial markets.

Statutory Auditor Supervision Act (APAG; *Abschlussprüfer-Aufsichtsgesetz*), Federal Law Gazette I No. 83/2016

Directive 2014/56/EU and Regulation (EU) No 537/2014 required a fundamental change of the former supervision

system applied with regard to statutory auditors. The APAG creates the independent Audit Oversight Body of Austria (APAB), which may carry out inspections at statutory auditors as well as quality assurance inspections. The former Statutory Auditor Quality Assurance Act (A-QSG; *Abschlussprüfungs-Qualitätssicherungsgesetz*) expires upon the APAG entering into force. The functions formerly assigned to the Working Committee on External Quality Assurance and the Quality Control Authority are transferred to the APAB.

Financial Markets Anti-Money Laundering Act (FM-GwG; *Finanzmarkt-Geldwäschegesetz*) and amendments to the Alternative Investment Fund Managers Act (AIFMG; *Alternatives Investmentfonds Manager-Gesetz*), the Austrian Banking Act (BWG; *Bankwesengesetz*) and others, Federal Law Gazette I No. 118/2016

The FM-GwG brings the due diligence requirements in relation to preventing money laundering and terrorist financing, which were previously set out in various different supervisory laws, together in a single framework applicable to the entire financial market. One significant new provision concerns the broadening of the risk-based approach. Obligated entities are now entitled to apply simplified due diligence to customers that they have found to be low risk as a result of a risk analysis. The FM-GwG no longer stipulates any specific applications of simplified due diligence requirements but these may be determined by the FMA in the form of regulations. As far as Austrian politically exposed persons (PEPs) are concerned (this includes members of parliament or the federal or governments), enhanced due diligence is now a mandatory requirement. The European Commission has for the first time drawn up a list of high-risk countries for the entire European financial market, entailing enhanced due diligence for financial flows from or to these countries.

The BWG amendment strengthens supervision of branches by eliminating shortcomings in administrative penal provisions and expanding supervisory powers. Furthermore, it is expressly stated that credit and financial institutions must set up proceedings to handle complaints.

FMA REGULATIONS

Regulation on Calculation Parameters for *Pensionskassen* (PK-RPV; *Pensionskassen-Rechnungsparameterverordnung*), Federal Law Gazette II No. 15/2016

This Regulation lowers the upper limits for two parameters used to calculate the technical provision. The maximum permissible assumed interest rate is lowered from 3% to 2.5%, and the upper limit for the technical surplus from 5% to 4.5%. The maximum permissible percentage of the assumed interest rate for the security-oriented IRG is lowered from 1.75% to 1.25% and for the technical surplus from 2.75% to 2.25%, effective as of 1 January 2017.

2016 Regulation on Forms and Annual Reports (FJMV 2016; *Formblatt- und Jahresmeldeverordnung*), Federal Law Gazette II No. 16/2016

The FJMV 2016 specifies the way in which *Pensionskassen* must report data from their annual reports and the report on activities to the FMA. The forms have been adapted to correspond to the provisions in the 2014 Accounting Amendment Act (RÄG 2014; *Rechnungslegungs-Änderungsgesetz*), Federal Law Gazette I No. 22/2015. The electronic annual reports submitted by the *Pensionskassen* to the FMA must now include the identification number of the legal entity concerned. This code is in line with the EIOPA (European Insurance and Occupational Pensions Authority) Guidelines on the use of the Legal Entity Identifier (LEI).

Amendment to the Bank Recovery Plan Regulation (BaSaPV; *Bankensanierungsplanverordnung*), Federal Law Gazette II No. 76/2016

This amendment takes account of national and European findings with regard to simplified requirements for central institutions of institutional protection schemes. In addition, the Regulation is adapted to reflect changes in the EBA Guidelines on the minimum list of qualitative and quantitative recovery plan indicators (EBA/GL/2015/02) compared with the previously underlying proposals put forth in Consultation Paper EBA/CP/2014/28.

**Amendment to the 2016 Regulation on Money Laundering and Terrorist Financing Risk
(GTV 2016; Geldwäscherei- und Terrorismusfinanzierungsrisiko-Verordnung),
Federal Law Gazette II No. 115/2016; repeal of GTV 2016, Federal Law Gazette II No. 369/2016**

Following a recommendation by the Financial Action Task Force, the Republic of Myanmar was first deleted from the list of those countries considered to pose a high risk of money laundering and terrorist financing.

In December the GTV was then repealed in full since the list of high-risk third countries now forms part of Commission Delegated Regulation (EU) 2016/1675.

**Amendment to the Capital Buffer Regulation (KP-V; Kapitalpuffer-Verordnung),
Federal Law Gazette II No. 117/2016**

In compliance with European regulations, this amendment specifies a capital buffer for systemically important institutions. According to Article 133(4) of Directive 2013/36/EU, the Fourth Capital Requirements Directive (CRD IV), in the case where a systemically important institution is subject to both an O-SII buffer and a systemic risk buffer, the higher of the two applies to the institution concerned.

Employee Categories and Verification Regulation

(MiKaNa-V; Mitarbeiterkategorien- und Nachweis-Verordnung), Federal Law Gazette II No. 151/2016

The MiKaNa-V transposes Article 9 of Directive 2014/17/EU on credit agreements for consumers relating to residential immovable property, detailing categories of employees in credit institutions concerned with the offering and conclusion of mortgage and property loan agreements. It also specifies requirements relating to the nature, scope and periodicity of verification of these employees' knowledge and skills.

**Amendments to the Maximum Interest Rate Regulation for Insurance Undertakings
(VU-HZV; Versicherungsunternehmen-Höchstzinssatzverordnung), Federal Law Gazette II No. 152/2016 and
Federal Law Gazette II No. 266/2016**

The first amendment specified that current interest rates must always be used for calculating the technical provisions where the term of insurance cover is extended or the premium increased by more than 25%.

The second amendment lowers the maximum interest rate for life insurance contracts and state-sponsored retirement provision contracts from 1.00% to 0.50% as of 1 January 2017, reflecting the trend of falling capital market interest rates in evidence for some years now.

**Regulation on Recovery, Resolution and Disaster Recovery Plans of Central Securities Depositories
(ZvSAN-V; Zentralverwahrer-Sanierungs-, Abwicklungs- und Notfallsanierungsplanverordnung),
Federal Law Gazette II No. 153/2016**

This amendment lays down the minimum content of recovery, resolution and disaster recovery plans prepared by central securities depositories (CSDs). The Regulation draws on the requirements stipulated for recovery and resolution plans of banks and on the draft regulatory technical standards concerning CSDs of the European Securities and Markets Authority (ESMA).

**Amendment to the Information Requirements Regulation for Pensionskassen
(PK-InfoV; Informationspflichtenverordnung Pensionskassen), Federal Law Gazette II No. 196/2016**

The amendment determines the content of information to be provided to beneficiaries, and brings the PK-InfoV into line with the Information Requirements Regulation for Occupational Group Insurance (BKV-InfoV; Betriebliche Kollektivversicherung Informationspflichtenverordnung). In addition, the calculation of the forecasts of the likely amount of pension benefits and entitlement is redefined.

**Amendment to the 2007 Issuer Compliance Regulation (ECV 2007; Emittenten-Compliance-Verordnung),
Federal Law Gazette II No. 214/2016**

The ECV 2007 has been adapted to comply with Regulation (EU) No 596/2014 on market abuse and the related

amendment of the BörseG. Noteworthy is also that issuers are now no longer required to submit their compliance guideline or any changes to it to the FMA.

Amendment to the Fourth Regulation on Risk Calculation and Reporting of Derivative Instruments (DeRiMV 4; 4. *Derivate-Risikoberechnungs- und Meldeverordnung*), Federal Law Gazette II No. 242/2016

This amendment introduces technical improvements regarding the reporting format and adapts the regime used to submit reports on legal questions within the meaning of Article 14 para. 4 no. 2 InvFG 2011 to the legal entity regime as referred to in Article 15 WAG 2007.

Amendment to the Deposit Guarantee Schemes Reporting Regulation (SiEi-MV; *Sicherungseinrichtungen-Meldeverordnung*), Federal Law Gazette II No. 257/2016

The SiEi-MV serves to determine the scope and form, as well as the contents and structure, of the reports to be submitted by deposit guarantee schemes in accordance with Article 33 para. 1 of the Deposit Guarantee Schemes and Investor Compensation Act (ESAEG; *Einlagensicherungs- und Anlegerentschädigungsgesetz*). Reports must be submitted exclusively to the Oesterreichische Nationalbank (OeNB), and some changes to technical reporting requirements are also stipulated.

Amendment to the Regulation on Forms for Corporate Provision Funds (BVK-FBIV; *Betriebliche Vorsorgekassen-Formblätterverordnung*), Federal Law Gazette II No. 312/2016

This amendment adapts the forms to be used by corporate provision funds for their balance sheet and income statement in order to comply with the RÄG 2014.

Amendment to the Life Insurance Profit Sharing Regulation (LV-GBV; *Lebensversicherung-Gewinnbeteiligungsverordnung*), Federal Law Gazette II No. 322/2016

This amendment brings greater readability with regard to the calculation of the minimum assessment basis for profit sharing, and more clarity with regard to the option of also taking into account deferred taxes that had already been included in the minimum assessment basis.

Amendment to the Accounting Regulation for Insurance and Reinsurance Undertakings (VU-RLV; *Verordnung über die Rechnungslegung von Versicherungs- und Rückversicherungsunternehmen*), Federal Law Gazette II No. 323/2016

This amendment adds additional provisions to the VU-RLV, with others being adapted to reflect practical experience. It includes, for instance, more detailed modalities for using the option relating to the valuation of investments described in Article 149 para. 2 of the 2016 Insurance Supervision Act (VAG 2016; *Versicherungsaufsichtsgesetz*).

Amendment to the 2016 Volatility Reserve Regulation (VU-SWRV 2016; *Schwankungsrückstellungs-Verordnung*), Federal Law Gazette II No. 324/2016

This amendment expands the scope of application referred to in Article 154 para. 1 VAG 2016 (volatility reserve) for the insurance class of non-life and accident insurance to include reinsurance, thus reinstating the legal situation as existed before the introduction of the VAG 2016.

Repeal of the Mapping Regulation pertaining to the Capital Requirements Regulation (CRR-*Mappingverordnung*), Federal Law Gazette II No. 367/2016

The Regulation expired as it was superseded by the new regulatory technical standards as referred to in Article 136(1) and (3) of Regulation (EU) No 575/2013, the Capital Requirements Regulation (CRR), concerning the EU-wide mapping of credit assessments to credit quality steps.

Deposit Guarantee Scheme Stress Test Regulation**(SiEi-StrV; *Sicherungseinrichtungen-Stresstestverordnung*), Federal Law Gazette II No. 370/2016**

The SiEi-StrV determines the content and format of the results to be submitted to the FMA for stress tests conducted by deposit guarantee schemes pursuant to the EBA Guidelines EBA/GL/2016/04.

2016 Master Data Reporting Regulation (StDMV 2016; *Stammdatenmeldungsverordnung*), Federal Law Gazette II No. 371/2016

This Regulation defines the reporting dates, structures and contents of the reports on corporate master data to be provided by credit institutions to the FMA, and replaces the former StDMV. Holding and equity interest data are no longer collected by way of an asset statement pursuant to the Regulation on Asset, Income and Risk Statements (VERA-V; *Vermögens-, Erfolgs- und Risikoausweis-Verordnung*) but according to the StDMV 2016. By centralising the reporting of groups and affiliations of credit institutions and by removing reporting obligations for certain data that is already available at the OeNB, the related administrative burden is reduced.

Amendment to the Regulation on Asset, Income and Risk Statements**(VERA-V; *Vermögens-, Erfolgs- und Risikoausweis-Verordnung*), Federal Law Gazette II No. 372/2016**

The amendment was introduced to adjust reporting content, to adapt the Regulation to comply with the RÄG 2014 and to harmonise reporting content with the provisions in the StDMV 2016. Furthermore, details are specified in relation to the data that credit institutions must report for payment accounts that they manage for or offer to consumers. In addition, an exemption from certain reporting obligations is implemented for credit institutions that are required to apply international accounting standards in accordance with Article 24(2) of the CRR.

Amendment to the Regulation on Financial Statements and Consolidated Financial Statements**(JKAB-V; *Jahres- und Konzernabschluss-Verordnung*), Federal Law Gazette II No. 392/2016**

The amendment was made to bring the Regulation into line with the RÄG 2014.

Amendment to the Regulation on Payment Institution and E-Money Institution Reports**(ZEIMV; *Zahlungs- und E-Geld-Institute-Meldeverordnung*), Federal Law Gazette II No. 393/2016**

The amendment was made to bring the Regulation into line with the RÄG 2014.

Amendment to the CRR Supplementary Regulation**(2nd CRR-BV Amendment; 2. *Novelle der CRR-Begleitverordnung*), Federal Law Gazette II No. 403/2016**

The amendment sets the framework in an abstract and general manner for the pre-authorisation for the redemption of capital holdings during the 2017 calendar year on the basis of called cooperative shares, as laid down in EU legislation (Article 77 of the CRR; Article 32(2) of the Own Funds RTS). At the same time, pre-authorisation is granted for 2017.

INTERNATIONAL LEGISLATION**LEGISLATION, REGULATIONS AND DIRECTIVES ADOPTED IN 2016****Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts (BMR)**

A benchmark is an index or indicator that is used as a reference price for a financial instrument or contract or to measure the performance of investment funds. Benchmarks are calculated in the financial industry on the basis of representative data or information, and influence the pricing of numerous (highly leveraged) derivatives. Examples include the two interest rate benchmarks LIBOR (London Interbank Offered Rate) and EURIBOR (Euro Interbank Offered Rate), as well as oil and foreign exchange benchmarks.

The Benchmarks Regulation aims at improving governance in connection with those benchmarks that are used in the EU for financial instruments such as bonds, shares, options and futures, and swaps. An example of governance as used here is how conflicts of interest are resolved. The new rules are also of direct relevance to consumers, considering that benchmarks determine how much millions of households in the EU pay in mortgage payments. The new Regulation is also intended to minimise the risk of manipulation, by requiring authorisation and supervision of benchmark administrators in the EU. Effective entry into force: 1 January 2018.

Regulation (EU) 2016/2340 amending Regulation (EU) No 1286/2014 on key information documents for packaged retail and insurance-based investment products as regards the date of its application

The PRIIPs Regulation introduced a series of measures aimed at enhancing investor protection, particularly requiring manufacturers of packaged retail and insurance-based investment products to produce a key information document (KID). This Regulation stipulates a deferral of twelve months for the application of the PRIIPs Regulation, giving additional time for those concerned to adhere to the new requirements. Consequently, the PRIIPs Regulation will now apply from 1 January 2018. Effective entry into force: 24 December 2016.

Regulation (EU) 2016/1033 amending Regulation (EU) No 600/2014 on markets in financial instruments (MiFIR) and Directive (EU) 2016/1034 amending Directive 2014/65/EU on markets in financial instruments (MiFID)

These legal acts defer the dates of application of MiFID II and MiFIR by one year, which became necessary given the complexity of the new legal framework. MiFIR now effectively applies from 3 January 2018, while the date by which Member States must have implemented MiFID II has been deferred to 3 July 2017. Effective entry into force: 1 July 2016.

Regulation (EU) 2016/2067 amending Regulation (EC) No 1126/2008 adopting certain international accounting standards as regards International Financial Reporting Standard 9

This Regulation adopts IFRS 9 in EU legislation, thus improving the financial reporting of financial instruments. Specifically, IFRS 9 means a move to a more forward-looking model for the recognition of expected losses on financial assets. The new standard will apply from 1 January 2018, with an earlier application being possible, and replaces the current International Accounting Standard 39 (IAS 39) “Financial Instruments: Recognition and Measurement”. Since IFRS 9 and IFRS 17 (the future standard for insurance contracts) have different effective dates, optional deferral of the application of IFRS 9 for the insurance sector is recognised. The Amendments to IFRS 4 (the current standard for insurance contracts), which the International Accounting Standards Board (IASB) published on 12 September 2016, enables insurance undertakings whose predominant activity is issuing contracts within the scope of IFRS 4 to defer application of IFRS 9 from 2018 to 2021. Effective entry into force: 1 January 2018.

Directive (EU) 2016/97 on insurance distribution (IDD)

This Directive replaces the former Insurance Mediation Directive (IMD I) to ensure that all operators involved in the distribution of insurance products enjoy a level playing field. The aim is to increase the level of consumer protection when concluding an insurance contract. Consumers should be given more options and provided with more information in future when they want to buy insurance products. Such rules on consumer protection will also apply in future to purchases of insurance products from an insurance company. Additionally, the Directive includes these changes in particular:

- Insurance distributors are required to ensure greater transparency with regard to pricing and costs. Consumers must at any rate be informed whether sellers of an insurance product have an economic interest of their own in selling the product.
- In relation to the distribution of non-life insurance products, better and easier-to-understand information must be provided by way of a standardised insurance product information document.

- Where insurance products are offered together with other goods or services (e.g. motor vehicle insurance included with a new car), the consumer must be able to buy the main good or main service without the insurance.
- Rules on transparency and business practices are prescribed, intended to prevent consumers from buying products that do not meet their needs. Additional requirements apply, for example, to the selling of life insurance-based investment products.
- In connection with the Markets in Financial Instruments Directive II (MiFID II), Member States may allow insurance operators to continue to generate income from commissions or payments from third parties when selling insurance products, provided that such commissions are proven to be for the benefit of the client.

Implementation deadline: 23 February 2018.

Directive (EU) 2016/2341 on the activities and supervision of institutions for occupational retirement provision (IORP II Directive)

This Directive is aimed at helping to strengthen the internal market for occupational retirement provision. It should facilitate the cross-border activities of institutions for occupational retirement provision (IORPs), ensure effective supervision of IORPs and strengthen governance. Moreover, the proposals extend the requirements relating to the disclosure of information to members and beneficiaries, and modify the rules on investment. Implementation deadline: 13 January 2019.

EUROPEAN LEGISLATIVE PROJECTS

The following legislative projects of particular relevance to the FMA's activities were discussed at European level in 2016 but have not yet been concluded.

Regulation on Money Market Funds – Commission proposal COM(2013) 615

The proposal introduces common standards to increase the liquidity of money market funds (MMFs) as well as to ensure the stability of their structure. Uniform rules will be introduced to ensure a minimum level of daily and weekly liquid assets. A standardised policy will be established to permit fund managers to gain a better understanding of their investor base. Common rules are also being introduced to guarantee that MMFs invest in high-quality and well diversified assets with good credit ratings. In this way it will be ensured that the liquidity of the fund is adequate to meet investors' redemption requests. The stability of MMFs will be ensured through the creation of clear and harmonised valuation rules for the assets in which the MMFs invest.

Regulation laying down common rules on securitisation and creating a European framework for simple, transparent and standardised securitisation (STS) – Commission proposal COM(2015) 472

This proposal contains rules for simple, transparent and standardised (STS) securitisations. Two types of STS requirements are defined, one for long-term and one for short-term securitisations. While the requirements are intended to apply to all financial sectors, only "true sale" securitisations will be allowed to be designated as STS. Originators, sponsors and securitisation special purpose entities (SSPEs) will in future be jointly responsible for ensuring compliance with STS requirements and for reporting to ESMA. Special due diligence requirements have been laid down for institutional investors.

Regulation amending Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms (CRR) – Commission proposal COM(2015) 473

Alongside the STS Regulation, a regulation to amend the Capital Requirements Regulation (CRR) with regard to capital requirements for securitisation positions has also been proposed. The amendments should tackle three problematic issues:

- mechanistic reliance on external ratings in determining capital requirements;

- insufficient risk-sensitivity due to the lack of sufficient risk drivers across approaches in determining risk weights; and
- procyclical cliff effects in capital requirements.

To remove any form of mechanistic reliance on external ratings, an institution should in future use its own calculation of regulatory capital requirements where the institution has permission to use the Internal Ratings Based approach (IRB) in relation to exposures of the same type as those underlying the securitisation and is able to calculate regulatory capital requirements in relation to the underlying exposures as if these had not been securitised (“Kirb”), in each case subject to certain pre-defined inputs (the “SEC-IRBA”). A Securitisation External Ratings-Based Approach (“SEC-ERBA”) should then be available to institutions that cannot use the SEC-IRBA in relation to their positions in a given securitisation. Under the SEC-ERBA, capital requirements should be assigned to securitisation tranches on the basis of their external rating. When the first two approaches are not available or the use of the SEC-ERBA would result in incommensurate regulatory capital requirements relative to the credit risk embedded in the underlying exposures, institutions should be able to apply the Securitisation Standardised Approach (the “SEC-SA”), which should rely on a supervisory-provided formula.

Regulation on the prospectus to be published when securities are offered to the public or admitted to trading – Commission proposal COM(2015) 583

This proposal is intended as a revision of Directive 2003/71/EC (Prospectus Directive). In future, an exception is to be made from the prospectus obligation for the raising of small amounts of capital, while the minimum thresholds requiring a company to issue a prospectus are to be increased. Specifically, no EU prospectus will be required where less than € 500 000 in capital is to be raised (currently € 100 000), while Member States will be able to set higher thresholds for their domestic markets; the corresponding maximum will be increased from € 5 million to € 10 million. Other proposals include a simplified prospectus for small companies (with a market capitalisation of up to € 200 million), briefer prospectuses and improved investor information, less stringent requirements for secondary issuances by listed companies, accelerated and simplified procedures for active issuers, and extended supervisory and investigatory powers for competent authorities.

Regulation in order to establish a European Deposit Insurance Scheme (EDIS Regulation) – Commission proposal COM(2015) 586

The proposal contains the following provisions concerning the planned European Deposit Insurance Scheme (EDIS):

- EDIS is to be built upon the existing system composed of national deposit guarantee schemes (DGSs); each investor will continue to enjoy the same level of protection (€ 100 000).
- EDIS is to be cost-neutral for the banking sector, as the contributions paid by the banks to EDIS may be compensated at the level of the national DGSs.
- EDIS is to be risk-weighted: banks facing higher risks will be required to contribute more than banks with lower risks, and this principle will be applied more vigorously as EDIS is gradually implemented, while such risk-weighting will apply from the outset.
- EDIS membership will be mandatory for euro area countries whose banks are currently under the Single Supervisory Mechanism (SSM) but also open to other EU Member States wishing to join the banking union.

EDIS is to be introduced in three stages by 2024, and a European Deposit Insurance Fund is to be created.

Directive amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing – Commission proposal COM(2016) 450

The Commission is proposing the amendment of the Fourth Anti-Money Laundering Directive to prevent the financial system from being used to finance terrorist activities. The following measures are proposed:

- Public access to registers disclosing beneficial ownership information: Member States should in future disclose via a register certain information on the beneficial ownership of companies and business-type trusts.

Information on all other types of trusts will be included in the national register and access provided to third parties demonstrating a legitimate interest to that information. Beneficial owners who hold at least 10% in certain types of entities which present a specific risk of being used for money laundering and tax evasion will be added to the register. The threshold for shareholdings remains at 25% for all other entities.

- Interconnection of registers: the proposal recommends interconnecting registers directly in order to improve cooperation amongst Member States.
- More information for companies: new and existing accounts should be monitored by applying customer due diligence, which should prevent accounts that are potentially being used for illegal activities remaining undiscovered. Passive non-financial entities and trusts will also be subject to stricter monitoring and tighter rules.

Regulation amending Regulation (EU) No 345/2013 on European venture capital funds (EuVECA) and Regulation (EU) No 346/2013 on European social entrepreneurship funds (EuSEF) – Commission proposal COM(2016) 461

The EuVECA and EuSEF fund structures were created to offer opportunities to raise and invest capital in innovative small and medium-sized enterprises (SMEs) and social undertakings throughout Europe. This Commission proposals aims to eliminate the following identified barriers:

- The group of fund managers that may manage and market EuVECA and EuSEF funds is being extended to include large managers whose portfolios exceed € 500 million.
- ESMA will be requested to develop regulatory technical standards on methodologies for determining the amounts of sufficient own funds.
- Host Member States may not charge fees on cross-border EuVECA and EuSEF funds.
- Investments in undertakings with up to 499 employees (small mid-caps) and in small and medium-sized enterprises listed on an SME growth market as defined in Directive 2014/65/EU on markets in financial instruments should be permitted to allow growth-stage entities that already have access to other sources of financing to also receive capital from EuVECA funds. Follow-on investments in a given undertaking that no longer meets the definition of a qualifying portfolio undertaking after the first investment should also be allowed.

Legislative package of the Commission including amendments to the following Regulations and Directives:

- **Regulation (EU) No 575/2013 (CRR) as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements and amending Regulation (EU) No 648/2012 (EMIR) – Commission proposal COM(2016) 850**
- **Regulation (EU) No 806/2014 as regards loss-absorbing and recapitalisation capacity for credit institutions and investment firms – Commission proposal COM(2016) 851**
- **Directive 2014/59/EU (BRRD) on loss-absorbing and recapitalisation capacity of credit institutions and investment firms – Commission proposal COM(2016) 852**
- **Directive 2014/59/EU (BRRD) as regards the ranking of unsecured debt instruments in insolvency hierarchy – Commission proposal COM(2016) 853**
- **Directive 2013/36/EU (CRD IV) as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures – Commission proposal COM(2016) 854**

On 23 November 2016 the Commission proposed far-reaching amendments to the Capital Requirements Regulation (CRR), the Fourth Capital Requirements Directive (CRD IV), the Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism (SRM). The most important projects are:

- (Mixed) financial holding companies are to be subjected to prudential supervision, thus also requiring a licence in future.

- A new asset class of ‘non-preferred’ senior debt will be created that would only be bailed-in after other capital instruments and subordinated loans but before other senior unsecured debt. Institutions may now issue either ‘non-preferred’ senior debt or continue to issue senior unsecured debt. This proposal applies solely to any future issues from July 2017 onwards.

The present proposals implement some outstanding elements of the regulatory framework recently finalised by the Basel Committee on Banking Supervision and the Financial Stability Board (FSB). These include:

- more risk-sensitive capital requirements, particularly in relation to market risk, counterparty credit risk and exposures to central counterparties (CCP);
- implementation of the provisions taking greater account of the actual risks to which banks are exposed;
- a binding leverage ratio preventing institutions from excessively increasing leverage;
- a binding net stable funding ratio (NSFR) to overcome excessive dependence on short-term sources of funding in the interbank market and to lower long-term financing risk;
- requirements for global systemically important institutions (G-SIIs) to hold a minimum level of own funds and other instruments with loss-absorbing capacity. The so-called total loss-absorbing capacity (TLAC) will be integrated into the existing minimum requirement on own funds and eligible liabilities (MREL) applicable to banks, boosting the EU’s ability to resolve failing G-SIIs without endangering financial stability while at the same time minimising risks for taxpayers. To this end, it is proposed to harmonise the ranking of unsecured debt instruments currently laid down in national insolvency laws, which would make it easier for banks to issue debt instruments with the required loss-absorbing capacity.

Moreover, the amendment aims at strengthening banks’ lending capacities. Some specific measures should help:

- to improve banks’ capacities to provide loans to SMEs and to fund infrastructure projects;
- to reduce the disproportionate administrative burden related to remuneration rules for smaller and less complex institutions (e.g. deferral and pay-out in instruments such as equity);
- to improve the proportionality of the rules contained in the CRR and the CRD, thus relieving the burden on smaller and less complex institutions.

Ultimately, banks’ ability to create deeper, more liquid EU capital markets for the Capital Markets Union will be enhanced. A few specific adjustments are planned in relation to the proposed measures in order:

- to avoid disproportionate own funds requirements for trading book positions, including positions from market-making activities;
- to reduce the cost for issuing/holding certain instruments (covered bonds, high-quality securitisation instruments, sovereign debt instruments, derivatives for collateralisation);
- to avoid any disincentives for institutions that interpose themselves in transactions cleared through central counterparties.

Regulation on a framework for the recovery and resolution of central counterparties – Commission proposal COM(2016) 856

This proposal for a regulation on the recovery and resolution of central counterparties (CCP) is designed to supplement the requirements for CCP according to Regulation (EU) No 648/2012, the European Markets Infrastructure Regulation (EMIR), and is based in terms of content on Directive 2014/59/EU, the Bank Recovery and Resolution Directive (BRRD). The key points of the Commission proposals are as follows:

- Preparation and prevention: CCPs will be required to prepare recovery plans, which will have to be reviewed by the competent supervisory authority and which must, among other elements, include measures that would exceed their default management resources and other requirements under EMIR.
- Early intervention: The aim of early intervention measures is to ensure that financial difficulties are countered as soon as they occur. Supervisory authorities responsible for a CCP should be granted specific intervention powers or be allowed to require the CCP to undertake specific actions in its recovery plan or to change its business strategy.
- Resolution tools and powers: In accordance with the guidance of the Financial Stability Board, a CCP should

be placed in resolution when it is failing or likely to fail, when no private sector alternative can avert failure, and when its failure would jeopardise the public interest and financial stability, or where the application of further recovery measures could compromise financial stability in the process.

- Cooperation among national authorities: Resolution colleges are to be set up for each CCP, and all competent national resolution authorities as well as ESMA and EBA should be represented in these colleges.

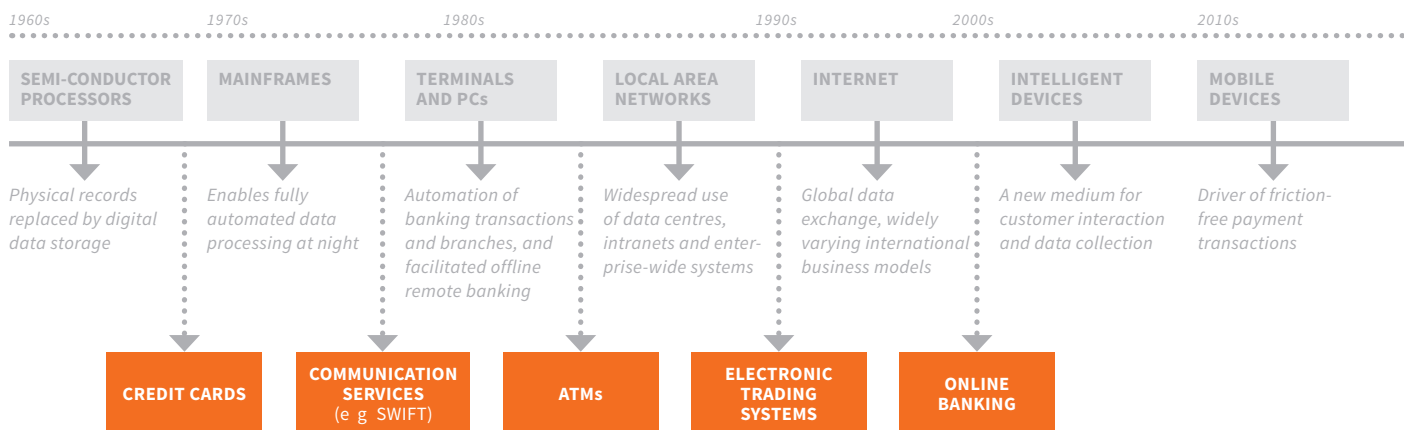
The FMA’s Digital Roadmap

Responses to the challenges posed by new technologies

The core and driver of every market economy is innovation: it generates progress, growth and prosperity. Seen thus, the much-touted “digital revolution” is nothing more than a further evolutionary step particularly affecting financial services markets. The development of semi-conductors and micro-processors in the 1960s led to paper files gradually being replaced by digital files, while the advances in computer technology – beginning with mainframes and on through desktop PCs to local networks – in the 1970s, 1980s and 1990s resulted in an acceleration and in enhanced cost-effectiveness, first of the processing of such data and then of financial transactions, so that in the end all banking operations became digitally automated and interlinked. Similarly, the internet and smartphones have been revolutionising the relationship between financial service providers and their customers since the 1990s. New technologies, new techniques and new technical solutions consistently give way to new horizons: new, improved and more efficient technical solutions and new, improved and more attractive products.

A whole string of new technologies are currently gaining a foothold and are soon to be capitalised on once they reach market maturity in the form of profitable applications: biometrics, cloud computing, cognitive computing,

Figure 1: Technological progress in the finance sector



distributed ledger technology and blockchain technology, machine learning and predictive analytics, quantum computing and robotics, to name just a few examples.

TECHNOLOGICAL CHANGE CHALLENGES REGULATORS

Yet, new technologies always confront regulatory and supervisory authorities with major challenges as well. On the one hand, such developments raise questions about the business models practised by existing (licensed) providers, while at the same time others are pushing into the market: new, young and dynamic providers with creative solutions as well as providers previously not active in financial markets, often with a huge input of capital and marketing power.

Regulators and supervisors are generally called on to take a neutral stance towards innovation and technological developments. They should especially not stand in the way of new developments that have the potential of improving the efficiency and effectiveness of the financial system and of contributing to competitiveness and prosperity. Instead, they should take efforts to ensure conditions that nurture technological change and innovation.

The FMA has accordingly developed its own strategy, referred to as the Digital Roadmap, which aims at defining how innovation in general and the digital revolution in particular can best be utilised to the benefit of the Austrian financial market:

- A call for input addresses supervised entities and the bodies representing their interests, along with stakeholders in general, inviting them to identify and jointly analyse with the Authority existing regulatory obstacles and impediments and to devise appropriate solutions.
- The FinTech point of contact established with the FMA last year provides a single point of contact for FinTechs (start-up companies specialised in financial technology) to clarify all regulatory issues swiftly.
- As a rule, the digital world favours (web-based) cross-border activities. The FMA correspondingly concentrates on international cooperation in this area, participating in transnational working groups of specialists representing regulators and supervisors.
- As part of ongoing supervision of companies licensed by the FMA, the Authority evaluates the regulatory challenges raised by technological change, responding in particular to the potential risks posed by the use of new technologies. A few buzzwords in this context, by way of example, are: cyber risk, IT and data security, outsourcing and interfaces, and operational risks.

With its Digital Roadmap, the FMA seeks to accompany technological change as a driver of growth in the Austrian financial market, while at the same time ensuring market stability, securing a level playing field (in other words, fair conditions for all, including competitors from other sectors and countries) and safeguarding the highest possible level of investor and consumer protection.

CALL FOR INPUT

The transition from the analogue to the digital world raises questions about previously proven regulatory practices. One example each from banking and insurance supervision practice demonstrate how regulations can impede new technologies, and how these obstacles can be overcome without compromising consumer protection or investors' confidence in the financial markets.

The Austrian Banking Act (BWG; *Bankwesengesetz*) has followed the “know your customer” (KYC) principle by requiring banks to physically identify every customer, at least when the first business relationship is initiated. That is, every customer must provide physical proof of identity at least once. This represents an impediment, however, when viewed in the context of cross-border or even global financial transactions carried out using new means of communication ranging from the internet to the smartphone.



Prompted by financial service providers, the FMA subsequently approached Austrian policymakers to have this legal impediment eliminated. While satisfying this request, policymakers simultaneously gave the FMA the legal mandate to identify a regulatory solution that nonetheless conforms with the KYC principle. The FMA fulfilled this mandate, issuing a regulation that specifies the terms under which video identification has been permitted as of 1 January 2017.

In insurance supervision legislation, comprehensive obligations for providing information to customers have been defined where the written form is required. An insurance contract, for example, still has to be presented to the customer in the form of a paper document. Directive (EU) 2016/97, the new Insurance Distribution Directive (IDD), insists in general that the information to be provided has to be made available in paper form. The information obligations can be met using digital means, however, if the customer consents to the information being provided by means of another durable medium or a website (and several other conditions as referred to in Article 23(4) and (5) are met). Information can be provided via a website where this is appropriate in the context of the underlying business and the customer has been notified electronically of the address of the website, and the place on the website where that information can be accessed. It also needs to be ensured that the information remains accessible on the website for such period of time as the customer may reasonably need to consult it. The provision of information using a durable medium other than paper or by means of a website is regarded as appropriate if there is evidence that the customer has regular access to the internet. If the customer provides an e-mail address, this is sufficient as such evidence. The insurance undertaking is nonetheless required to provide the document free of charge on paper at any time on the customer's request.

Supervisory authorities have the general responsibility of evaluating whether new financial services or those with a modified underlying technology need to be regulated by law to ensure a level playing field and consumer protection, and to safeguard financial market stability. A case here is Directive (EU) 2015/2366, the Second Payment Services Directive (PSD2), in which several proposals made by regulators and supervisors were taken into account, specifically through subjecting certain innovative financial services to licensing requirements and thus to supervision; implementation of the Directive at national level is scheduled for 2017. Certain account information services and payment initiation services ("third-party payment service providers") will subsequently fall within the scope of the Payment Services Act (ZaDiG; *Zahlungsdienstegesetz*). Parties who provide consolidated information on accounts with payment service providers as well as providers who initiate payments via interfaces with payment service providers will be subjects of regulation in future, even though they do not directly come into contact with customer funds. The ZaDiG already contains provisions regulating mobile payment providers, payment apps, NFC payment services and all types of payment interfaces.

The call for input is intended to result in a systematic screening of all regulatory measures in order to identify similar impediments and obstacles, thereby allowing them to be replaced by solutions that are more appropriate in terms of contemporary requirements and technologies.

FINTECH POINT OF CONTACT

Like the innovative applications they yield, new technologies are generally not developed in large, established firms but are frequently the product of young, creative and dynamic teams that found start-ups to seek market opportunities. Those developing applications for financial markets are often referred to as "FinTechs". Subcategories have already come into use for certain areas, for example "InsurTechs" for the insurance sector (see box on page 21).

The FMA defines FinTech products as referring to innovations in the area of financial services that are based on information technology and that:

- are frequently but not necessarily developed by non-licensed companies;
- typically include interfaces to the systems of licensed enterprises; and
- have the potential of causing changes that permanently affect how the financial sector currently operates.

INSURTECH – THE DIGITAL CHALLENGE IN THE INSURANCE SECTOR

In a way similar to the banking sector, the rapid technological progress unleashed by digitisation and the use of big data will permanently change the face of the insurance business in the coming years and decades. This development is being driven especially by start-up companies specialised in the use of advanced financial management technologies. The term “InsurTech” has been coined to designate such a firm with a specialisation in the insurance business.

Such InsurTechs offer a broad spectrum of innovative products and solutions: digital insurance managers, insurance brokers and insurance intermediaries; comparison calculators for insurance premiums; digital management of insurance contracts; apps for selling insurance products; claims management solutions; GPS-supported, individually customised insurance products in line with use and risk; and peer-to-peer insurance. And these are just a few examples.

Due to complex insurance products requiring a great deal of additional information, InsurTechs are for the time being concentrating mostly on standard and mass products. According to CSC’s Digital Insurance Monitor 2016, customers currently appreciate in particular: the broad overview of a variety of insurance products (62%), the direct avenue of communication with the insurance undertaking or their intermediaries (11%), easy comparison of products (10%), direct digital exchange of documents (10%) and the ability to directly conclude contracts (2.7%). Yet the CSC study also identified a continued divide in the actual use of digital services:

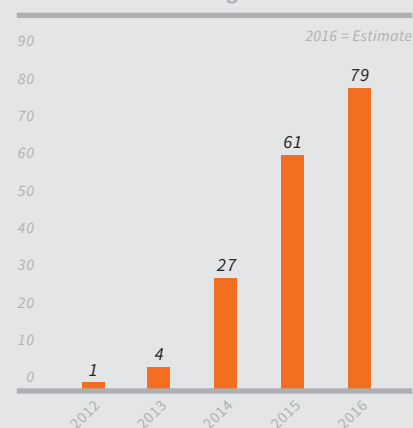
- One in four customers in Austria has already concluded at least one insurance contract online (most often cancellation and travel insurance in the context of internet purchases or bookings), yet the initial online contract does not always motivate customers to conclude further contracts in this way.
- Over 70% of customers, while actually concluding the contract “offline”, gather information from various insurance companies beforehand online. Only 35% of all customers still get in touch with a broker first when looking for the right insurance product.
- The “digital natives”, that is the generation that has grown up with the internet, mobile phones and social media, obtain their information almost exclusively from the internet. Yet, in the end, 42% of them do not conclude a contract and are relatively underinsured.
- When it comes to claims reporting, 50% of all Austrian customers prefer to do this through their personal insurance intermediary. In this context, customers give the highest priority to their claims being handled swiftly.

Nonetheless, it is generally agreed today that the digital revolution will impact and transform every element of the insurance sector’s business model.¹ This gives way to an abundance of risks and opportunities for both insurance undertakings and their customers.

OPPORTUNITIES

- **Providing more information:** New technologies facilitate access to more information, allow efficient comparison – at least of less complex products – and make it easier for customers to change insurance suppliers.
- **Improved customer communication:** According to the CSC study, only 48.4% of customers still prefer personal contact, while 27.6% would rather communicate via e-mail, 13.2% by phone and only 4.8% by letter. More efficient and effective communication is possible through digital interfaces such as online portals,

Chart 1: InsurTech investments by insurance undertakings 2012–2016



¹ Oliver Wyman presents similar conclusions in “Versicherung 2025, ein Zukunftsszenario für die Gewinner von morgen” (*Insurance 2025: A Future Scenario for the Winners of Tomorrow*), 2016.

customer sign-in sites, live chats or Skype, while functions such as claims tracking, image uploading and the management of all contracts in a single app can also contribute. Customers benefit from enhanced convenience and companies from cost-savings.

- **New distribution channels:** For both customers and insurance undertakings, digital media pave the way for customised, convenient and cost-effective distribution services available 24/7. What is more, disintermediation effects can lead to contract negotiations being made easier, to improved customer care and accelerated claims processing.
- **Personalised insurance coverage:** Increased digitisation – represented by keywords such as big data, the internet of things and customer tracking – allows insurance undertakings to collect and analyse an almost unfathomable volume of data and information, to observe and monitor customers’ behaviour, and to subsequently offer customised and personalised products. In the motor vehicle insurance sector, for example, “pay as you drive” rates can be offered that vary according to the individual’s driving habits and patterns of vehicle use. In health insurance, plans can be offered that include premium refunds depending on the distance the policyholder walks each day.
- **Further development of insurers’ business models:** The consistent application of new technologies can open new distribution channels and new markets while at the same time unleashing enormous potential for cost savings. Cyber risks, for example, not only represent a potential threat but also carry with them inherent potential for innovative insurance products. National borders have little or no meaning in the digital world, which translates to cross-border business opportunities. Regulation and supervision, meanwhile, are being put at an international level.

RISKS

- **Data security:** As digitisation progresses, so does the vulnerability for cyber risks, where a specific security system does not keep pace with the rate of innovation. Due to the sensitive nature of the data managed (for instance where health data is involved), especially high standards in the way of data privacy, data security and data sovereignty need to be observed.
- **Undermining the risk pool:** Increasing digitisation could lead to extreme segmentation or even individualisation of insurance policyholder groups, which would ultimately undermine the notion of the risk pool and risk sharing. As a consequence, there is a danger that certain customers, for instance those with a high claims rate or at high risk, might no longer be offered insurance contracts or only at significantly higher premiums. Insurance based on the “law of small numbers” just cannot work.
- **Digital divide:** The digital natives are the driving force behind the digital revolution. Shaping the development, they have learned to think logically by gaming and make use of technology intuitively. At the same time, the societies in the developed industrialised nations are facing the problem of an increasingly elderly population, with large segments unable or unwilling to keep up with the latest technological and digital advances and therefore being left behind. In a worst case scenario, society might come to be divided between digital residents and digital foreigners. Meanwhile, incomes, assets and insurance needs are generally higher among the older segments of the population, that is digital foreigners. This divide should be given more attention when developing new products and devising business models.
- **Market and product segmentation:** InsurTech products are mainly suited for standardised needs in the mass market and as products requiring little or no advice. Distribution for this segment will increasingly shift to the digital world. At the same time, the need for advice will increase in the case of complex products and for customer groups falling under the digital foreigner category.

The innovative technical solutions offered in this category are currently concentrated especially in these areas: new payment systems, virtual currencies and alternative means of payment, automated advice systems and automated platforms, algo trading, social trading, signal trading and mirror trading, (equity or investment) crowdfunding, and interfaces or other technical services for financial service providers. Here either new financial services are provided or previously existing products are simply distributed through new channels, including online platforms, apps or innovative technologies such as the distributed ledger.

Banks, for example, use smartphone apps to present their existing account or credit products to customers in a way that is adapted to the needs of digital natives, that is the generation which has grown up with the internet, smartphones and social media. In the meantime, many people take 24/7 banking and mobile devices for granted. For payment services and securities transactions, large, established financial service providers are working on faster and more cost-effective solutions, based on distributed ledger and blockchain technologies, which nonetheless ensure safe transactions.

International management consultant Oliver Wyman observes that in the initial stages of the digital revolution FinTechs usually tried to push out established providers with their products and business models. Oliver Wyman refers to this phase as “FinTech 1.0”. Today, he says, FinTechs can be seen to dock onto established (and licensed) providers to get around regulatory obstacles while also to quickly gain substantial market shares and establish their particular technical solution in a position dominating the market. Oliver Wyman calls this “FinTech 2.0”.

Since financial markets represent one of the most toughly regulated sectors of the economy, it can often be found that regulatory provisions also have a bearing on innovative products, technical solutions or business models. The legal basis in such cases is usually highly complex and diverse, often presenting an unsurmountable challenge for such newcomers who in most cases have a technical or business background. Innovations can intersect with supervisory legislation in many and varying ways:

- The service offered can per se represent a financial transaction subject to licensing requirements. Business models in the areas of new payment methods, means of payment, crowdfunding and virtual currencies can fall under licensing requirements as defined in the BWG, the ZaDiG and the 2010 Electronic Money Act (E-GeldG 2010; *E-Geldgesetz*).
- In the case of equity crowdfunding, both the provider and the platform brokering the service can be subject to licensing requirements. Of particular relevance here are the BWG and the 2007 Securities Supervision Act (WAG 2007; *Wertpapieraufsichtsgesetz*). A public offering of certain kinds of securities and investments can trigger a prospectus obligation as defined in the Capital Market Act (KMG; *Kapitalmarktgesetz*).
- Automated advice and brokering systems, trading systems and trading robots can trigger in particular a licensing obligation based on the WAG 2007 or the BWG, depending on the instrument used by the system in the individual case.
- What is more, other regulatory provisions such as those intended to prevent money laundering and terrorist financing have to be observed when providing practically any financial service.

And this list represents only a few examples.

The FMA's integrated approach to supervision, which unites the regulation and supervision of Austria's entire financial market under one roof, is proving itself in the face of these future issues. With their knowledge and skills, the FMA's experts cover all sectors of the financial market – from banks to insurance undertakings and *Pensionskassen*, from investment firms and investment funds to securities and investments, from prospectus requirements and anti-money laundering to combating unauthorised business activities. Yet this expertise also takes in interdisciplinary issues such as data security, IT system reliability, signing digital contracts and forms of identification. The FMA deals with such subjects, largely avoiding any inefficiencies, at a level overriding individual sectors and products while leveraging any possible synergies.

With its FinTech point of contact, the FMA has established a single point of contact for enquiries related to financial innovation and FinTechs, which serves as a central enquiry desk for any such issues, clarifying these questions through integrated action within the FMA and with the support of the Authority's network of experts, i. e. its “knowledge centre”.

At the basis is the comprehensive range of information on the topic of FinTechs provided on the FMA's website as well as a specially designed online entry form, which facilitates enhanced structuring and background information when submitting legal enquiries concerning a particular business model.

The contact point subsequently coordinates the preparation of an integrated response to the queries concerning FinTechs (even those submitted through other avenues) within the FMA, while responding as a single contact representing the FMA to the outside and as an expert consultant for FinTech companies.

After being set up in October 2016, in the first six months of operation the contact point already evaluated 25 cases involving problems or business models related to FinTechs, investigating the issues and proposing appropriate solutions from a supervisory perspective.

INTERNATIONAL COOPERATION

Financial market law today is for the most part EU law. At the same time, where offering financial services is involved, the digital revolution does not halt at national boundaries. Within the European Economic Area, financial services are offered across all borders, and activity in today's financial markets is generally based on global networks. Similarly, regulatory and supervisory authorities need to work together on a cross-border basis as well.

Particularly where innovation and technological development are concerned, international cooperation is vital to be able to rule out from the start any regulatory or supervisory arbitrage. Correspondingly, Europe's financial market regulators are attending to this issue and have installed related working groups, while also publishing relevant discussion papers, market studies, reports, opinions and guidelines. As the national competent authority, the FMA is an integral part of the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA); having a seat and voting rights in these bodies, the FMA represents Austria's interests. Similarly, the FMA is the competent Austrian authority in the Single Supervisory Mechanism (SSM) established at the European Central Bank (ECB).

The FMA correspondingly contributes through active participation in and commitment to a large number of working groups dealing with the issue of technological change and the digital challenge. The most significant working groups are listed here:

- ESMA Financial Innovation Standing Committee FISC
- ESMA Crowdfunding supervisory forum
- JCSC CPFI subgroup on automation in financial advice
- ESMA Post-Trading Standing Committee (PTSC)
- EBA Subgroup on Innovative Products (SGIP)
- Standing Committee on Consumer Protection and Financial Innovation (SCConFin)
- EBA SGIP workstream on lending-based crowdfunding
- EBA SGIP workstream on FinTechs
- EBA Task Force on Virtual Currencies
- Task Force on IT Supervision – Outsourcing (TFIT)
- EBA-ECB/ SeCuPay
- European Commission Task Force on Financial Technology (TFFT)
- ECB working group – licensing of FinTechs
- ECB Interbank Authorisation Network
- SSM Expert Group on IT Risk (EGIT)
- ECB working group on outsourcing
- OECD fact-finding mission on digitalisation, economic growth and social cohesion
- JC SC CPFI subgroup on big data

The FMA's main focus here is on the issues of big data and data security, (equity) crowdfunding, outsourcing and FinTechs in general.

DIGITAL DIVIDE

Just as it is important for regulation and supervision to keep pace with technological change, so too is society at large faced with the challenge of making sure that technological progress does not leave behind large segments of the population and deprive them of access to financial services. Contemporary sociologists are already referring to a “digital divide” that is splitting society. Whereas the digital natives, that is the generation that has grown up with the internet, smartphones and social media, have a natural, intuitive attitude towards these media and the financial market applications they support, major groups within the older generation have no access to these media or are overwhelmed when having to deal with or use them. Demographic change will thus also face society with the challenge in the coming decades of ensuring that older and less educated people continue to have access to financial services. The Consumer Payment Accounts Act (VZKG; *Verbraucherzahlungskontogesetz*), which entered into force in 2016, is one example of a move in this direction: here legislators have required banks to make at least a basic payment account available to every consumer.

The new supervisory regime for trading in listed securities

MAR and CSMAD: Uniform rules EU-wide and more effective weapons for combating market abuse

New legislation on market abuse became effective in the European Union, and thus also in Austria, on 3 July 2016. This has placed the regulation and supervision of trading in listed securities on a completely new foundation. The centrepiece of the new regulatory regime is Regulation (EU) No 596/2014, the Market Abuse Regulation (MAR), which as directly applicable Union law was not required to be implemented in national law. In this way any diverging implementation or application at national level was avoided from the outset. The only exception was the sanctioning regime, defined in Directive 2014/57/EU (CSMAD), which had to be enshrined in national laws since the EU has no direct competence in this area. In this case, national legislators can exercise discretion in implementation, for instance in determining which offences are punishable under administrative penal law and which fall under the criminal code. CSMAD nonetheless specifies a uniform definition of the elements constituting individual offences and provides for a minimum level of the maximum fines or prison sentences to be determined at national level. In other words, the national states can only legislate more severe but not more lenient levels of punishment.

One of the lessons drawn from the global financial crisis was to reform market abuse law. The limits of the regulatory framework had been increasingly challenged by expansion of the European single market and the globalisation of the world of finance as well as the rapid pace of technological change and the accelerated development of new products. The new market abuse legislation now truly represents a uniform system of rules for the entire European Union, while responding to the challenges arising from the internationalisation of financial transactions as well as to technological change and to forces driving the design of new products. In choosing a regulation as the legislative form for enshrining the set of rules to prevent market abuse, European legislators followed the conclusions of the report issued by the High Level Group on Financial Supervision in the EU, chaired by Jacques de Larosière. Specifically, the recommendation was to establish a stronger, uniform framework to avoid regulatory arbitrage and to provide market participants with enhanced legal certainty.

REGULATION

Market transparency is one of the key conditions for allowing all players in the economy to participate in integrated financial markets.¹ European legislators have correspondingly specified in unequivocal terms how such

¹ Recitals 2 and 7 MAR.

transparency is to be achieved. The legal framework obliges issuers to regularly publish financial reports (periodic disclosure) and specifies clear standards for the fair presentation of investment recommendations; it also requires the immediate disclosure of inside information (ad hoc disclosure), of exceeding or falling short of specified thresholds applying to the shares held by investors (reports on holdings), and of the purchase or sale of a company's securities by members of its management (directors' dealings). Moreover, sanctions are defined for the misuse of an information advantage, either through passing on inside information or through exploiting such information by trading on one's own account in the securities concerned, and for exploiting market power to the end of manipulating the price of a security, either by making concrete orders or by spreading misleading information.

Market abuse is a concept that encompasses such unlawful behaviour in the financial markets.

The European Securities and Markets Authority (ESMA) plays a central role in specifying the details of the new European legal framework to prevent market abuse. ESMA has the mandate to ensure that the rules are interpreted, specified and applied uniformly throughout the EU. Additionally, MAR empowers the European Commission to issue provisions, referred to as level 2 measures, to specify implementation in detail, while ESMA is tasked with preparing such measures. ESMA is additionally responsible for preparing guidelines and recommendations, known as level 3 measures, to cover a variety of topics.

EXPANDED SCOPE OF APPLICATION

Not only does the new legal framework to prevent market abuse standardise the provisions and their application throughout the EU, it also expands their scope of application appreciably.

Recital 8 of MAR refers in detail to the fact that in recent years financial instruments have been traded not only on regulated markets but also increasingly on electronic trading facilities (MTFs). The scope of the preceding set of rules (Directive 2003/6/EC) focused on financial instruments admitted to trading on a regulated market or for which an application for admission to trading on such a market has been made. The new Market Abuse Regulation radically expands the scope of application. It now applies to financial instruments that:

- are admitted to trading on a regulated market or for which a corresponding application has been made;
- are traded on a multilateral trading facility (MTF), are admitted to trading on an MTF or for which a corresponding application has been made;
- are traded on an organised trading facility (OTF); or
- to which none of the items above applies yet the price or value of which depends on or affects the price or value of a financial instrument of the kind specified above. Examples of the latter include credit default swaps and contracts for difference.

In specifying how the term "financial instrument" is to be interpreted, MAR refers to the definition in Directive 2014/65/EU, the Markets in Financial Instruments Directive (MiFID II). According to this definition, financial instruments are transferable securities, derivative contracts relating to securities and all other instruments specified in Section C of Annex I of MiFID II.

DEALING WITH INSIDE INFORMATION

With regard to what constitutes inside information, MAR uses the same definition as in the preceding set of rules, the Market Abuse Directive. Thus, the prohibition on insider dealing and the ad hoc disclosure requirement continue to be linked to the same definition of inside information.

"Inside information" is information of a precise nature, which has not been made public, relating, directly or indirectly, to one or more issuers of financial instruments or to one or more financial instruments, and which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments.

- "Precise information" indicates a set of circumstances which exists or which may reasonably be expected to

come into existence, or an event which has occurred or which may reasonably be expected to occur, where it is specific enough to enable a conclusion to be drawn as to the possible effect of that set of circumstances or event on the prices of the financial instruments.

- Information is relevant to prices if a reasonable investor would be likely to use it as part of the basis of his or her investment decisions, whereas the term “reasonable investor” is not defined in MAR.

A new aspect of MAR is that European legislators have incorporated significant elements of the judgment by the European Court of Justice (ECJ) in the case of *Geltl v Daimler*, concerning the question of protracted processes, directly into the text of the Regulation. According to the judgment, in the case of a protracted process that is intended to bring about a certain future event, not only the future event but also the intermediate steps bringing about or resulting in that event can be regarded as precise information. Taken by itself, the intermediate step must, however, satisfy the criteria of inside information.

Issuers of financial instruments must inform the public as soon as possible of inside information which directly concerns that issuer. In this context, issuers are required to ensure that any inside information is made public in such a manner as to allow investors and members of the public who are interested in investing to access the information quickly, in order to evaluate it completely, correctly and in a timely manner.

DELAYING DISCLOSURE OF INSIDE INFORMATION

As previously, issuers are permitted to delay disclosure of inside information at their own responsibility where:

- immediate disclosure is likely to prejudice the issuer’s legitimate interests;
- delay of disclosure is not likely to mislead the public;
- the issuer is able to ensure the confidentiality of the information.

The Regulation also expressly allows disclosure to be delayed in the case of a protracted process that occurs in stages and that is intended to bring about, or that results in, a particular circumstance or a particular event.

Where the issuer is no longer able to ensure the confidentiality of the inside information, the information is no longer exempt from the disclosure requirement and the issuer must disclose it as soon as possible. The issuer is similarly required to do so where a rumour explicitly relates to inside information the disclosure of which has been delayed and that rumour is sufficiently accurate to indicate that the confidentiality of that information is no longer ensured.

A new aspect is that issuers are now required to inform the competent authority of the delay immediately after disclosing the information to the public. At the FMA’s request, the issuer is to provide an explanation of how the conditions for delay were met. Under the previous set of rules, the FMA had to be informed as soon as the issuer decided to delay disclosure.

A new, separate set of rules has been introduced for cases involving delay of disclosure in which the inside information refers to a credit institution or financial institution, especially where such institutions receive central bank lending, including emergency liquidity assistance. In such cases the competent authority is responsible for assessing whether the information is of systemic importance and whether delay of disclosure would be in the public interest, with this step being taken as appropriate after consulting the national central bank, the national macroprudential authority or another relevant national authority.² In such cases the FMA is responsible for determining whether the conditions for delaying disclosure are met. If the FMA does not consent to the delay, the issuer is required to disclose the inside information immediately.

INSIDER LISTS

Issuers or any person acting on their behalf or on their account are also required to keep a list of all persons who have access to inside information and who are working for them under a contract of employment, or otherwise performing tasks through which they have access to inside information, including persons such as advisers, accountants or credit rating agencies. This insider list is to be updated promptly on an ongoing basis and to be

² Recital 53 MAR.

provided to the competent authority, which in Austria is the FMA, immediately on request. Where another person acting on behalf or on the account of the issuer assumes the task of drawing up the insider list, the issuer remains fully responsible for ensuring that the insider list complies with the statutory provisions.

The form and content of insider lists are defined in MAR and in related regulations (Commission Implementing Regulation (EU) 2016/347 of 10 March 2016 laying down implementing technical standards with regard to the precise format of insider lists and for updating insider lists in accordance with Regulation (EU) No 596/2014 of the European Parliament and of the Council).

INSIDER DEALING

Insider dealing is generally prohibited, since it gives insiders an unfair advantage to the detriment of third parties who are unaware of such information and, furthermore, undermines the integrity of financial markets and investor confidence.³ The offence of insider dealing also includes using inside information by cancelling or amending an order connected with a financial instrument to which that information relates, where the order is issued before the inside information is obtained.

Prohibited inside dealing also exists where the case involves using recommendations or inducing another person to act where the person using the recommendation or following the inducement knows or ought to know that it is based upon inside information.

A new aspect is a separate Article in MAR that enumerates cases of legitimate behaviour where it is not assumed that a person has used the inside information. The examples listed here include the situation where adequate and effective internal arrangements and procedures exist within a legal entity to ensure that neither the natural person who made the decision on behalf of the entity to acquire or dispose of financial instruments to which the information relates, nor another natural person who may have had an influence on that decision, was in possession of the inside information. Here the FMA can give a final evaluation only after investigating the individual case.

UNLAWFUL DISCLOSURE OF INSIDE INFORMATION

The unlawful disclosure of inside information is also prohibited. Such a case always exists where a person possessing inside information discloses that information to another person. An exception from the prohibition exists where disclosure is made in the normal exercise of an employment, a profession or duties. Thus, the provisions referred to above do not interfere with normal business operations. This aspect illustrates very clearly how the individual provisions of the Regulation are interrelated. All persons who obtain access to inside information through the normal exercise of an employment, a profession or duties should be included in the insider list. Pursuant to the provisions of MAR, advisers such as lawyers, tax consultants, accountants as well as other persons whose work serves the purpose of the business are allowed to receive inside information. Yet it is imperative that the arrangements and rules described above, which have been laid down in MAR and the delegated acts, be adhered to.

MARKET SOUNDINGS

The rules applying to market soundings are entirely new. Here too the regime sets forth an assumption, and a case qualifying under that assumption is not considered a breach of the provisions prohibiting market abuse. Market soundings are interactions between a seller of financial instruments and one or more potential investors, prior to the announcement of a transaction, in order to gauge the interest of potential investors in a possible transaction and its pricing, size and structuring.⁴ In Recital 32 of MAR, this practice is specifically cited as “a highly valuable tool to gauge the opinion of potential investors, enhance shareholder dialogue, ensure that deals run smoothly, and that the views of issuers, existing shareholders and potential new investors are aligned”.

³ Recital 23 MAR.

⁴ Recital 32 MAR.

Yet, even though market soundings are highly regarded, the provisions governing them are complex, so that it is nonetheless necessary to adhere to a very stringent and exacting set of requirements in order to take advantage of this exception. The totality of rules applying to this context can be distilled down to the requirement to maintain complete documentation of each individual step taken by every party involved in a market sounding. Only then can it be assumed, following an examination by the FMA of the individual case, that the inside information was disclosed to allow a person to normally exercise an employment, a profession or duties.

Where the person who is the recipient of the market sounding engages in inside dealing or unlawfully discloses the inside information, despite receiving mandatory information that the misuse of inside information is prohibited, that person is liable to punishments under provisions of national law as specified in the Stock Exchange Act (BörseG; *Börsegesetz*).

MARKET MANIPULATION

Market manipulation is the second offence constituting market abuse. The definition of this term in MAR corresponds by and large to that specified in the preceding set of rules, the Market Abuse Directive, while also including the additional methods falling under the broadened scope of MAR as well as the manipulation of benchmarks. The latter item is rooted in the LIBOR scandal, which came to light during the legislative process leading to MAR. The offence of market manipulation under MAR's scope of application also includes spot commodity contracts which are not wholesale energy products, where the transaction, order or behaviour has an effect on the price or value of a financial instrument. Based on this definition, the entire discussion below implicitly refers to a financial instrument, a related spot commodity contract or auctioned products based on emission allowances – even where only the term “financial instrument” is used.

The term “market manipulation” accordingly comprises the following activities:

- entering into a transaction, placing an order to trade or any other behaviour which
 - gives, or is likely to give, false or misleading signals as to the supply of, demand for, or price of, a financial instrument, or
 - secures, or is likely to secure, the price of one or several financial instruments at an abnormal or artificial level, unless the person entering into a transaction, placing an order to trade or engaging in any other behaviour establishes that such transaction, order or behaviour have been carried out for legitimate reasons, and conform with an accepted market practice;⁵
- entering into a transaction, placing an order to trade or any other activity or behaviour which affects or is likely to affect the price of one or several financial instruments and which employs a fictitious device or any other form of deception or contrivance;⁶
- disseminating information through the media, including the internet, or by any other means, which gives, or is likely to give, false or misleading signals as to the supply of, demand for, or price of, a financial instrument, or secures, or is likely to secure, the price of one or several financial instruments at an abnormal or artificial level, including the dissemination of rumours, where the person who made the dissemination knew, or ought to have known, that the information was false or misleading;⁷
- transmitting false or misleading information or providing false or misleading inputs in relation to a benchmark where the person who made the transmission or provided the input knew or ought to have known that it was false or misleading, or any other behaviour which manipulates the calculation of a benchmark.⁸

MAR also specifies examples and defines indicators potentially representing market manipulation. The indicators enumerated in one of the annexes to MAR are specified in more detail in Annex II of Commission Delegated Regulation (EU) 2016/522 of 17 December 2015 by referring to examples.

⁵ The literature refers to this form of market manipulation as “trade-based market manipulation”. This terminology is used in the following.

⁶ The term “action-based market manipulation” is also used for this form of market manipulation, and further reference is made to the term in the following.

⁷ The term “information-based market manipulation” is used to designate this form of market manipulation.

⁸ This is referred to in the following in brief as “benchmark manipulation”.

A review of these examples, indicators and descriptions of practices clearly reveals that attention has been given to technological developments while including in the catalogue of abuses several of the strategies used in high-frequency trading. Examples of sanctioned practices include issuing one or a series of trading orders or carrying out one or a series of transactions with the intent of triggering or exacerbating a trend, thereby enticing other market participants to accelerate or widen the trend, to the end of creating an opportunity to sell off or set up a position at an advantageous price. The practice described above is referred to as “momentum ignition”.

DIRECTORS’ DEALINGS

Greater transparency of transactions conducted by persons discharging managerial responsibilities at the issuer level and, where applicable, persons closely associated with them, constitutes a preventive measure against market abuse, particularly insider dealing. The publication of those transactions on at least an individual basis can also be a highly valuable source of information to investors.⁹

A major change from the previous rules is the broadening of the scope of financial instruments and of transactions which fall under the notification requirement. For example, debt instruments now fall under the requirement. The pledging or lending of financial instruments is now also considered a transaction required to be notified. In Recital 58 MAR it is stated that the pledging of shares can result in a material and potentially destabilising impact on the company in the event of a sudden, unforeseen disposal. Without disclosure, the market would not know that there was the increased possibility of, for example, a significant future change in share ownership, an increase in the supply of shares to the marketplace or a loss of voting rights in that company. For that reason, notification of directors’ dealings is required where the pledge of the securities is made as part of a wider transaction in which the manager pledges the securities as collateral to gain credit from a third party.

The deadline for disclosing information has also been shortened, with notification having to be made immediately and within no later than three business days (instead of the previous five business days).

INVESTMENT RECOMMENDATIONS AND STATISTICS

As repeatedly mentioned above, harmonising the applicable rules is one of the main objectives of MAR. Persons who produce or disseminate investment recommendations or other information recommending or suggesting an investment strategy are required to take reasonable care to ensure that such information is objectively presented, and to disclose their interests or indicate conflicts of interest concerning the financial instruments to which that information relates.

Besides disclosing any interests and conflicts of interests, the identity of the person producing the recommendations, the date when produced and the methods and ratings underlying the recommendations are to be made known. Where investment recommendations produced by third parties are to be modified, this fact also has to be disclosed. All these provisions are aimed at allowing the recipients of investment recommendations to arrive at a comprehensive picture of financial instruments, thereby creating a level playing field that allows all players to take their decisions based on trust in the market.

MAR furthermore specifies that public institutions disseminating statistics or forecasts liable to have a significant effect on financial markets are required to disseminate them in an objective and transparent way.

SUPERVISION

INVESTIGATIONS BY THE FMA

The FMA has the legal mandate to supervise trading in the financial instruments falling under MAR to ensure that

⁹ Recital 58 MAR.

it is carried out in an orderly manner and that issuers and other market participants comply with transparency rules. In cases of suspected infringement of any provisions of MAR, the FMA as competent authority conducts the corresponding investigations and imposes sanctions where required. Besides ongoing market observation and the Authority's internal surveillance system, investigations can be triggered by reports received from market participants or inside informants ("whistleblowers"). While MAR specifies the potential grounds that will trigger investigations by the Authority, the Austrian Stock Exchange Act (BörseG; *Börsegesetz*) defines the powers to support the FMA in carrying out its supervisory duties in this regard.

PREVENTION AND DETECTION OF MARKET ABUSE

Under this heading in MAR, Europe's legislators have defined an additional mechanism to involve market participants in achieving the goal of ensuring uniform market conditions.¹⁰ Specifically, operators of trading venues are now under obligation to put in place effective arrangements, systems and procedures aimed at preventing and detecting insider dealing, market manipulation and attempted insider dealing and market manipulation. Any irregularities identified are to be reported to the FMA immediately.

STOR – SUSPICIOUS TRANSACTION AND ORDER REPORTS

MAR also obliges any person professionally arranging or executing transactions to establish and maintain effective arrangements, systems and procedures to detect and report suspicious orders and transactions. Where such a person has a reasonable suspicion that an order or transaction in any financial instrument could constitute insider dealing, market manipulation or attempted insider dealing or market manipulation, the person is required to notify the competent authority (the FMA) without delay.

Such persons are provided with the option of transferring the responsibility for monitoring, detecting and identifying suspicious transactions to others within the same group or to transfer responsibility for analysing data and preparing warning notices, where appropriate prerequisites are met. The option of transferring responsibility is aimed at enabling the joint use of resources, centralised development and maintenance of monitoring systems, and the training of new skills within the framework of order and transaction monitoring.¹¹ The person transferring responsibility for these tasks nonetheless remains fully responsible for ensuring that the requirements specified in Article 16 MAR are met.

These provisions reflect observations made in the past that, in addition to authorities' internal systems, the operators of trading venues and even more so the traders themselves have valuable information that is useful for detecting market abuse. This obligation to actively observe the market for irregularities represents a new aspect introduced by MAR.

Commission Delegated Regulation (EU) 2016/957 of 9 March 2016 specifies a form for reporting suspicious transactions and orders (STORs), which the FMA has made available on its website. A STOR can be submitted to the FMA in any number of ways, and the mailbox reached at suspicious-transactions@fma.gv.at is mentioned here as just one of these options.

REPORTING OF INFRINGEMENTS

Details provided to the FMA by whistleblowers can also trigger investigations by the FMA. It should be ensured that adequate arrangements are in place to enable whistleblowers to alert competent authorities to possible infringements of MAR and to protect them from retaliation.¹² The key element of this whistleblowing system is to ensure that the personal information concerned is protected, of both the person reporting and the person reported on. Articles 48h and 48i BörseG specify comprehensive rules covering the structures of the systems to be set up. An example of implementing these rules is found on the FMA website (www.fma.gv.at), where on the homepage access is offered to a completely anonymous, externally operated whistleblowing system, allowing

¹⁰ See Recitals 45 and 46.

¹¹ See Recital 4 of Commission Delegated Regulation (EU) 2016/957 of 9 March 2016.

¹² Recital 74.

individuals to provide information to the FMA in accordance with the law, without any possibility of the source being traced.

POWERS OF SUPERVISORY AUTHORITIES

Effective supervision of compliance with statutory provisions is possible only where the supervisory authority has suitable tools enabling it to fulfil its legal mandate.¹³ In recognition of this, MAR provides for a minimum set of supervisory and investigative powers competent authorities of Member States should be entrusted with under national law. The powers accorded to the FMA are defined in Article 48b BörseG.

The FMA is, for example, to be allowed access to any and all documents and data, which are to be made available to the Authority in the form of copies where applicable. The FMA is entitled to request information from any person and, if required, to summon any person for questioning. The FMA is empowered to conduct on-site investigations, except in private dwellings, and is entitled to request existing records of telephone conversations or electronic messages or records of data traffic in the possession of investment firms, for example. As competent authority the FMA is additionally entitled to suspend trading in the financial instruments concerned, to request parties to temporarily desist from critical behaviours, to temporarily prohibit persons from pursuing their profession and to inform the public of measures and sanctions. Where reasonable suspicion exists, the FMA can also petition the Vienna Regional Court for Criminal Matters to have premises searched that are protected under home privacy laws or to have electronic communications monitored.

SANCTIONS

In MAR it is noted that a sound prudential and conduct of business framework for the financial sector should rest on strong supervisory, investigation and sanction regimes. To this end, supervisory authorities should be equipped with sufficient powers to act and should be able to rely on equal, strong and deterrent sanction regimes against all financial misconduct. Care should especially be given that sanctions are enforced effectively. In the view of the de Larosière Group, these specifications in particular had not been in practice EU-wide prior to MAR and CSMAD. Recitals 70 and 71 of MAR consequently call for a set of administrative sanctions and other administrative measures to ensure a common and uniform approach in all Member States.¹⁴

In the recitals of Directive 2014/57/EU of the European Parliament and of the Council of 16 April 2014 on criminal sanctions for market abuse (CSMAD), it is observed that the adoption of administrative sanctions by Member States has proven to be insufficient to ensure compliance with the rules on preventing and fighting market abuse. It is therefore regarded as essential that compliance with the rules on market abuse be strengthened by the availability of criminal sanctions, which demonstrate a stronger form of social disapproval compared to administrative penalties. In the words of the CSMAD recitals: “Establishing criminal offences for at least serious forms of market abuse sets clear boundaries for types of behaviour that are considered to be particularly unacceptable and sends a message to the public and to potential offenders that competent authorities take such behaviour very seriously.”¹⁵

To implement the provisions of MAR and CSMAD and to accommodate the observations made in the recitals of the two EU laws, Austrian legislators have amended the BörseG by modifying related existing provisions and by adding new ones. A central concern in this regard was to clearly delineate between offences punishable under administrative law and those punishable in criminal court.

Limits have accordingly been specified in the Austrian legislation, which should facilitate the ready classification of infringements. Cases of insider dealing, or transactions or trading orders potentially representing trade-based or action-based market manipulation and involving a sum exceeding € 1 million fall under the jurisdiction of the criminal courts, if the accused is suspected of having acted with intent. Cases of unlawful disclosure of inside

¹³ Recital 62.

¹⁴ See Recitals 70 and 71 MAR.

¹⁵ See Recitals 4 and 5 CSMAD.

information are subject to prosecution in criminal court where, when gauged according to the most significant market in terms of liquidity, the price of the financial instruments concerned changes by at least 35% and the volume traded amounts to at least € 10 million within the five trading days after the inside information becomes known, and where intent is suspected on the part of the accused.

Articles 48c to 48e BörseG now contain the provisions specifying the conditions under which administrative penal proceedings are to be initiated against persons suspected of infringement of legal provisions governing market abuse. The conditions for criminal court jurisdiction in cases of infringement of market abuse provisions are specified in Articles 48m and 48n BörseG.

Cases of market manipulation fall under criminal court jurisdiction only where trade-based or action-based manipulation and a sum exceeding the value limit mentioned above is involved and where intent is suspected. In all other types of market manipulation (that is, information-based manipulation and benchmark manipulation), as well as in cases in which no intent is involved or in which the value limit is not exceeded, jurisdiction lies with the administrative penal authority (the FMA).

Table 1: Criminal court jurisdiction

| | Who | Fault element | Punishment |
|----------------------------|--|---------------------|--------------------|
| Market manipulation | Any person | Intent | 6 months – 5 years |
| Insider dealing | Primary insiders Secondary insiders | Intent Knowledge | 6 months – 5 years |
| Recommendation, inducement | Primary insiders Secondary insiders | Intent Knowledge | 6 months – 5 years |
| Unlawful disclosure | Primary insiders Secondary insiders | Intent Knowledge | 2 years |

Table 2: Jurisdiction of the FMA as administrative penal authority

| | Natural person | Legal person |
|------------------------------|----------------|--|
| Market manipulation | € 5 million | € 15 million or 15% of total annual revenue |
| Misuse of inside information | € 5 million | € 15 million or 15% of total annual revenue |
| STOR | € 1 million | € 2.5 million or 2% of total annual revenue |
| Ad hoc | € 1 million | € 2.5 million or 2% of total annual revenue |
| Insider lists | € 500 000 | € 1 million |
| Directors' dealings | € 500 000 | € 1 million |
| Investment recommendations | € 500 000 | € 1 million |

SANCTIONS UNDER CRIMINAL LAW

“Primary insiders” refers to all persons designated as “insiders” in Article 48m para. 4 BörseG. Examples of such include members of an issuer’s administrative, management or supervisory bodies, persons holding equity in the issuer and persons who through pursuing employment or a profession or fulfilling duties have access to the inside information concerned. For the sake of simplification, “secondary insiders” in the table refers to the category of individuals described in the following passage in paras. 5 to 7 of Article 48m BörseG: “Any person who [...] receives inside information or a recommendation from an insider”.

SANCTIONS UNDER ADMINISTRATIVE PENAL LAW

In each case an additional administrative fine can be imposed at a maximum of three times the amount

of the benefit gained from the infringement, including any loss avoided thereby, provided that the benefit can be quantified.

ADDITIONAL ADMINISTRATIVE MEASURES

Pursuant to Article 48f BörseG, the FMA can additionally take these administrative measures:

- issue an order instructing the person responsible for the infringement to cease such behaviour and refrain from repeating it;
- issue an order declaring any profits gained or losses avoided through the infringement to be forfeited, provided that such sums can be quantified;

- issue a public warning regarding the person responsible for the infringement and the type of infringement;
- withdraw or suspend the authorisation of a legal entity pursuant to Article 15 of the 2007 Securities Supervision Act (WAG 2007; *Wertpapieraufsichtsgesetz*) if it is not sufficiently probable that other measures will prevent infringements of Articles 48c, 48d and 48e BörseG;
- temporarily prohibit persons from discharging managerial responsibilities who hold management positions in a legal entity pursuant to Article 15 WAG 2007 or any other natural person responsible for the infringements from discharging managerial responsibilities pursuant to Article 15 WAG 2007;
- in cases of repeated infringement of Article 14 or 15 MAR, permanently prohibit persons from discharging managerial responsibilities who hold management positions in a legal entity pursuant to Article 15 WAG 2007 or any other natural person from discharging managerial responsibilities in the legal entity pursuant to Article 15 WAG 2007;
- temporarily prohibit persons who discharge managerial responsibilities in a legal entity pursuant to Article 15 WAG 2007 or any other responsible natural person from engaging in transactions for their own account.

In this way, legislators at European level and in Austria have equipped national authorities with numerous effective sanctions and measures with which to respond to infringements of MAR and the provisions of the BörseG pertaining to market abuse.

To reinforce the dissuasive effect of the decisions made by competent authorities, the latter are normally required to publish any sanctions and measures imposed.¹⁶ This policy of “naming and shaming” is considered an important tool to encourage transparency, deter misconduct and promote good behaviour amongst market participants.

This principle is restricted in Recital 73 of MAR only to the extent that, if such publication causes disproportionate damage to the persons involved or jeopardises the stability of financial markets or an ongoing investigation, the competent authority may publish the administrative sanctions and other administrative measures on an anonymous basis in accordance with national law. In such cases the authority should also have the option of delaying the publication. Where such procedures do not adequately avoid the risk of jeopardising the stability of financial markets, the competent authority should also have the option of deciding against publication. Competent authorities should also not be required to publish measures which are deemed to be of a minor nature and the publication of which would be disproportionate.

In summary, it should be noted that the FMA is generally required to publish every future decision to impose an administrative sanction or administrative measure in relation to an infringement of MAR on its website. The only exceptions are cases in which the considerations described above to ensure the stability of financial markets play a role and where an examination reveals that the publication of insignificant measures would be disproportionate. Such publications serve as an important source of information for market participants, informing them of the behaviours not tolerated by the FMA and of market participants who breach the rules of good market conduct.

Time will tell whether the arrangements described above will help us to successively achieve the goals envisioned at the outset of the reform of market abuse legislation.

¹⁶ Recital 73.

The FMA's role in consumer protection

Collective consumer protection: How it works and how it protects consumers

One of the core tasks of the Financial Market Authority (FMA) is to protect investors, creditors and consumers in accordance with the law. As the authority responsible for supervising Austria's financial market, the FMA is required to be equidistant from the supervised entities and from those entities' customers. This means that the FMA is not permitted to side with individual consumers and may not assist them in enforcing any claims for damages. This role falls to the classic consumer protection organisations such as the Association for Consumer Information (VKI), the Chambers of Labour and, in particular, the relevant advisory professions such as lawyers. In contrast, the FMA is obliged to offer collective consumer protection.

Rather than focusing on individual interests, the aim of collective consumer protection is to uphold and protect the interests of a community of consumers, a collective. Individuals are protected indirectly through the collective. It is the role of collective consumer protection to uphold the interests of the community of savers vis-à-vis the banks, to protect the community of borrowers from being cheated, to guarantee insurance policyholders benefits that match their policies, and to ensure that the community of investors receives proper and fair advice, to name just some examples. The concept of the collective to be protected increasingly extends beyond individual products and sectors, particularly in relation to efforts for fair and comparable information and advice.

In its capacity as an integrated supervisory authority, bringing together regulation and supervision for the entire financial market under one roof, the FMA is optimally placed to meet the requirements of an efficient and effective form of collective consumer protection. It pools information covering the entire financial market, is familiar with that market's interdependencies, and can leverage the synergies across all sectors and products.

The FMA's collective consumer protection is based on three main pillars:

- As the authority responsible for prudential supervision, the FMA ensures that the supervised companies are stable and able to withstand crises, also monitoring the ability of providers of financial services to meet their obligations.
- In its capacity as the body responsible for conduct supervision, the FMA monitors whether companies are properly organised, providing correct information and advice, and applying the statutory rules.
- As the micro and macro-supervisor, the FMA also ensures that findings and measures at the level of individual institutions are linked to those at an aggregated level, and vice versa.

However, the aim of collective consumer protection is not just to protect individual consumers, but to strengthen confidence in Austria's financial market and to contribute to its stability. Given the dynamic pace of technological

change, complex product innovations and the provision of products and services from across the entire European internal market, securing a level playing field for all is an area that is growing in importance. The European lawmakers, and the European regulatory and supervisory authorities that they deploy, are also contributing in this regard, with a broad range of initiatives geared towards collective consumer protection.

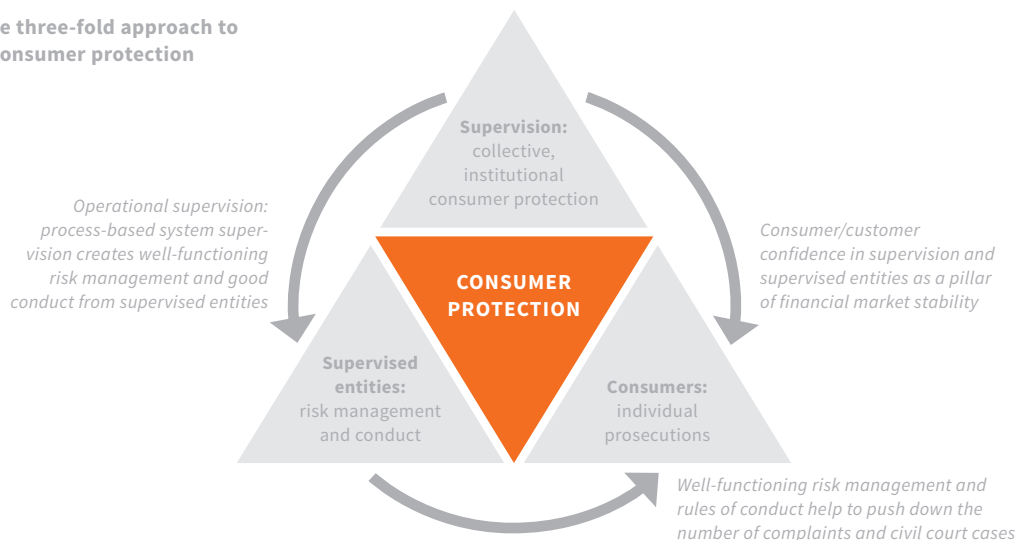
THE CONCEPT OF COLLECTIVE CONSUMER PROTECTION IN THE FMA

To achieve collective consumer protection, the FMA engages in process-based system supervision, aimed at well-functioning risk management and the conduct of the supervised entities. How this works in practice is described here briefly using the example of complaints management.

The FMA has its own complaints management system in place, enabling any consumer to provide information, by letter, e-mail, telephone or via the internet, on malpractice on the financial market or on a personal problem encountered with a company supervised by the FMA. The FMA looks into every complaint received, analyses its legitimacy and checks whether there is a systematic shortcoming/breach requiring supervisory measures. Given its statutory obligation to maintain an equidistant position from supervised entities and their customers, the FMA may, however, generally not help complainants to enforce their individual rights but must refer them to the company concerned or to the civil courts. The FMA's statutory obligation to maintain official secrecy also means that it is only permitted to provide the complainant with very limited information on the outcome of the review of the information submitted, as complainants are generally not recognised as a party in these official proceedings. The FMA will therefore remedy the malpractice for the collective of consumers but can at best only help the individual consumer indirectly with regard to enforcing the law.

Meanwhile, as part of its process-related system supervision, the FMA ensures that the companies that it supervises have a proper complaints management system of their own in accordance with the European Guidelines on Complaints-Handling, processing customer complaints quickly, correctly and in a targeted manner. The FMA checks, for example, whether the companies have appropriate written in-house measures on complaints management in place that are accessible to all employees and whether they have set up a complaints management function. Using specific cases of complaints, checks are then made to determine whether the internal written measures on the processing of complaints are actually applied and observed in practice, whether complaints are fairly investigated, and whether any potential conflicts of interest are identified and avoided. The FMA then analyses experiences with the practical application of various models and techniques in complaints management, developing a best practice catalogue, which it communicates to the supervised entities as a means of generally improving standards.

Figure 2: **The three-fold approach to collective consumer protection**



Efficient and effective complaints management on the part of companies not only reduces the risk of legal action but also supplies valuable information on weaknesses in the provision of the financial service. When implemented consistently, it increases customer satisfaction and boosts confidence in the financial market in general and in the providers in particular.

The increasingly anonymous character of financial transactions prompted by rapid technological change is also increasing the need for effective, efficient and fair complaints management. Back in 2000, only one in ten bank customers were making use of electronic and/or online banking. Today, this figure has increased to more than half. While customers once had their own specific banking adviser, insurance intermediary or asset manager, building up a business relationship over decades, the focus today is increasingly shifting to anonymous, standardised, electronic financial services. This transition, driven by technology, is also reinforcing the need for an effective form of collective consumer protection. (For further information on the challenges posed by technological change, see “The FMA’s Digital Roadmap” on page 18.)

COLLECTIVE CONSUMER PROTECTION AT EU LEVEL

The European lawmakers have given the European Supervisory Authorities – the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA) – a clear statutory remit to protect consumers. The ESAs are regulators, working to create a uniform, harmonised and market-based legal framework across Europe in the areas that they supervise. For the purposes of implementation and legal enforcement, they rely on the decentralised network of national competent authorities, which form an integral part of the European regulatory and supervisory system. Correspondingly, these national competent authorities also have a seat and a vote in the ESAs. The role of the ESAs is to create a regulatory framework in the European Economic Area that is as uniform and harmonised as possible and to ensure that it is implemented as uniformly as possible, particularly also in the area of consumer protection, with the focus here too on collective consumer protection.

This has a direct impact on the normative approach and aims of the supervisory regimes put in place by the national authorities. The latter are obliged to adhere to the evaluations and targets set by the European institutions. In particular, the national competent authorities, and among them the FMA, are explicitly responsible for regulating and monitoring transparency, simplicity and fairness on the financial products market. Collective consumer protection is therefore the benchmark defining the specific design and implementation of all regulatory rules.

The most important rules set by the European supervisory institutions in collective consumer protection currently stem from the revised Markets in Financial Instruments Directive (MiFID II), the Regulation on packaged retail and insurance-based investment products (PRIIPs), the Insurance Distribution Directive (IDD), the product governance rules, the product intervention power and the Payment Accounts Directive (2014/92/EU), transposed into Austrian law in the form of the Consumer Payment Accounts Act (VKZG; *Verbraucherzahlungskontogesetz*).

MIFID II

MiFID II, which is applicable with effect from 3 January 2018, defines conduct of business rules for investment advice in relation to structured products, products with a capital guarantee, derivatives, investment funds and structured deposits, in order to create financial markets in Europe that are more efficient, more resistant to crisis and more transparent. Its product governance provisions specify that credit institutions and investment firms that issue or manufacture financial instruments including structured deposits must set up their own product approval process. This should refer to the intended target market and determine whether the product features and product risk are appropriate for the selected target group.

The power to intervene in products means that supervisory authorities monitor the marketing, distribution and sale of structured deposits, financial instruments and insurance products. Furthermore, supervisory authorities are given the additional power to prohibit or restrict the distribution of financial instruments including struc-

tured deposits or financial activities and practices. Specific conditions must apply in these cases, for example the authority must have considerable reservations with regard to investor protection. Any restrictions or bans of this kind may be introduced for a fixed term or on a permanent basis.

PRIIPs

The aim of the PRIIPs Regulation is to improve transparency on the investment market for retail investors. A key information document (KID) is now required during the selling of investment funds, life insurance with an investment element and structured products, offered by both banks and insurance undertakings, providing investors with essential information in a clear and easily comprehensible way. European retail investors should always receive short, comparable and standardised disclosures in the form of a Europe-wide and uniform KID, regardless of the investment product that they are considering (see box below).

IDD

Directive (EU) 2016/97, the Insurance Distribution Directive (IDD), is due to be implemented by 23 February 2018. It includes conduct of business rules applicable to all parties involved in the sale of insurance products, creating equal competition conditions and improving the protection of policyholders. In particular, the Directive states that insurance distributors must act in accordance with the best interests of customers. Before the conclusion of a contract, the agent or insurance undertaking must have looked into the customer's wishes and needs. Where advice is provided prior to the sale of an insurance product, a personalised recommendation should be

KIDs: THE KEY INFORMATION DOCUMENTS FOR PACKAGED RETAIL AND INSURANCE-BASED INVESTMENT PRODUCTS (PRIIPs)

Regulation (EU) No 1286/2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs Regulation) sets a common standard for customer information, harmonising the format and content of information that must be made available to retail customers. The aim is to create uniform transparency rules for these products and to enable them to be compared across the different sectors.

The key component of the PRIIPs Regulation, which will be binding as of 1 January 2018, is the introduction of key information documents (KIDs) for certain investment products with a defined format and content. Alongside the information obligations imposed by other rules (such as the 2016 Insurance Supervision Act – VAG 2016; *Versicherungsaufsichtsgesetz* or the Capital Market Act – KMG; *Kapitalmarktgesetz*), their aim is to provide the customer with standardised information so that these products can also be compared across different sectors. The manufacturer of the respective investment product is responsible for preparing the KID.

The PRIIPs Regulation covers “packaged retail and insurance-based investment products”, i.e. investments in packaged form where the amount repayable to the retail investor is exposed to fluctuations. These essentially include:

- structured financial products, such as warrants, packaged in the form of securities or bank products;
- financial products, the value of which is derived from reference values such as equities or exchange rates (derivatives);
- closed and open-ended investment funds;
- investment-type insurance products (including insurance products offering a maturity value or redemption value that is exposed in full or in part to direct or indirect market fluctuations, such as classic and unit-linked life insurance contracts or hybrid products); and
- instruments issued by special purpose vehicles.

The scope of the Regulation has deliberately been made as broad as possible to take account of the heterogeneous nature of financial products in the EU Member States. This prevents providers from attempting to circumvent the Regulation, by selecting a particular legal form, name or purpose for the financial product.

The key information document should be no longer than three sides of A4-sized paper, written in language that is easy for retail investors to understand, with the individual section headings formulated as questions (e.g.: “What is this product?”). The KIDs must be written in the official language of the EU Member State in which the PRIIP is to be distributed. They must also be self-contained documents and be clearly distinguishable from the manufacturer’s advertising material.

It is crucially important that the customer is informed in a comprehensible manner about the product’s level of risk and its costs, in the form of aggregated indicators, a summary risk indicator and a summary cost indicator.

The summary risk indicator provides information on the risks being assumed by the consumer in making the investment. The factors included in this calculation of the risk indicator include market risk (i.e. investment performance) and credit risk (i.e. the risk of a PRIIP manufacturer or guarantor failing). A numerical scale from 1 to 7 is used for this purpose. The liquidity risk, i.e. the risk of it no longer being possible to trade the PRIIP, making redemption impossible or very difficult, is also depicted.

The KID should also cover the potential returns from the product, by setting out various different performance scenarios including the underlying assumptions and also stating the maximum potential loss.

All of the costs associated with the product must also be set out clearly, accurately and in a non-misleading way in the KID. Direct and indirect costs, and one-off and recurring costs should be explained in a summary cost indicator. This indicator should give the costs in percentage and in absolute terms, thereby guaranteeing that different products can be compared.

The PRIIP KID must also contain a clear reference to the fact that advisers, distributors and all other persons who sell PRIIPs are required to provide detailed information on any cost of distribution not already included in the direct or indirect costs of a PRIIP.

To ensure maximum comparability, regulatory technical standards (RTS) define the rules of the PRIIPs Regulation in a very detailed form.

The KID must be made available to retail investors in good time so that they understand the basic features and risks of the products before concluding a contract and, where applicable, can compare the product against others.

Overall, the rules on the KID should mean that this type of product is easier to compare across Europe, both within a sector (e.g. comparing different life insurance products) and across different sectors (e.g. comparing a life insurance product with an investment in an investment fund).

given to the customer explaining why a particular product best meets the customer’s insurance wishes and needs. The policyholder should be given all of the information about the product needed to make a well-informed decision.

The IDD also requires a standardised insurance product information document (IPID) to be prepared for non-life insurance products as of 2018, supplementing the existing pre-contractual information obligations. The IPID should generally comprise two pages and be no longer than three pages in exceptional circumstances, provided that the need for this extra length can be demonstrated due to the nature of the product. This document must contain the following information: type of insurance, summary of the insurance cover, main risks insured, insured sum, geographical scope, excluded risks, means of payment of premiums and duration of payments, main exclusions where claims cannot be made, obligations at the start of the contract, obligations during the term of the

contract and obligations in the event that a claim is made, term of the contract including the start and end dates of the contract, and the means of terminating the contract.

VZKG

The Consumer Payment Accounts Act (VKZG; *Verbraucherzahlungskontogesetz*) regulates the comparability of fees related to payment accounts, payment account switching and access to payment accounts with basic functions. Since 18 September 2016, every consumer has been entitled to a basic account. A basic account is a payment account with basic functions such as the ability to pay in cash, to make cash withdrawals at bank counters or ATMs within the EU, direct debits (within the EU), online payments and payment transactions with payment cards. Moreover, this is an area in which the FMA is the statutory complaints body.

The European System of Financial Supervision ensures that the European Economic Area not only has a limitless supply of financial services but also provides a form of consumer and investor protection that is harmonised on a cross-border basis. The decentralised structure of the European regulatory and supervisory regime also ensures that appropriate account can be taken of individual national economic structures and cultures.

INFORMATION AS A KEY TOOL IN COLLECTIVE CONSUMER PROTECTION

Without information and transparency, responsible consumers cannot make an appropriate decision about a financial service. The information must be provided in good time, must be accurate and must be easy for the investor to understand. Some years ago the FMA launched its “Information requirements” initiative with this in mind. This concept is based on three pillars:

1. Minimum regulatory standards governing the information obligations for certain financial products oblige the providers to give their customers precise information as clearly defined by the supervisory authority prior to the contract being concluded, during the contract term and upon its termination.
2. The FMA publishes folders and guides with simple explanations of the basic information required, and setting out the opportunities and risks.
3. On its website and in regular reports, the FMA publishes key figures and statistics that enable consumers to compare and rank the information given to them in relation to an individual product.

To date, the FMA has drawn up minimum standards on information requirements for life insurance, *Pensionskassen*, corporate provision funds and on foreign currency loans and/or bullet loans with repayment vehicles. As part of its day-to-day operational supervision, the FMA also reviews compliance with these information requirements. Furthermore, the civil courts apply the FMA's minimum standards during compensation cases as one of the benchmarks of proper conduct. The FMA regularly updates its minimum standards in line with market developments and new regulatory requirements, carrying out focus campaigns to review compliance.

In 2016 for example, the supervisory authority focused on information requirements in the field of life insurance, as these had been revised and significantly extended as a result of the related Information Requirements Regulation. The amendments were aimed at increasing the transparency and comparability of insurance products, particularly with regard to performance and costs.

In accordance with the Life Insurance Information Requirements Regulation (LV-InfoV; *Lebensversicherung Informationspflichtenverordnung*), the policyholder should be provided with two standardised tables before the declaration of willingness to enter into a contract is submitted. These tables are to be prepared on an individual basis for the respective policyholder applying a particular rate and specific contract data. A specimen calculation should be used to compare the insurance benefits against the policyholder's premium payments for each year. In addition, the consequences of premature termination and of exemption from premiums are also to be presented transparently as part of the specimen calculation. Using this standardised table, the policyholder will be able to determine the amount of their premium payment and the benefits that will be received from the insurance undertaking.

A further focus is disclosure of costs, so that customers can see what proportion of the premium paid is actually

available for investment and how high the effective total interest and the effective guaranteed interest rate are. Here again a standardised table is to be used to make it easier to compare different life insurance products.

The FMA immediately reviewed compliance with the new information standards on a sector-wide basis. It focused in particular on the presentation of costs and benefits, the provision of information on any guarantee and the undertaking's solvency reports. The provision of the information required on taxes, on the responsible complaints body and the competent supervisory authority was also reviewed. Overall, the findings were satisfactory. The FMA has also revised its guide "Life insurance – what are the insurance customer's information rights?" accordingly. This guide answers the most frequently asked questions on the most common types of life insurance. The product types are briefly described and explained, the opportunities and risks analysed, and the obligation to depict returns and costs explained. An explanation is provided of what the term "guarantee" actually means and how likely these are to maintain or lose value. Information is also provided on the options for exiting from the contract, on the associated benefits and disadvantages, and on the resulting costs.

The FMA's consumer information is centred around its website (www.fma.gv.at), where there is a section dedicated to the subject. Key issues relating to the protection of consumers are dealt with in simple language that is easy to understand.

The section of the website entitled "The Basics: the Financial Market" provides definitions of basic financial market terms such as loans, investment, building savings and certain investment products, and explains what should happen during consultations with advisers. Detailed information is provided in the form of questions and answers.

The "FMA Thematic Focuses" section deals with current issues that are dominating the headlines. These include foreign currency loans, alternative currencies, crowd funding models, bitcoins, and binary options and CFDs.

The FMA also uses the most frequently posed questions received in the context of complaints management to draw up a list of FAQs covering consumer protection issues. The areas covered range from deposit guarantee schemes at banks or investment firms through to banking secrecy and the obligation to provide identification documentation at the start of a business relationship with a licensed entity, the legal entitlement to a basic payment account and its minimum features, the time taken for payment transfers, the old-age provision system and the approval process for securities prospectuses.

Meanwhile, the FMA's investor warnings have proved particularly effective, warning consumers about providers on the Austrian market that are not entitled to provide the financial service that they are offering. Often, and indeed in most cases, these are dubious providers who are acting fraudulently. The investor warnings are stored chronologically and alphabetically in a database that can be accessed quickly. It provides a valuable and up-to-date form of information on dubious, and often criminal, providers.

All of the FMA's information brochures are also available to download, including a guide to life insurance, a flyer on the opportunities and risks associated with foreign currency loans and the FMA's investor guide. In addition, the website also provides access to the FMA's corporate database, which includes up-to-date details of all licensed financial service providers in Austria and the scope of their licences. This means that anyone can check, quickly and simply, whether a provider is in fact authorised to provide a particular financial service.

The above gives an initial insight into the large amount of consumer information available on the FMA website. The aim is to warn consumers about dubious offerings and to enable them to take responsibility for their own investment decisions through objective and clear information that is not driven by sales.

INTEGRATED SALES SUPERVISION PROJECT

The boundaries between different products and sectors are becoming ever more blurred on the financial markets. Investments may be designed as banking or insurance products, as financial instruments or securities, or they may be designed in such a way that they escape regulation and supervision altogether. A consumer who is looking for a suitable investment product for a pension, for example, will be confronted with an entire range of different information obligations and levels of protection. The global financial crisis and low interest rates in

evidence ever since have generated painful losses on many investment products and laid bare the differences in the levels of legal protection afforded to investors investing in different financial products, extending from pre-contractual information obligations and transparency rules through to their legal position in the event of claims for damages. What this has meant is that the regulatory and supervisory focus across Europe has been placed on proper information and advice in the area of selling. MiFID, PRIIP and IDD are just some examples of the regulatory response to this challenge.

One of the European regulators' key concerns is to harmonise the rules on selling financial products across all sectors and product types. This involves increasing and harmonising the transparency of products, as well as the quality of advice, extending rules on conflicts of interest and improving investor protection. Every customer who makes use of a financial service should have the right to appropriate, transparent and fair advice. The quality of the advice provided should not be dependent on the product or provider concerned.

The FMA is dedicated to this challenge, introducing its own "Integrated sales supervision" project. In its capacity as an integrated supervisory authority, bringing together regulation and supervision for practically the entire financial market under one roof, the FMA therefore has the optimum basis for this project. Its aim is to create the same basic parameters for services and products with the same investment targets, with such services and products also being as uniformly supervised as possible. Firstly, this needs a harmonised legal framework, while also requiring the implementation of a similarly oriented understanding of supervision, given that the European supervisory and regulatory authorities continue to be organised on a sector-specific basis.

The aim of the "Integrated sales supervision" project is to arrive at a harmonised and coherent view of information, transparency and advisory obligations, implementing these in as integrated a manner as possible. By building on a cross-sector survey of the basic legal parameters in the sales chain and of the operational supervisory practices, the aim is to achieve a shared understanding of supervision on the FMA's part, as well as harmonisation of the selling practices used by the industry.

Lessons from the 2016 FATF Report

Austria is optimising its system for the prevention of money laundering and terrorist financing

In 2016 the Financial Action Task Force (FATF) published its fourth country report¹ on anti-money laundering (AML) and counter-terrorist financing (CTF) measures in Austria. For the first time, the FATF applied its international standards as revised in 2012, the 40 FATF Recommendations, and its new assessment methodology. The latter places effectiveness at the heart of the evaluation, moving away from a rule-based approach to a risk-based assessment. The aim is to carry out a comprehensive review, which extends beyond a purely formal approach, of the effectiveness of measures in place in the respective country to tackle and prevent money laundering and terrorist financing. This 2016 Mutual Evaluation Report was critical of Austria in many areas.

CRITICAL ANALYSIS

Generally, the results of the evaluation showed that Austria has a comprehensive and well-functioning system in place to tackle money laundering and the financing of terrorism. However, it is the FATF's view that the risk of Austria's financial centre being misused for money laundering purposes is disproportionately high. This is partly due to Austria's role as a financial and economic centre for the markets in Central, Eastern and South-Eastern European (CESEE) countries, and also related to the high number of asylum seekers and migrants from conflict zones.

Applying its strict standards, the FATF found some areas with deficiencies during its evaluation of Austria. In particular, the FATF identified a need for improvement regarding prevention where professionals and companies outside the financial market are concerned, regarding the Financial Intelligence Unit's analysis activities, and regarding the criminal prosecution system with its excessive focus on proving money laundering predicate offences. As far as the FMA is concerned, criticism was levelled at a lack of adequate resources for monitoring of the preventive system to avoid money laundering, with a call for the frequency of on-site inspections of banks to be stepped up in a risk-oriented manner. More generally, the FATF also noted a lack of cooperation among the institutions in Austria's AML/CTF system.

¹ During the period from May 2015 to June 2016, the FATF conducted an assessment of Austria's AML/CTF policies, reviewing their compliance with its international standards as revised in 2012 (40 FATF Recommendations). This was the FATF's fourth country evaluation of Austria. The final results were adopted at the FATF Plenary meeting in Busan, South Korea, and published on 13 September 2016.

However, the FATF also expressly stated in its Report that both credit and financial institutions, as well as the FMA, had a high level of expertise in and knowledge of preventing money laundering and terrorist financing, taking measures in line with the risks. In particular, the system developed by the FMA for the risk classification of banks was evaluated very positively.

With only a few exceptions, the FATF was also consistently positive in its assessment of Austrian credit and financial institutions. Banks in particular were recognised as having robust, risk-based systems and procedures for preventing and detecting money laundering and terrorist financing. One area in which the FATA sees risks, based on Austrian banks' strong presence in CESEE, continues to be in the management of money laundering and terrorist financing risk at group level, recommending changes to the law in this area.

Tribute was also paid to the progress made to date in such areas as banking secrecy, the accounts register and the automated exchange of information.

THE FEDERAL GOVERNMENT'S ACTION PLAN

Prompted by the 2016 FATF Report, the Austrian Federal Government has reaffirmed its commitment to effective action against money laundering and terrorist financing, immediately drawing up an action plan for the prompt removal of the shortcomings highlighted and in order to improve the Austrian system and make it more effective. This package of measures will help to improve the reputation and integrity of Austria as a business location and financial centre, improving security standards in efforts to combat money laundering and terrorist financing. The first steps in the legislative process have already been taken with Directive (EU) 2015/849, the Fourth Anti-Money Laundering Directive, being transposed into national law through the new Financial Markets Anti-Money Laundering Act (FM-GwG; *Finanzmarkt-Geldwäschegesetz*).

The Federal Government's action plan encompasses the following measures in particular:

- **FMA resources:** In a first step, the FMA has increased its resources devoted to the prevention of money laundering and terrorist financing by adding five additional employees, as a result of which the number of on-site inspections will grow by 50%.
- **Group compliance:** In line with the FATF's recommendation, the FM-GwG increases the overall responsibility of parent companies of transnational banking groups for the implementation and compliance of systems and processes aimed at preventing money laundering and terrorist financing. In addition to specific rules on group-wide strategies and procedures, the new law also enshrines the anti-money laundering officer's responsibility at group level. The law also expressly states that the cross-border exchange of customer-related information is permitted within the group. Additionally, the FM-GwG defines the corresponding responsibility of the FMA for on-site inspections of group members based abroad.
- **Supervision of agents:** The new FM-GwG gives the FMA comprehensive inspection powers with regard to the agents of foreign payment service providers. These include providers that are only operating on the basis of a trade licence (particularly mobile phone shops) but that also offer financial transfer services for foreign payment institutions in Austria.
- **National coordination body:** The FM-GwG institutionalises the previously informal coordination within Austria, creating a new "national coordination body" based at the Federal Ministry of Finance. As well as Finance Ministry representatives, this body will be made up of representatives from the Federal Ministry of Justice, the Federal Ministry of the Interior, the Federal Ministry of Science, Research and Economy, and the Federal Ministry of Europe, Integration and Foreign Affairs, as well as members representing the FMA and Oesterreichische Nationalbank (OeNB). Bringing together all of these areas, the aim is for the national coordination body to meet at least twice a year and/or in response to specific events.

The body's main tasks include the development of measures and strategies to combat money laundering and terrorist financing and, where necessary, the issuing of implementation recommendations. In addition, the body will also be responsible for the preparation and ongoing updating of the National Risk Assessment for Austria.

- **National Risk Assessment (NRA):** The National Risk Assessment should focus to a greater extent on current AML/CTF methods and techniques, as well as identifying specific risk areas that should be given priority.
- **Financial intelligence:** At Austria's Financial Intelligence Unit (FIU) based at the Federal Office of Criminal Investigation (BKA), there should be a clear division between the area responsible for receiving, analysing and forwarding suspicious transaction reports and the operational area responsible for investigations. Moreover, the personnel and technical (analysis database) capacities should be further expanded and a dedicated analysis group set up. To simplify administrative procedures at the FIU, direct electronic access to the central accounts register should be put in place.
- **Expansion of criminal prosecution:** With regard to public prosecutors, a greater level of specialisation is to be ensured. In future, specialist departments dedicated to proprietary orders are to be set up at practically every public prosecutor's office (to date there have only been four such specialist departments). On a similar scale, specialist units detected to extremist crimes are also to be established, focusing on terrorist financing and closely related criminal offences. To increase the punishments for money laundering, a legislative proposal on the harmonisation of penalties and sanctions for money laundering is to be introduced before the end of 2017, based on the European Union's Action Plan to strengthen the fight against terrorist financing. The list of predicate offences to money laundering (Article 165 of the Criminal Code – StGB; *Strafgesetzbuch*) is to be extended to include all tax offences in relation to direct and indirect taxes that are subject to a maximum penalty of a prison sentence of more than one year.
- **Supervision of tradespersons:** Supervision of tradespersons, who are also subject to rules on the prevention of money laundering, is to be stepped up. For this purpose, the district administration authorities will be provided with appropriate resources and training opportunities to enable them to carry out their role, and on-site checks in particular, more effectively. The creation of centres of excellence is recommended.

This comprehensive package of measures, the future register for beneficial owners and the new FM-GwG will ensure that Austria continues to operate in line with high international standards in future and that the integrity of the Austrian financial market is afforded the best possible protection.

THE NEW FINANCIAL MARKETS ANTI-MONEY LAUNDERING ACT

Austria's new Financial Markets Anti-Money Laundering Act (FM-GwG; *Finanzmarkt-Geldwäschegesetz*) entered into force on 1 January 2017. By means of this new law, Austria has transposed the parts of the Fourth Anti-Money Laundering Directive applicable to financial markets into national law in good time while also laying the foundation for the direct application of Regulation (EU) 2015/847, the new Transfer of Funds Regulation, from June 2017 onwards. The recommendations made in the FATF's 2016 Mutual Evaluation Report on Austria have also been taken into account. Moreover, the FM-GwG brings the due diligence requirements in relation to preventing money laundering and terrorist financing, which were previously set out in various different supervisory laws, together in a single framework applicable to the entire financial market. The scope of the new law extends to credit and financial institutions based in Austria and those institutions operating in Austria through the freedom to provide services (obliged entities).

One of the key changes in the FM-GwG is the expansion of the risk-based approach as provided for in the Fourth Anti-Money Laundering Directive. Obligated entities may now use their own risk analysis and the risk classification of their customers to decide whether simplified or enhanced due diligence requirements should apply. The FM-GwG no longer stipulates any specific applications of simplified due diligence requirements but these may be determined by the FMA in the form of regulations.

ENHANCED DUE DILIGENCE REQUIREMENTS

With regard to enhanced due diligence requirements, the FM-GwG expressly provides for individual areas of application. In particular, the provisions regarding politically exposed persons (PEPs) have been extended. Compared with the previous legal situation, according to which enhanced requirements only applied to transactions or

business relationships with foreign PEPs, Austrian PEPs are now also covered by the rules. As far as Austria is concerned, this particularly applies to the Federal President, the Federal Chancellor and members of the Federal Government, the members of parliament sitting in the National Council and the members of the provincial governments (but not the members of parliament in the provincial parliaments or at local authority level), as well as members of the executive bodies of the parties represented in the National Council. Enhanced due diligence requirements are also to be applied to natural or legal persons based in a third country that presents a high level of risk.

A list of the countries concerned is now being drawn up by the European Commission for the first time for uniform application across the entire EU in the form of a delegated regulation.

ONLINE IDENTIFICATION

A further key change relates to the option of identifying and verifying the identity of customers and their authorised representatives using an online identification process. In order to reduce the risks associated with the lack of any physical presence during such an online identification and verification process, the FMA has defined appropriate security measures in the form of its own regulation (Online Identification Regulation).

The following prerequisites have been defined as necessary security measures:

- The obliged company must capture screenshots showing the potential customer and their official photo identification.
- The potential customer must hold the identification document in front of the camera, tilting it horizontally and vertically so that the holographic security features can be verified by specially trained employees.
- The employee concerned must also check that the document is physically intact and check its serial number by having the potential customer hold it accordingly in front of the camera.
- The online identification process must be carried out by the obliged company in a separate room, access to which is controlled.
- The process must be halted if it is not possible to carry out a visual check of the potential customer or of the official photo identification, or in the event of any other uncertainties.

OTHER FMA REGULATIONS

On the basis of the FM-GwG, the FMA has enacted a further five regulations. These enable the applicability of simplified due diligence requirements to be expressly stipulated. In such cases, the obliged entity does not have to determine a low level of risk independently by means of its own risk analysis but can generally rely on the FMA's findings in the absence of any information indicating that the risk of money laundering or terrorist financing in that specific case is not low.

By means of its due diligence regulations governing life insurance, school savings schemes, fiduciary accounts and corporate provision funds, the FMA has determined that:

- with regard to certain policies in the life insurance sector (contracts covering small amounts, pension insurance contracts, company old-age provision, state-sponsored retirement provision, supplementary pension insurance);
- with regard to school savings schemes;
- with regard to certain types of fiduciary accounts held by lawyers, notaries and estate agents; and
- in the area of corporate provision funds,

the risk of money laundering or terrorist financing is low. Consequently, in such cases, obliged entities may generally apply simplified due diligence procedures, as stipulated in some cases in the respective regulations. In addition, corporate provision funds are excluded from the obligation of carrying out their own risk analysis of the money laundering or terrorist financing risk.

Finally, the existing Savings Association Regulation has been brought into line with the new legal situation in order to maintain the existing alleviated rules for establishing and checking the identify of members of the association.

REGISTER OF BENEFICIAL OWNERS

Under the terms of the Fourth Anti-Money Laundering Directive, the Member States are obliged to set up a register of the beneficial owners of companies and other legal persons (e. g. foundations). In Austria, this is to be implemented in the course of 2017 by means of the Beneficial Owners Register Act (WiEReG; *Wirtschaftliche Eigentümer Registergesetz*), resulting in the creation of an appropriate register. All of the relevant companies and legal persons will be included in this register, along with details of their beneficial owners, with this information being kept permanently up to date. The aim of the register is to make it easier to establish and verify the identity of customers' beneficial owners.

Another key change in this regard is an amendment to the rules on indirect beneficial owners: in contrast to the current legal situation, the future definition of beneficial owner, based on the Fourth Anti-Money Laundering Directive, is to be based only on an active concept of control from the second level of holding. Such a form of active control would apply, for example, if a majority of the shares or voting rights in the intermediate company or legal person were held. The aim of this amendment is to harmonise the provisions with the international understanding of the concept of control, thereby also harmonising the definition of beneficial owner in the Member States.

In future, a beneficial owner is to be identified and verified for every company and legal person. If, after all possibilities have been exhausted, it is not possible to determine who the beneficial owner is or to be certain beyond doubt, the natural persons at the highest management level of the customer should be identified as the beneficial owner. This should only cover the most senior level of operational management, however. This would be the management board in the case of a joint stock company or the managing director in the case of a limited liability company. Establishing the most senior management level should however only be used as a last resort once all other options for ascertaining the actual beneficial owner have been exhausted and if it has not been possible to determine the correct beneficial owner beyond doubt.

This comprehensive package of measures from the Federal Government, to be introduced on the basis of a strictly scheduled action plan, will strengthen the efficiency and effectiveness of the Austrian AML/CTF system and, in this way, protect the integrity and reputation of Austria as a business location and financial centre.

The integrated approach to supervision in asset management

The boundaries between different products and sectors are becoming ever more blurred on the financial markets. At the same time, individual sectors are becoming increasingly interlinked. To give just some examples of the complex relationships on the financial markets: insurance undertakings are packaging investment funds or indices as insurance products; banks are selling investment funds and alternative investments; *Pensionskassen* and corporate provision funds mainly invest in investment funds; investment firms manage investment funds; banks administer the securities held in securities accounts; and old-age retirement provision may take the form of insurance products, investment fund units, *Pensionskassen* or corporate provision funds or savings products from banks.

In response to this highly interwoven financial market, the lawmakers have embraced and developed the concept of integrated supervision, bringing regulation and supervision of the entire financial market, encompassing both prudential and conduct supervision, under one roof. This should ensure that, as far as possible, economically equivalent products and services are regulated and supervised in the same way, regardless of the legal form of the companies offering them. It also means that the interactions, created by interweaving and interdependencies between sectors and industries of the financial market, are taken into account in an optimal way. The integrated supervisory model not only leverages synergies in terms of costs and knowledge, it also helps to create a level playing field across all products and sectors.

At a European level, the trend is also moving in the direction of integrated supervision and regulation. Consequently, the three sector-based European Supervisory Authorities – the EBA, EIOPA and ESMA – have set up a Joint Committee. Moreover, the development of European supervision is currently being driven forward by intensive harmonisation of regulation and enforcement, and the increased development of cross-sectoral supervisory standards. One of the aims in this regard is to minimise regulatory and supervisory arbitrage.

The Austrian Financial Market Authority (FMA) was initially created as an integrated supervisory authority on the basis of an international comparative study of best practices, and it is an approach with a proven track record, particularly in relation to the global financial crisis.

How the FMA's integrated approach to supervision works in practice is shown here using the example of the asset management sector.

STEPPING UP THE INTEGRATED APPROACH TO SUPERVISION IN ASSET MANAGEMENT

Asset management is a task being fulfilled across all of the key sectors of the Austrian financial market. Correspondingly, it is also regulated in various different supervisory laws that fall within the FMA's remit, such as the 2011 Investment Fund Act (InvFG 2011; *Investmentfondsgesetz*), Alternative Investment Fund Managers Act (AIFMG; *Alternative Investmentfonds Manager-Gesetz*), Pensionskassen Act (PKG; *Pensionskassengesetz*), Company Employee and Self-Employment Provisions Act (BMSVG; *Betriebliches Mitarbeiter- und Selbständigenvorsorgegesetz*), 2016 Insurance Supervision Act (VAG 2016; *Versicherungsaufsichtsgesetz*), Austrian Banking Act (BWG; *Bankwesengesetz*) and the 2007 Securities Supervision Act (WAG 2007; *Wertpapieraufsichtsgesetz*). This means that the various operational departments of supervision are responsible for monitoring the asset management industry's compliance with the statutory requirements and for enforcing these rules, particularly the Banking Supervision, Insurance Supervision, Pension Supervision and Securities Supervision Departments.

For the purposes of avoiding any regulatory and supervisory arbitrage, and to ensure fair competition across different sectors and products, the FMA has developed an integrated regulation and supervision strategy covering all aspects of asset management.

An internal working group in the form of the Asset Management Committee has been set up, bringing together experts from all of the Departments and Divisions concerned. This Committee decides on the interpretation and application of the law across all Departments, agreeing the FMA's position in all policy issues. Initially, a uniform definition of the term "asset management" was established, and a list of the issues requiring clarification drawn up. Asset management was defined as the individual and collective, active and passive, direct and indirect management of assets (financial instruments, etc.), the management of which falls within the FMA's supervisory remit.

The AM Committee prepares papers on individual asset management subjects, which are then submitted in the form of a shared understanding of supervision (GAV) to the FMA for adoption. A GAV is aimed at the FMA employees and affects all companies supervised by the FMA that engage in asset management activities. Asset managers are deemed to be managers of collectively and individually invested funds whose main task lies in managing the assets of others.

A GAV either sets out the FMA's internal legal opinion on statutory provisions, defines an internal FMA position on policy issues, or derives requirements from market standards, compliance with which is expected by the FMA. The specific implementation and application of the GAV takes account of the applicable legal basis and/or sector-specific characteristics, and is the responsibility of the relevant operational departments at the FMA.

What this means in practice is shown here using three subject areas as examples: the GAV on due diligence in asset management, the GAV on HTM valuation and the GAV on the definition of leverage.

GAV ON DUE DILIGENCE IN ASSET MANAGEMENT

The GAV regarding due diligence in asset management set outs the FMA's legal view of the following statutory provisions:

- Article 39 BWG;
- Articles 28, 30 and 32 InvFG 2011;
- Article 10 AIFMG in conjunction with Article 20 of the AIFM Delegated Regulation¹, Article 18 AIFMG;
- Articles 23 and 25 to 26 PKG, Article 12 para. 3 no. 3 of the Risk Management Regulation for *Pensionskassen* (PK-RIMAV; *Pensionskassen-Risikomanagementverordnung*);
- Article 5 no. 36, Article 109, Articles 106 et seq. VAG 2016 in conjunction with Articles 70 and 84 of the Stock Corporation Act (AktG; *Aktiengesetz*);
- Article 25 WAG 2007.

¹ Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision.

It clarifies how due diligence is to be carried out and documented in relation to a business partner on the basis of uniform FMA standards.

For the purposes of upholding investor interests and achieving the best possible results, potential contractual partners should be evaluated, using appropriate measures, when entering into transactions and agreements for managed funds or managed assets with business partners.

Moreover, offers or markets should be subject to comparisons whenever specific tasks or contracts are being awarded in order to avoid the risk of any disadvantage being suffered by the shareholders as a result of a business partner and, at the same time, to find the best possible offer in that specific case.

This means that, depending on the significance and value of the potential contract concerned, and thus the individual circumstances, sufficient time and efforts should be devoted to selecting the optimum approach in line with the due diligence principles of orderliness and professional integrity.

Express reference is also made to the FMA's view that a due diligence process should also be carried out for intra-group assignments or contracts (e. g. custodian bank), using an arm's length approach where necessary.

Due diligence helps to determine an appropriate business partner and to minimise the business risk. Depending on the individual case, either basic due diligence or enhanced due diligence processes are required in relation to potential business partners. Only once appropriate due diligence has been carried out may an asset manager decide on appropriate business partners in the interests of investors. Documentation of the decision-making process together with regular reviews of the business partner selected (ongoing due diligence) is also required, this being an integral part of the obligation to achieve the best possible result and maintain investors' interests.

In relation to due diligence, FMA minimum standards in relation to special-purpose credit institutions and alternative investment fund managers (AIFMs) were published on 1 February 2016² (applicable to investment fund management companies, real estate investment fund management companies, AIFMs and corporate provision funds), while FMA minimum standards on due diligence for *Pensionskassen* were published on 24 May 2016.³ The minimum standards are requirements derived from market standards and also encompass further-reaching recommendations. The FMA expects supervised entities to adhere to these standards.

GAV ON HTM VALUATION

Rather than applying a valuation method based on the principle of current values, corporate provision funds and *Pensionskassen* may carry out their valuations for certain debt securities at amortised cost using the effective interest method (held-to-maturity valuation) pursuant to Article 31 para. 1 no. 3a BMSVG and Article 23 para. 1 no. 3a PKG respectively. As at 31 December 2016, assets under management of € 1.91 billion had been classed as HTM (€ 1.62 billion or 17.19% of assets under management at corporate provision funds and € 0.29 billion or 1.38% of assets under management with *Pensionskassen*).

With regard to HTM valuation, the GAV is a legal opinion of the FMA on Article 31 para. 1 no. 3a BMSVG and Article 23 para. 1 no. 3a PKG. Its aim is, in particular, to harmonise supervision and interpretation in practice across securities and pension supervision with regard to corporate provision funds and *Pensionskassen* classifying assets as HTM.

The applicable criteria for classing debt securities as HTM at corporate provision funds and *Pensionskassen* are defined uniformly in the GAV. These include:

- debt securities from issuers with a particularly good credit rating;
 - debt securities with a fixed term, fixed interest rate and fixed repayment amount; and
 - separate classification as held to maturity, alongside evidence of HTM eligibility in the form of a liquidity plan.
- Ongoing checks of HTM eligibility and reasons for reversing the decision to class debt securities as HTM are

² www.fma.gv.at/download.php?d=1860 (available in German)

³ www.fma.gv.at/download.php?d=1485 (available in German)

defined in more detail in the GAV, taking the statutory differences in the BMSVG and PKG into account. With regard to reasons for reclassification, the following areas are dealt with:

- reclassification due to change in the debt security's credit rating;
- reclassification due to change in the debt security's conditions (e. g. change to the prospectus);
- reclassification due to special circumstances.

GAV ON THE DEFINITION OF LEVERAGE

This GAV provides an overview of how the concept of leverage is defined in the different supervisory laws. Basically, there is no explicit statutory definition of leverage. The term is generally understood as referring to an increase in risk caused by the use of borrowing, derivatives or securities financing transactions. The GAV highlights differences and common features, while also setting out agreed positions in policy issues in this area. Included in this GAV alongside investment firms are credit institutions, insurance undertakings, *Pensionskassen* and corporate provision funds.

Three different forms of leverage can be identified from the definitions provided in the supervisory laws:

- leverage from borrowing;
- leverage from derivatives; and
- leverage from securities financing transactions (SFTs), such as securities lending and repurchase agreements.

One method for measuring leverage, referred to in the various laws covering investment funds, insurance undertakings, *Pensionskassen* and corporate provision funds, is the commitment method (see Articles 4 to 10 of the Fourth Regulation on Risk Calculation and Reporting of Derivative Instruments). This method takes account of derivative positions based on equivalent positions in the underlyings, while deducting hedging/netting arrangements and SFTs. It is based on the limiting of leverage for undertakings for collective investment in transferable securities (UCITS). Based on Article 80 para. 1 InvFG 2011, loans may only be taken up for UCITS on a temporary basis and up to a level of 10%, as a result of which the commitment method does not take account of borrowing. With regard to alternative investment funds (AIFs), however, the commitment method pursuant to Article 8 of the AIFM Delegated Regulation also takes account of leverage from borrowing. For a full consideration of leverage, it appears appropriate to discuss and include all three sources in future policy processes.

INTEGRATED SUPERVISION OF ASSET MANAGEMENT IN THE INVESTMENT FUND TRIANGLE

In the area of collective asset management, the FMA engages in fully integrated prudential supervision across the entire spectrum of the investment fund triangle: investors – management company – custodian bank (see Figure 3). The investment fund is at the centre of this triangle, collecting capital from investors (both professional and retail investors). The capital paid in is managed and invested by the management company (management company, real estate management company or AIFM). The activity of the custodian bank is kept separate. Its role is to keep the assets safe and to monitor the actions of the management companies in the interests of the investors.

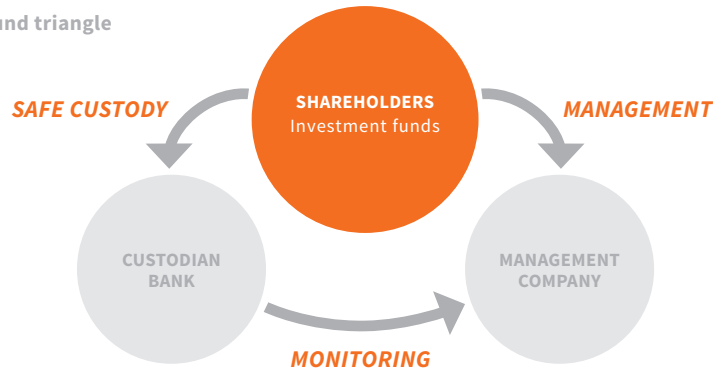
The FMA, in its capacity as the integrated supervisory authority, has responsibility for all of the institutions concerned.

By pooling specialist knowledge of investment, holding assets in custody and rules of conduct in an institution, it can guarantee an optimised form of supervision in terms of resources and costs, while combining prudential supervision and investment protection for optimum effect.

The FMA's tasks and powers in relation to the investment fund triangle include supervisory procedures that encompass both notification and approval processes, as well as ongoing analysis and operational supervision of compliance with statutory standards.

An important aspect in the context of integrated supervision is the approval process for fund regulations pursuant to InvFG 2011. The fund regulations govern the legal relationship between the shareholders, the manage-

Figure 3: The investment fund triangle



ment company and the custodian bank, and must be approved by the FMA for the first time when a fund is launched. However, the importance of the FMA's supervisory activity in the investment fund triangle is also clearly demonstrated in the context of the licensing procedure pursuant to InvFG 2011 and AIFMG. This includes, among other aspects, a review of the processes implemented to protect shareholders with regard to the handling of conflicts of interests, valuing assets, risk management and remuneration policy.

Another of the FMA's key tasks in the area of integrated supervision in the investment fund triangle lies in carrying out on-site inspections of management companies, real estate management companies, AIFMs and custodian banks (in conjunction with their depositary function). Particularly in the area of on-site inspections, comprehensive knowledge of processes in the interplay between investor interests, fund management and safe custody is crucially important in order to detect any potentially relevant supervision issues. In this regard the FMA analyses the key investment and risk management processes from the investment decision to the booking of a transaction in the fund. Essential areas covered by on-site inspections, such as organisational set-up, valuation procedures for illiquid assets, due diligence or implementation of a best execution policy relate to the individual aspects of the investment fund triangle.

The importance of integrated supervision in the context of this triangle is also clear from the development of supervision over the years: In 2014 the UCITS V Directive was adopted. It was transposed into Austrian law in 2015 through an amendment to the InvFG 2011. As a response to the financial crisis, the rules on UCITS depositaries, which had been largely unchanged since 1985, were completely overhauled as they no longer offered sufficient investor protection. The InvFG 2011 now includes far-reaching obligations for custodian banks and sub-custodians, stricter rules for a separation of the custodian bank and asset management company, and stricter liability rules and penalties for the depositary. These new provisions, which affect a range of institutions and were introduced to improve investor protection, are also monitored by the FMA. This is done through ongoing supervision but also in the form of on-site inspections of custodian banks and management companies.

INTEGRATED SUPERVISION OF ASSET MANAGEMENT AND LEGAL DEVELOPMENTS

The implementation of new European supervisory rules at national level, and their subsequent enforcement, with the FMA's involvement, also highlight the benefits of integrated supervision. By way of example, reference is made here to the FMA's activity in relation to the Benchmarks Regulation⁴. Introduced in response to the scandals surrounding the manipulation of the LIBOR and EURIBOR interest rate benchmarks, this new legislation not only impacts on the different areas of asset management but also has significant implications for the work of banks, insurance undertakings, *Pensionskassen* and investment firms. Moreover, companies working on the provision of benchmarks (administrators) are now subject to the terms of this Regulation.

⁴ Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014.

In future, the only benchmarks permitted in the EU for loans, funds and securities will be those that comply with the strict transparency and compliance rules set out in the Benchmarks Regulation. Benchmarks must be officially approved and included in a benchmark register maintained by the European Securities and Markets Authority (ESMA), and this also applies to any benchmarks calculated by a third-country provider. The aim is to substantially improve the protection of investors and consumers from any manipulation of these benchmarks. Again, the advantages of an integrated approach to supervision are clear to see given the different categories of institutions with different characteristics that are affected, all of which fall under the responsibility of the FMA. Another key change in the area of asset management is the Securities Financing Transactions Regulation (SFTR)⁵. This Regulation, the first European legislation of its kind to tackle SFTs (such as securities lending or repurchase agreements) previously forming part of the shadow banking sector, will impact on both financial (e.g. management companies, depositaries and banks) and non-financial counterparties. The Regulation will make transactions more transparent by making it compulsory to record them in a central trade repository in future. Investment funds will also be required to include information on these transactions in their documents, and the Regulation also sets new minimum requirements regarding collateral reuse. Given the broad range covered by this Regulation, extending beyond asset management itself, the FMA's contribution benefited greatly from the integrated approach to supervision in the context of developing the SFTR.

Just as a financial sector with cross-border activity needs a form of regulation and supervision that has at least been agreed internationally, an interwoven financial market where the boundaries between industries and sectors are increasingly blurred needs an integrated approach to supervision for the optimum blend of efficiency and effectiveness, particularly in the case of small, open economies. This too is a lesson learned from the global financial crisis.

⁵ Regulation (EU) 2015/2365 of the European Parliament and of the Council of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012.

Resolution planning

Comparing and contrasting resolution and recovery planning for Austrian credit institutions

The European Bank Recovery and Resolution Directive (BRRD)¹ was adopted in response to the financial crisis, creating a new framework for crisis management at banks and investment firms. In Austria, Directive 2014/59/EU was transposed into national law through the Federal Act on the Recovery and Resolution of Banks (BaSAG; *Bundesgesetz über die Sanierung und Abwicklung von Banken*)², which focuses on preparing for crisis situations, early intervention and, where necessary, resolution measures.

If a bank finds itself in a difficult financial situation, efforts generally focus in the first instance on recovery. During this phase, the bank itself is authorised to introduce the necessary measures (e.g. capital and liquidity measures, measures to minimise risk, etc.). The aim is to re-establish economic stability and to prevent the crisis from spreading. In accordance with BaSAG, the credit institution is supported during this time by the supervisory authority. Any decision to introduce or to refrain from introducing a measure included in the recovery plan must therefore be communicated to the supervisory authority immediately in writing.³

In the event that the measures introduced by the institution itself do not stabilise the financial situation, the supervisory authority may take appropriate early intervention measures where necessary (e.g. change of business strategy, dismissal of managers, etc.) and take active steps to rescue the bank.

If, despite these recovery measures, the credit institution is still deemed to be failing or likely to fail, the national resolution authority (in Austria's case the FMA) must decide whether the conditions for resolution pursuant to BaSAG are met or whether the institution should be wound up by means of normal insolvency proceedings.⁴

This operational approach as stipulated by law – from recovery carried out by the institution itself to recovery by the supervisory authority and through to the decision to resolve pursuant to BaSAG or proceed with liquidation pursuant to the Austrian Insolvency Act (IO; *Insolvenzordnung*) – is supported by a number of tie-in measures to prepare for crisis management. This applies to both recovery measures introduced by the bank and resolution measures by the resolution authority. Consequently, institutions are required to draw up recovery plans as a means of preparing for recovery, while it is the resolution authorities that are charged with preparing resolution plans.

¹ Implementation of Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, OJ L 173/2014, p. 190 (BRRD).

² Federal Law Gazette I No. 98/2014 as amended by Federal Law Gazette I No. 118/2016.

³ Article 10 para. 4 BaSAG.

⁴ See Article 49 para. 1 BaSAG.

RECOVERY PLANNING

AIM OF THE RECOVERY PLAN

Recovery planning is intended to make institutions more robust in the event of a crisis by forcing them to consider potential crisis scenarios and how to solve these long before any such crisis arises. The recovery plan stipulates the measures that could be taken in the event of a significant deterioration in the institution's financial situation in order to restore its financial position.⁵ It should include possible courses of action for re-establishing the institution's financial health and securing it over the long term without triggering any significant negative effects for the financial system. To ensure that the recovery measures can be introduced in good time, qualitative and quantitative recovery indicators (e. g. capital or liquidity indicators) as well as appropriate thresholds should be included in the plan.⁶

The aim of recovery planning is therefore to have the institution resolve its crisis independently, in order to avoid any worsening of the crisis for the institution itself or any impact on the wider financial market.⁷

RECOVERY PLAN BY AND FOR BANKS

Recovery plans should be drawn up by the institutions themselves and updated regularly.⁸ They should be submitted to the competent authority for review (in the case of institutions subject to direct supervision by the European Central Bank they should be submitted to the ECB, for other Austrian banks they should be submitted to the FMA).⁹ Primary responsibility for preparing a recovery plan therefore lies with the banks themselves.

CONTENT OF A RECOVERY PLAN

The content of a recovery plan is stipulated by law, primarily in Article 9 BaSAG and the Annex to Article 9 BaSAG and in Article 16 BaSAG (recovery plans for group institutions). In addition, together with the OeNB, the FMA has published a guide on preparing a recovery plan pursuant to BaSAG. This is intended to help institutions during the process of drawing up their plan, and also contains further tips on how to prepare the plan properly.¹⁰

As well as a summary of the key elements of the plan, a recovery plan must at least include information on governance (corporate governance including a description of the escalation process), a strategic analysis (description of the companies covered by the recovery plan and the recovery options), and an analysis of all necessary preparatory measures. Recovery measures specific to the institution should also be developed so that any crisis can be responded to appropriately.¹¹ The effectiveness of the selected recovery measures and suitability of the indicators included in the plan are tested during hypothetical stress scenarios.¹² Given that proper communication has a key impact on the success or failure of measures, particularly during a crisis situation, a communication and information plan should also be prepared.¹³

RESOLUTION PLANNING

AIM OF RESOLUTION PLANNING

Unlike the term "recovery", the term "resolution" is sometimes associated with negative connotations, albeit incorrectly.¹⁴ A resolution plan is often viewed as a bank's last will and testament, and given that a will is naturally

⁵ Article 8 para. 2 BaSAG.

⁶ Reisenhofer/Galostian Fard/Habliczek, *Sanierung und Abwicklung von Banken – BaSAG [Recovery and resolution of banks – in German] (2015) 2–7 et seq.*

⁷ Reisenhofer/Galostian Fard/Habliczek, *Sanierung und Abwicklung von Banken – BaSAG (2015) 2–8.*

⁸ Article 8 para. 1 BaSAG.

⁹ See Article 12 para. 2 BaSAG.

¹⁰ See FMA/OeNB, *Erläuterungen von FMA und OeNB zur Erstellung von Sanierungsplänen nach dem BaSAG [FMA and OeNB Guide on preparing recovery plans pursuant to BaSAG – in German] (last updated in April 2016).*

¹¹ See FMA/OeNB, *Erläuterungen von FMA und OeNB zur Erstellung von Sanierungsplänen nach dem BaSAG (last updated in April 2016), para. 45 et seq.*

¹² Article 9 para. 2 BaSAG.

¹³ FMA/OeNB, *Erläuterungen von FMA und OeNB zur Erstellung von Sanierungsplänen nach dem BaSAG (last updated in April 2016), para. 48 et seq.*

¹⁴ The term "resolution", unlike "recovery", gives the impression that the institution will cease to exist at the end of the process.

associated with death, the aims of the resolution plan are portrayed inaccurately. The term “living will” is in fact a more accurate encapsulation of the principle behind a resolution plan, which is in effect a plan for the organised resolution of an institution in a way that avoids any damage to confidence in the stability of the financial market as a whole, and at the same time enables the viable parts of the bank to survive.

The resolution regime is basically a type of standardised recovery process intended to protect the institution as a whole or at least parts of that institution from insolvency and thus from full dissolution. This means that the institution’s commercial activities are continued, although possibly on a smaller scale.

It should however be noted that resolution measures will only be actively ordered and an institution only deemed to be “failing” or “likely to fail” if no alternative private-sector measures are possible and if the resolution lies in the public interest (e.g. in order to protect public money, avoidance of negative impact on financial market stability, etc.).¹⁵ Such questions are not dealt with fully at the time of the plan being drawn up but would be clarified in an acute crisis situation. In particular, the question of whether resolution lies in the public interest will depend to a large extent on the actual situation prevailing during a crisis. Where there is no public interest in a bank being resolved, it should generally be wound up by means of an insolvency process.

The resolution plan should develop a promising resolution strategy in advance, encompassing both the resolution approach¹⁶ and the resolution target,¹⁷ applying the resolution tools as core elements. Based on the preferred resolution strategy, the critical functions should be continued.

The assessment of a function to determine how critical it is is based on its significance for the functioning of the real economy and the financial markets.¹⁸ A function is deemed to be critical if the sudden loss or failure of that function would be likely to have significant effects on third parties, create a risk of contagion or undermine general market confidence.¹⁹ Any obstacles to resolution that are detected must be removed to ensure that the resolution can proceed successfully.

The credibility of resolution strategies must be reviewed. The resolution plan must be updated regularly to ensure that it remains relevant regardless of any changes to the bank itself or with regard to the situation on the financial market.²⁰

RESPONSIBILITY FOR PREPARING THE RESOLUTION PLAN

Unlike a recovery plan, the resolution plan is not drawn up by the institution itself but by the competent resolution authority. As far as Austria is concerned, the FMA is the national resolution authority²¹ and is therefore required to prepare a specific resolution plan for each Austrian institution that is not part of a group subject to consolidated supervision.²²

The European lawmakers, in learning the lessons from the financial crisis, are creating a banking union based on three pillars: the Single Supervisory Mechanism (SSM), a common deposit guarantee scheme and the Single Resolution Mechanism (SRM). For this purpose, a Single Resolution Board (SRB) has been set up in Brussels. The SRB is responsible for the resolution of significant institutions (SIs) in the eurozone that are subject to direct supervision by the ECB within the SSM²³, as well as for the resolution of all banking groups with cross-border operations within the banking union.²⁴ There are currently 15 institutions in Austria for which the SRB is responsible,

¹⁵ Article 49 para. 1 BaSAG.

¹⁶ A distinction must be made in this regard between the SPE (single point of entry) and MPE (multiple point of entry) approaches. SPE: central application of resolution measures via the head of the group. Bail-in liabilities are located at the head of the group, losses can be transferred within the group. MPE: decentralised application of resolution measures within the group. Losses can be absorbed by the respective group units.

¹⁷ Financial restructuring: loss absorption through reduction and/or conversion of liabilities into equity (bail-in); legal and operational structures remain unchanged. Structural reorganisation: reduction of capital requirements and/or adjustment of the business/operating model in order to ensure that critical functions are maintained.

¹⁸ See EBA, Technical advice on the delegated acts on critical functions and core business lines, EBA/Op/2015/05, para. 9.

¹⁹ See Article 2 no. 37 BaSAG.

²⁰ See Reisenhofer/Galostian Fard/Habliczek, *Sanierung und Abwicklung von Banken – BaSAG (2015) 5–1 et seq.*

²¹ Article 3 para. 1 BaSAG.

²² Article 19 para. 1 BaSAG.

²³ See Article 7(2) of Regulation (EU) No 806/2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010, OJ L 225/2015, p. 1 (SRM Regulation).

²⁴ Article 7 para. 2b BaSAG. There are currently approximately 480 institutions.

although it should be noted that the FMA, in its capacity as national resolution authority, forms an integral part of the SRB and has both a seat and a voting right at the SRB. The FMA also contributes greatly to the SRB's preparation of resolution plans for Austrian institutions, communicating with the institutions concerned in such cases²⁵. The term "institution" encompasses institutions as defined in Article 4(1)(1) of the Capital Requirements Regulation (CRR)²⁶ and investment firms as defined in Article 4(1)(2) CRR whose initial capital as defined in the 2007 Securities Supervision Act (WAG 2007; *Wertpapieraufsichtsgesetz*) amounts to at least € 730 000.²⁷

STRUCTURE OF A RESOLUTION PLAN

Resolution plans must be structured as detailed in Article 20 para. 5 BaSAG. The SRB has prepared a manual for the national resolution authorities as a guide and to guarantee a uniform approach.²⁸

A strategic business analysis forms the starting point. This should provide a detailed overview of the bank, particularly with regard to its ownership structure, governance, balance sheet, business model, critical functions, core business areas, internal and external interdependence, IT systems and access to the financial market infrastructure (FMI).

Based on this information, the resolution authority develops the resolution strategy as a second step. Clarification is required in the first instance as to whether insolvency is a credible and viable approach, or whether the bank should be resolved in the event of a failing or likely to fail decision. If preference is given to resolution over insolvency, the appropriate resolution strategy must be presented together with the relevant tools.

The four main resolution tools are:

- the sale of business tool (Article 75 et seq. BaSAG);
- the bridge institution tool (Article 78 et seq. BaSAG);
- the asset separation tool (Article 82 et seq. BaSAG); and
- the bail-in tool (Article 85 et seq. BaSAG).

The third step involves considerations on how to guarantee the financial and operational continuity of the institution in the event of resolution. The maintenance of liquidity during resolution is crucially important. If a failing or likely to fail decision has been announced, this is very likely to increase the institution's liquidity requirements. The costs of acquiring fresh capital will also rise, as will the requirements made of the related collateral. Consequently, the amount and timing of any necessary injections of capital must be assessed in the resolution plan taking account of the resolution strategy. Firstly, the internal options for acquiring liquidity at short notice will be assessed (e. g. sale of assets or reduction of expenses). If the internal injection of liquidity is not sufficient, external sources of capital will be needed to maintain solvency. However, care must be taken to ensure that such sources do not dry up in the event of a crisis. One of the lessons learned from the financial crisis is that state funds²⁹ must generally not be permitted as short-term liquidity finance in the resolution plan.³⁰

In order to be sufficiently equipped in the event of a crisis, the resolution plan should also include a section dedicated to information and communication channels (e. g. between the responsible authorities and with stakeholders) and methods for securing access to the required financial market infrastructure (e. g. clearing, settlement).

On the basis of findings to date and the resulting measures, any obstacles to resolution should then be analysed in a subsequent step, with the measures needed to remove them set out in the resolution plan.

Ultimately, institutions are given the opportunity to issue a statement on the prepared resolution plan, which is then to be incorporated into the document.

²⁵ Article 19 para. 1 BaSAG.

²⁶ Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, text with EEA relevance, OJ L 176/2013, p. 1.

²⁷ Article 2 para. 23 BaSAG; see Reisenhofer/Galostian Fard/Habliczek, *Sanierung und Abwicklung von Banken – BaSAG (2015) 5–2*.

²⁸ See the following in particular with regard to the structure of resolution plans: SRB, *The Single Resolution Mechanism – Introduction to Resolution Planning (2016) 32*, <https://srb.europa.eu/en/node/163> 19 et seq.; Reisenhofer/Galostian Fard/Habliczek, *Sanierung und Abwicklung von Banken – BaSAG (2015) 5–4 et seq.*

²⁹ State funding may only be used in very precisely regulated cases, see Article 99 BaSAG.

³⁰ See SRB, *The Single Resolution Mechanism – Introduction to Resolution Planning (2016) 32*, <https://srb.europa.eu/en/node/163>.

RECOVERY PLANNING VS. RESOLUTION PLANNING – COMMON FEATURES AND DIFFERENCES

While resolution planning differs from recovery planning in many regards, there are also common features.

COMMON FEATURES

Both types of plan aim to preserve the stability of the financial market.

Given that it is the institution itself that prepares any recovery plan, the management is forced to face up to potential crises in advance. This alone helps to make banks more robust.³¹ Moreover, recovery planning is intended to avoid the disorderly insolvency of institutions by ensuring that, at the first signs of a crisis, the institutions themselves are required to take action to avoid any further escalation of the situation.

If the bank's recovery measures and any subsequent intervention measures by the supervisory authority are not successful, insolvency proceedings will ultimately be introduced. If insolvency is not viable due to systemic relevance from a public perspective, efforts should be taken to ensure that any functions, the loss of which would jeopardise financial market stability, are maintained by means of the planned resolution procedure.

In terms of content, there are parallel features, at least as far as the initial sections of the recovery and resolution plans are concerned. A strategic business analysis with a description of business structure, business model and interrelationships is required in one of the first steps during the creation of both recovery and resolution plans. Another key element with regard to the recovery plan is the identification of core business areas and critical functions.³² Consequently, the plans are very similar at the outset. The content of each does however differ greatly in the subsequent sections, given the respective aims, and the two plans are structured independently of each other.

DIFFERENCES

Recovery planning and resolution planning share the common goal of preserving financial market stability. However, the route taken and, in particular, the available measures differ greatly in terms of the fine detail. While recovery planning focuses on the bank's crisis management, and is therefore basically aimed at ensuring the survival of the existing institution, resolution planning focuses primarily on maintaining an institution's critical functions. If there is no public interest in the remit being fulfilled³³, the institution will not be resolved but insolvency proceedings will be started.

Differences also apply in relation to responsibility for drawing up the two types of plan. Recovery plans are prepared by the institutions themselves and then reviewed by the responsible supervisory authority, the FMA or ECB.³⁴ The latter must determine whether the recovery plan complies with the statutory requirements, assessing its suitability on the basis of such criteria as completeness, clarity, relevance of information and coherence.³⁵

In contrast, the resolution plan is prepared by the competent resolution authority, namely the FMA or the SRB. For their part, the institutions concerned must provide all of the required information, primarily by supplying data templates. At the current stage in resolution plan preparation, the main template used is the Liability Data Template (LDT), which focuses on the bank's critical functions, IT systems and FMI access.

The resolution authorities strive to make as much use as possible of existing data held at the FMA, OeNB and ECB in order to avoid any redundancies.

³¹ See Reichenhofer/Galostian Fard/Habliczek, *Sanierung und Abwicklung von Banken – BaSAG (2015) 2-1*.

³² See FMA/OeNB, *Erläuterungen von FMA und OeNB zur Erstellung von Sanierungsplänen nach dem BaSAG (last updated in April 2016), para. 17*.

³³ Article 49 para. 1 no. 3 BaSAG.

³⁴ Article 12 para. 2 BaSAG.

³⁵ Article 12 BaSAG in conjunction with Article 16 et seq. of Commission Delegated Regulation (EU) 2016/1075 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges, OJ L 184/2016, p. 1.

SUPREME POWER OF THE FMA TO ENFORCE RECOVERY AND RESOLUTION MEASURES

In both recovery and resolution planning, the authorities have recourse to sanctions in the event that the statutory rules are not observed.³⁶ Otherwise, the options for prescribing measures in the recovery and resolution plans vary.

LEGAL ENFORCEMENT IN RECOVERY PLANNING

If the review and assessment by the supervisory authority (ECB or FMA) reveal significant shortcomings in the recovery plan or if there are significant obstacles to the implementation of the planned recovery process, the supervisory authority will call on the institution to improve its plan.³⁷ As a general rule, institutions will be given a period of two months to make the improvement, which may be extended to three months.³⁸ Prior to ordering an institution to make improvements, however, the supervisory authority must give the institution the opportunity to issue a statement on the provisional findings of the assessment.³⁹

If the shortcomings are not adequately tackled, the supervisory authority may order the institution to make particular changes to its plan.⁴⁰ If such changes are not made within the prescribed period, official measures can also be imposed as a final measure, such as a reduction in the institution's risk profile or enabling timely recapitalisation measures.⁴¹

LEGAL ENFORCEMENT IN RESOLUTION PLANNING

The resolution authority also has recourse to a comprehensive range of official measures in order to avoid obstacles to resolution. These measures, described in more detail below, extend further in some cases than those applicable as part of recovery planning.⁴² The rules on the MREL⁴³ (Minimum Requirement for Eligible Liabilities) and the raising of contributions for the resolution fund⁴⁴ will also have a considerable financial impact on the institutions.

SCOPE OF THE RESOLUTION PLAN

With regard to the resolution plans for individual institutions, the resolution authority stipulates when these should be prepared, their content and the degree of detail required,⁴⁵ with due regard in particular for proportionality. Relevant factors include the type of business activity, risk profile, size and the complexity of the activity.⁴⁶ The scope of the resolution plans depends above all on the impact that the institution's failure could have and the question of whether insolvency proceedings would be likely to have significant negative effects on the financial markets, other institutions, refinancing conditions or the economy as a whole.⁴⁷ After assessing these factors, the institutions can be assigned to categories, on the basis of which the scope of the required plan is determined. Institutions may, however, be moved into a different category according to their subsequent development, and this should be reviewed annually.

MINIMUM REQUIREMENT FOR ELIGIBLE LIABILITIES (MREL)

The MREL ratio is a new regulatory indicator in the resolution regime (Article 100 et seq. BaSAG).⁴⁸ Institutions are

³⁶ Article 152 et seq. BaSAG.

³⁷ Article 13 para. 1 BaSAG.

³⁸ Article 13 para. 2 BaSAG.

³⁹ Article 13 para. 3 BaSAG.

⁴⁰ Article 14 para. 1 BaSAG.

⁴¹ Article 14 para. 3 BaSAG, see Reisenhofer/Galostian Fard/Habliczek, *Sanierung und Abwicklung von Banken – BaSAG (2015) 2–34 et seq.*

⁴² Article 29 para. 6 BaSAG.

⁴³ Article 100 et seq. BaSAG.

⁴⁴ Article 123a para. 2 BaSAG.

⁴⁵ Article 4 para. 1 BaSAG.

⁴⁶ Article 1 para. 2 BaSAG on proportionality.

⁴⁷ Article 4 para. 2 BaSAG.

⁴⁸ See Schiele, *Minimum Requirement for Eligible Liabilities (MREL) – Eine neue regulatorische Anforderung für Banken [A new regulatory requirement for banks]*, *Banken-Times SPEZIAL Banksteuerung/Treasury* (2016) 21.

required to hold a minimum level of own funds and eligible liabilities so that, in the event of a resolution, they would have sufficient loss-absorbing capacity and recapitalisation options. The stipulated MREL ratio is based on the resolution strategy taking into account the institution's business model, risk profile and refinancing strategy. The eligible liabilities for the purposes of the MREL ratio (Article 100 para. 1 BaSAG) are not the same liabilities as those eligible for a bail-in (Article 85 para. 1 BaSAG).⁴⁹

The MREL ratio is set individually for each institution on a case-by-case basis. With regard to banking groups, there should generally be both a consolidated MREL and an MREL at the level of the individual institutions,⁵⁰ although the need to stipulate an MREL for individual institutions may be waived by a group under certain conditions.⁵¹

The criteria set out in Article 100 para. 4 BaSAG must be taken into account when setting the MREL, considering such factors as whether the liabilities eligible for inclusion in the MREL figure would be sufficient for the institution to be resolved in line with the resolution targets, and whether the MREL is consistent with the institution's size and business model. It might not always be necessary to make plans for a resolution during resolution planning, as this will not always be in the public interest. If, therefore, insolvency appears to be a viable option, a lower MREL ratio may be set as no eligible liabilities would be required for a recapitalisation. No provision is made in the BaSAG for a minimum level of MREL.⁵²

The aim of the MREL is to ensure that an institution that is going through resolution can be recapitalised by means of a bail-in (or in combination with other resolution tools) and returned to market viability. This means that the prerequisites for having a bank licence issued or for retaining a licence must be met and that market confidence must be restored. Consequently, a sufficiently high level of own funds is essential.⁵³ The own funds and eligible liabilities must therefore be sufficient to recapitalise the institution in such a way that investor confidence in the institution is restored.

Given that many Austrian banks are primarily financed through deposits, compliance with the MREL requirements will pose a major challenge for both the institutions and the FMA in the capacity of resolution authority, as deposits from private individuals and SMEs do not count towards the MREL.⁵⁴

CHALLENGES OF GROUP RESOLUTION PLANNING

A large number of banks now have a highly branched corporate structure and are organised as groups. Often, a banking group will have its registered office in one EU Member State but subsidiaries and significant branches elsewhere in the EU or even in third countries. This creates major challenges for the resolution authorities within the EU as coordination between the respective national authorities is unavoidable, dealing with such issues as resolution planning, resolvability, setting an MREL, measures to remove significant obstacles and potential concepts for use in the event of resolution. At the same time, the aim is generally to provide such groups with a main contact person responsible for the tasks referred to above.

RESOLUTION COLLEGES: CROSS-BORDER GROUP RESOLUTION PLANNING

If a group has its registered office in the banking union and one or more subsidiaries or major branches in other states that are also members of the banking union (i. e. it has cross-border activities), the SRB is the competent resolution authority.⁵⁵ Coordination between the different national resolution authorities takes place through Internal Resolution Teams (IRTs), with any decisions being taken by the SRB in its capacity as competent resolution authority.

⁴⁹ See SRB, *The Single Resolution Mechanism – Introduction to Resolution Planning (2016) 38 et seq.*, <https://srb.europa.eu/en/node/163>.

⁵⁰ Article 101 et seq. BaSAG.

⁵¹ Article 100 para. 5 BaSAG.

⁵² See Reisenhofer/Galostian Fard/Habliczek, *Sanierung und Abwicklung von Banken – BaSAG (2015) 5–21 et seq. with further refs.*

⁵³ Reisenhofer/Galostian Fard/Habliczek, *Sanierung und Abwicklung von Banken – BaSAG (2015) 5–18 with further refs.*

⁵⁴ Article 100 para. 1 no. 6 in conjunction with Article 131 para. 1 no. 2 BaSAG.

⁵⁵ Article 7(2)(b) SRM Regulation.

As soon as a group institution has at least one subsidiary or one significant branch in a Member State outside the banking union (non-participating Member State), a resolution college is to be established in order to include the other Member States in the decision-making process. Responsibility for establishing the resolution college lies with the group-level resolution authorities (the SRB or national authority in the country in which the parent company has its registered office).⁵⁶

The members of a resolution college are the competent resolution authorities, the competent supervisory authorities, the responsible ministries, the authorities responsible for the deposit guarantee scheme in the Member State, and the European Banking Authority (EBA). Resolution authorities from third countries may be invited to participate as observers.⁵⁷ Joint decisions on the items proposed by the group-level resolution authority⁵⁸ are taken by the resolution authorities responsible for the group resolution plan together with the resolution authorities from the non-participating Member States.⁵⁹

SINGLE POINT OF ENTRY (SPE) VS. MULTIPLE POINT OF ENTRY (MPE)

In order to determine a banking group's resolution strategy, clarification is needed regarding the institutions within the group to which the resolution tools will apply. Depending on whether the resolution tools are only to be applied to the parent institution or to several sub-institutions, the resolution approach is referred to as single point of entry (SPE) or multiple point of entry (MPE).⁶⁰ Neither the BRRD nor the BaSAG contains rules regarding the two approaches, leaving the resolution authorities to make their own choice. The selection of one approach may, however, entail considerable restructuring for the banking group, which is why the resolution authority should take the principle of proportionality into account when making its choice.⁶¹

The SPE approach is applied when only the group-level resolution authority is to be involved in the process, applying the resolution tools at the parent institution. The losses that require covering are transferred to the group's parent institution, where they will, for example, be absorbed by means of a bail-in. Recapitalising the parent company means that the subsidiaries can again be provided with capital and liquid assets. The group is then reorganised, during which time the causes of the crisis should be eliminated.⁶²

An SPE approach is pursued for those groups with a centralised structure including, for example, central liquidity management, risk management, treasury, central IT organisation or other critical services. Ideally, the parent company will only be a holding company, the resolution of which will not involve any deposits, thereby facilitating a bail-in. Applying the resolution tools in this case is less complex, with the result that less comprehensive cooperation is required with the other resolution authorities. This means that the resolution process, which is sometimes difficult but needs to be carried out quickly, appears easier to implement.⁶³

Ultimately, to be able to apply an SPE approach, the parent company must own sufficient loss-absorbing capital in order to bear its own losses and also those of the subsidiaries. A further prerequisite is the de facto and legal option of transferring losses from the subsidiary companies to the parent company.⁶⁴

The MPE approach means that two or more resolution authorities can apply resolution measures to different parts of the group, which results in the group being split into one or more sub-groups. This division may take

⁵⁶ Article 32 SRM Regulation and Article 88(1) BRRD (Article 134 para. 1 BaSAG).

⁵⁷ Article 88(2) BRRD and Article 135 BaSAG.

⁵⁸ Group resolution plan, resolvability of an institution, amount of the MREL, measures to remove significant obstacles and potential concepts to be used in the event of resolution.

⁵⁹ For further details on decision-making see Article 61 et seq. of Commission Delegated Regulation (EU) 2016/1075 supplementing Directive 2014/59/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the content of recovery plans, resolution plans and group resolution plans, the minimum criteria that the competent authority is to assess as regards recovery plans and group recovery plans, the conditions for group financial support, the requirements for independent valuers, the contractual recognition of write-down and conversion powers, the procedures and contents of notification requirements and of notice of suspension and the operational functioning of the resolution colleges, OJ L 184/2016, p. 1.

⁶⁰ Reisenhofer/Galostian Fard/Habliczek, *Sanierung und Abwicklung von Banken – BaSAG (2015) 6–1*.

⁶¹ Article 3 para. 2 BaSAG.

⁶² Reisenhofer/Galostian Fard/Habliczek, *Sanierung und Abwicklung von Banken – BaSAG (2015) 6–4*.

⁶³ FSB, *Recovery and Resolution Planning for Systemically Important Financial Institutions: Guidance on Developing Effective Resolution Strategies (2013) 13*; Reisenhofer/Galostian Fard/Habliczek, *Sanierung und Abwicklung von Banken – BaSAG (2015) 6–5*.

⁶⁴ FSB, *Recovery and Resolution Planning for Systemically Important Financial Institutions: Guidance on Developing Effective Resolution Strategies (2013) 13*.

place at national or regional level. The preferred resolution strategies for the individual parts of the group are then defined. While these may vary across the different parts of the group, they must nevertheless be coordinated by the resolution authorities in the context of a resolution strategy for the entire group. If the authorities do not coordinate their approach in this way, problems may be created, or the resolution process could trigger a scramble for the assets.⁶⁵

An MPE approach should be pursued whenever a group can be divided into clearly definable sub-groups that can exist largely independently from a financial, legal and organisational perspective. In order to be able to use bail-in as a resolution tool, eligible liabilities must be issued to third parties on a decentralised basis by the different sub-groups. An MPE approach will be difficult to implement if the critical functions of a sub-group are reliant on services from other parts of the group.⁶⁶

For an MPE approach, the entry points must first be established. A resolution strategy with its own resolution tools must be planned for each individual entry point without any inconsistencies in the different strategies across the entire group. Any critical functions and services must be retained during the resolution process. This can be guaranteed by having a dedicated service unit safeguard critical shared services. Effective liaison and consultation is required among all of the resolution authorities involved, particularly with regard to the timing of resolution tools and clearly defined remits in order to avoid a run on the institution's assets in the event of a crisis.⁶⁷

REMOVAL OF OBSTACLES TO RESOLUTION

As part of the resolution planning process, the resolution authority assesses the resolvability of an institution or group. A bank is deemed to be resolvable if it can be liquidated by means of an insolvency process or viably and credibly resolved by applying resolution measures.⁶⁸

If the resolution authority's assessment shows there to be significant obstacles to resolution, the institution is informed accordingly by means of an administrative decision.⁶⁹ Upon the issuing of the decision, the institution has a period of four months in which to propose measures for the removal of the obstacles to the resolution authority.⁷⁰ The resolution authority reviews the institution's proposal and, after a hearing with the supervisory authority, assesses whether the measures are suitable for removing or sufficiently reducing the obstacles.⁷¹

Where the proposed measures are appropriate, the resolution authority will order the institution to implement them without delay.⁷² Otherwise, the resolution authority is required to devise one or more alternative measures with which the institution can remove the obstacles, imposing such measures by means of an administrative decision.⁷³ The resolution authority must take due account of the need for and proportionality of the measures, as well as their impact on the institution, the threat to financial stability posed by the obstacles to resolution, the stability of the institution, and its ability to contribute to the economy.⁷⁴ Possible alternative measures include limiting risk positions, selling off certain assets, limiting certain existing or planned activities, etc. Once the measures have been set, the institution has one month to draw up an implementation plan.⁷⁵

CONCLUSION

While both recovery and resolution planning are derived from the same statutory basis, they have very different

⁶⁵ See FSB, *Recovery and Resolution Planning for Systemically Important Financial Institutions: Guidance on Developing Effective Resolution Strategies* (2013) 13.

⁶⁶ Reisenhofer/Galostian Fard/Habliczek, *Sanierung und Abwicklung von Banken – BaSAG* (2015) 6–7.

⁶⁷ Reisenhofer/Galostian Fard/Habliczek, *Sanierung und Abwicklung von Banken – BaSAG* (2015) 6–8.

⁶⁸ Geier, *Abwicklung [Resolution]*, in Jahn/Schmitt/Geier (ed.), *Handbuch Bankensanierung und -abwicklung [Bank recovery and resolution manual – in German]* (2016) para. 95 et seq.

⁶⁹ Article 29 para. 1 in conjunction with para. 7 BaSAG.

⁷⁰ Article 29 para. 2 BaSAG.

⁷¹ Article 29 para. 3 BaSAG.

⁷² Article 29 para. 4 BaSAG.

⁷³ Article 29 para. 4 in conjunction with para. 7 BaSAG.

⁷⁴ Article 29 para. 5 BaSAG.

⁷⁵ Article 29 para. 4 BaSAG.

aims, as shown here. What they have in common is that both involve learning the lessons of the global financial crisis. Another common feature is that both will make a significant contribution towards strengthening confidence in the banks and towards financial market stability.

Distribution of loss-absorbing bank securities – a challenge for supervision

The new MiFID II & MiFIR regime provides new supervisory tools covering advice and distribution

The MiFID II package (the revised Markets in Financial Instruments Directive – MiFID II and the Markets in Financial Instruments Regulation – MiFIR) enters into force on 3 January 2018. This new European regime relating to the advice and distribution of financial instruments brings new rules, which signify a paradigm shift. While the regulatory approach has previously focused on internal processes, compliance organisation and the institutions' internal guidelines relating to conduct of business obligations to be adhered to when dealing with customers, the new requirements and obligations centre on the securities products being distributed. In addition, under the new MiFIR regime, the competent authorities are given the power to restrict or even prohibit financial instruments, structured deposits or financial activities and practices where these give rise to serious concerns regarding investor protection or the stability or integrity of the financial system or financial markets.

At the same time, major changes to capital requirements and the requirements relating to the recovery and resolution of banks in accordance with the Bank Recovery and Resolution Act (BaSAG; *Bankensanierungs- und Abwicklungsgesetz*) require additional and new equities and equity-like financial instruments to be raised on a massive scale. Certain debt instruments will also be eligible for loss absorption and the recapitalisation of banks in future. In conjunction with the MiFID II package, all of this poses completely new challenges in relation to the provision of investment advice about bank securities and in relation to their distribution. In its capacity as an integrated supervisory authority, bringing together prudential banking supervision, bank recovery and resolution as well as conduct of business supervision with regard to the distribution of financial instruments under one roof, the FMA is optimally positioned to tackle these challenges, thereby making a significant contribution to strengthening confidence in the banks and ensuring the stability of Austria as a financial marketplace.

THE NEW RECOVERY AND RESOLUTION REGIME – A CHALLENGE FOR THE DISTRIBUTION OF BANKS' FINANCIAL INSTRUMENTS

During the financial crisis numerous banks across Europe were supported or saved by government aid. In order to keep the costs for taxpayers as low as possible during any future banking crisis and to avoid a repeat of this vicious circle of bank bail-outs and government debt crises, the European Union (EU) has completely overhauled

its recovery and resolution regime for banks as the third pillar of the banking union. The aim of Directive 2014/59/EU, the Bank Recovery and Resolution Directive (BRRD), is to enable the recovery and resolution of financial institutions without resorting to taxpayers' money. In future, banks' investors, and not the wider public, are to be held accountable for the costs incurred by failing banks.

To this end, the BRRD grants the competent supervisory and resolution authorities two very important tools:

- Authorities are required to prescribe a new, additional capital ratio: the MREL (Minimum Requirement for Own Funds and Eligible Liabilities) applies to institutions that are deemed to be resolvable pursuant to the BRRD. This ratio stipulates the amount of own funds and eligible liabilities that could, if necessary, be used to absorb losses and to recapitalise a bank, and that need to be held for this eventuality.
- The BRRD also specifies that shareholders and creditors are first and foremost responsible for covering any losses, and must provide the basis for recapitalisation measures. Such a bail-in allows resolution authorities to write down the eligible liabilities of an institution or to convert them into equity (waterfall). In addition, to ensure continued services and to mitigate the negative impact on financial market stability, the FMA may separate performing, viable assets from the impaired or under-performing assets of an institution in crisis. To this end, the FMA may transfer shares in an institution or assets to a private-sector purchaser or to a bridge bank.

It should be noted that the definitions provided for MREL-eligible liabilities and bail-in liabilities differ. Due to these requirements set forth in the BRRD and the generally substantially increased requirements related to the quantity and quality of banks' own funds, it is evident that banks will have to issue high volumes of bail-in liabilities and MREL-eligible liabilities over the next few years.

The new supervisory regime does not simply make the costs entailed with a failing bank disappear but distributes them differently. The taxpayer is to be protected while shareholders and creditors are to be held accountable. Those investing in a bank's financial instruments must be aware that the government will no longer as a matter of course protect them from losses on the grounds of banks being "systemically relevant", and bail them out using taxpayers' money.

Investors must therefore seek sufficient information about the opportunities and risks associated with such financial instruments to be able to make an informed investment decision. Banks in turn are obliged to make available comprehensive and fair information about those instruments, and to properly advise customers.

The MiFID II package lays down particularly strict conduct of business rules for providers of financial instruments when advising retail clients about these instruments and when distributing them. Five of those rules are particu-

BAIL-IN FINANCIAL INSTRUMENTS

Basically, all liabilities of a credit institution are deemed to be bail-in financial instruments, with the exception of some items laid down in the BaSAG (Article 86 para. 2). Among these statutory exceptions are: covered deposits, secured liabilities, liabilities from holding client funds and client assets in custody, liabilities from trust transactions, liabilities to credit institutions, central securities depositories and securities settlement systems with a maturity of less than seven days, liabilities to employees (excluding bonuses), liabilities from remuneration claims, trade payables and any contributions for deposit guarantee schemes.

Under certain conditions eligible liabilities are eligible for the MREL (Article 100 para. 2 BaSAG): the liability was issued and paid in full; the liability is neither to the institution itself nor has it been covered or guaranteed by it; the acquisition of the instruments was not financed by the institution, directly or indirectly; the liability has a residual maturity of at least one year; the liability is not the result of a derivative instrument; and the liability is not from deposits that are to be treated preferentially in the insolvency creditor hierarchy (retail deposits not covered).

larly relevant to the sale of bail-in liabilities and MREL-eligible liabilities to retail clients:

1. Requirements related to product governance include an obligation on the part of product manufacturers to assess whether the financial instrument is basically consistent with the needs of the identified target market at the outset, and to document such assessment.
2. In the case of a self-placement, particular attention must be paid to the conduct of business rules on how to deal with conflicts of interest.
3. During the marketing and advice phase, (potential) customers must be clearly and unambiguously informed of any (default) risks associated with bail-in liabilities.
4. With regard to the marketing and sale of financial instruments, the requirements related to investment services' suitability and appropriateness must be fulfilled.
5. Finally, under certain conditions such as a threat to the orderly functioning of the financial market, the supervisory authority is even entitled to take official intervention measures, e.g. restricting the distribution of bail-in financial instruments to a particular target market.

Chart 2: Placement of bail-in financial instruments (in € billions, rounded)

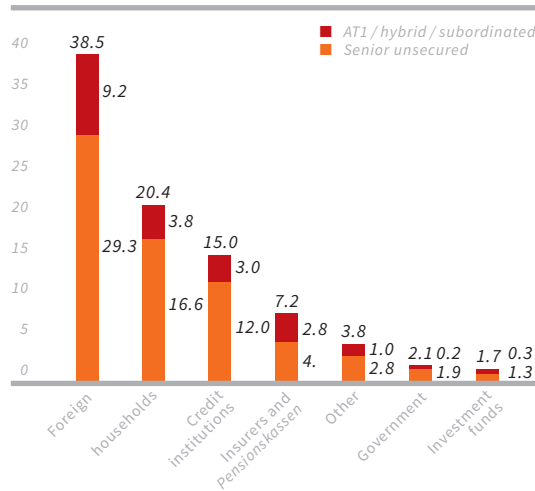
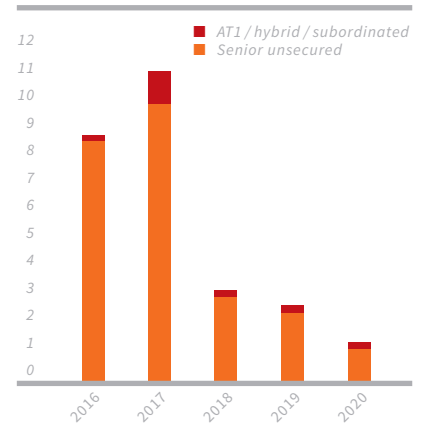


Chart 3: Distribution of liabilities abroad by residual maturity 2012-2016 (in € billions)



MANUFACTURING PHASE: PRODUCT GOVERNANCE

MiFID II specifies that credit institutions and investment firms that issue or manufacture (product manufacturers) financial instruments (including structured deposits) must set up an internal product monitoring process. Each and every financial instrument must be subjected to this product monitoring process before it is marketed or distributed. Significant adjustments of financial instruments already in the market must also undergo the product monitoring process.

One important component of this product monitoring process is the definition of a suitable target market for each newly developed financial instrument. This is intended to determine in advance – taking product characteristics (particularly product risk) into account – the target market for which the product in question has been devised and is suitable (for example the mass market or, alternatively, a specific, limited group of investors). Accordingly, the distribution strategy should be consistent with the needs of the identified target market. Product manufacturers are obliged to ensure that the product is subsequently only distributed to the identified target market. For this purpose they must make available to any distributor all appropriate information on the product approval process, and particularly any information on the definition of the target market. Distributors in turn are obliged to make arrangements so that such product information is used appropriately. This information will enable distributors to understand the characteristics of the products they offer and to assess, taking the identified target market into account, whether the product in question is consistent with the (investment) needs of their clients.

The product governance requirements under MiFID II may also apply to financial instruments that have already been placed and that may be eligible for use in a bail-in according to the new resolution regime. This is because the new set of rules also includes the obligation to periodically review the products that are already in the

market, thereby considering any subsequent event that could have affected the original risk assessment or whether the financial instrument remains consistent with the needs of the previously identified target market. If product governance rules are not observed, the MiFID II package provides for intervention powers for the supervisory authorities: if a company subject to the MiFID II regime has no product governance process in place, or does not apply the process implemented, the supervisor may suspend distribution of the financial instruments concerned.

SELF-PLACEMENT: CONFLICTS OF INTEREST

It can be assumed that the distribution of bail-in financial instruments (particularly to comply with the MREL) will be effected in part by self-placement. Self-placement means companies placing with their clients financial instruments that they, or their group companies, have issued. This means that the interest of the bank in fulfilling the MREL ratio by distributing eligible (i.e. bail-in) financial instruments stands in contrast with the interest of clients who expect the bank to act in their best interests (and recommend a financial instrument that is consistent with the clients' needs).

This potential conflict arising between the interests of the credit institution issuing the financial instrument and those of the client during distribution of the security must be countered by the credit institution taking appropriate and efficient steps to prevent conflicts of interest. The currently still applicable MiFID I regime (transposed in Austria by way of the 2007 Securities Supervision Act – WAG 2007; *Wertpapieraufsichtsgesetz*) specifies that companies must maintain and operate effective organisational arrangements designed to prevent conflicts of interest from adversely affecting the interests of its customers. To achieve this aim, suitable guidelines for addressing conflicts of interest must be set out and consistently applied; they must be prepared in writing and take into account the nature, scale and complexity of the business.

In the event of a self-placement of bail-in financial instruments, the credit institution must first of all identify this conflict of interest in its conflicts of interest policy and declare in no uncertain terms that the principle of acting in the best interests of clients must not be impeded in the case of bail-in financial instruments. Moreover, the credit institution must define guidelines for their customer advisers' behaviour in relation to the distribution of bail-in financial instruments and take conflict-mitigation steps (e.g. objective pricing, no incentives through remuneration policy, distribution strategy). If all of these measures cannot remove the conflict of interest, the customer will ultimately have to be informed of it.

DISTRIBUTION PHASE: INFORMATION TO CLIENTS

The applicable WAG 2007 stipulates that legal entities (banks, investment firms) must provide their clients with appropriate information in a comprehensible form. The information should be provided in such a manner that clients are reasonably able to understand the nature and risks of the investment service and of the specific type of financial instrument that is being offered and, consequently, to take investment decisions on an informed basis. Clients should be informed of the characteristics of the product offered to them, enabling them to understand the exact features of the service rendered.

Retail clients cannot always easily grasp the risks that are entailed with bail-in financial instruments, and this applies to both new issues and financial instruments that have already been issued. Back in 2014 the European Securities and Markets Authority (ESMA) expressed its view in a "Statement on Potential Risks associated with Investments in Contingent Convertible Instruments" that the ability to understand the characteristics and potential risks inherent to CoCos requires analysis that can only take place within the skill and resource set of knowledgeable institutional investors. CoCo bonds (or contingent convertibles) are long-term subordinated debt securities, usually with mostly fixed coupons that are designed to automatically convert into shares if a pre-set trigger is breached. CoCo bonds improve the issuer's capital resources in economically unfavourable circumstances. However, upon conversion, they also turn investors into liable shareholders. In connection with the

distribution of bail-in financial instruments, ESMA expressly pointed out its legal view in 2016 and stated that “the universe of instruments which meet the definition of a ‘CoCo’ is much narrower than the generality of bank financial instruments subject to the resolution regime”.¹

The complexity of the bank resolution regime, which was introduced with the BRRD, and the discretion afforded to resolution authorities within that regime to make claims on investors should the need arise could make it difficult particularly for retail clients to understand the outcomes that the resolution regime would deliver for their investments. It is important that investors receive fair, clear and not misleading information about the features and related risks of bail-in financial instruments, so that they are able to understand fully that the BRRD has introduced strict limits on the use of public funds to protect bank debt investors from losses.

In the distribution of bail-in financial instruments, investors must be informed demonstrably, clearly and fairly of the fact that the product offered to them is subject to the BRRD regime. This information must be provided in good time and in any case before clients are bound to the product by any agreement. ESMA is also of the opinion that clients or potential clients should receive accurate disclosure on the fact that:²

- the product is unsecured by a deposit guarantee scheme and therefore subject to the resolution regime;
- the impact on investors, in a resolution scenario, depends crucially on the rank of the liability in the resolution creditor hierarchy;
- in the event of resolution, the outstanding amount may be reduced to zero or the security may be converted into shares of the bank or other instruments of ownership;
- in the event of resolution, a transfer of assets to a bridge bank or a sale of business may limit the capacity of the firm to meet repayment obligations;
- in the event of resolution, the maturity of instruments or the interest rate under these instruments can be altered and the payments may be suspended for a certain period;
- the liquidity of the secondary market in any bail-in financial instruments may be particularly sensitive to changes in financial markets;
- existing liquidity arrangements might not protect clients from having to sell these instruments at a substantial discount below their principal amount, in case of financial distress of the issuing firm;
- liability holders have a right to compensation if the treatment they receive in resolution is less favourable than the treatment they would have received under normal insolvency proceedings.

To comply with these information obligations, companies must define and implement appropriate internal procedures. These procedures should also ensure that clients who hold bail-in financial instruments are properly informed, in good time, about any material changes to their investments including if any material changes occurred to the situation of the issuer or to the features/conditions of the instruments. Clients who already hold financial instruments subject to the BRRD resolution regime should be provided with complete and updated information on the effects of BRRD on their financial instruments. This applies specifically where credit institutions and investment firms maintain a relationship with their clients in which MiFID investment services are provided.

Investors (particularly those already holding such financial instruments) could receive this information through periodic reporting or through a specific ad hoc communication. The information can be provided through a corporate website or other electronic media provided that these means of communication fulfil the conditions set out in Article 16 para. 2 in conjunction with Article 42 para. 3 WAG 2007. With regard to material changes, the relevant disclosure could be provided through the ordinary reports to clients (if in good time) or via ad hoc communications including through websites.

DISTRIBUTION PHASE: SUITABILITY AND APPROPRIATENESS

During the provision of investment advice, companies are obliged (even according to the current legislative

¹ ESMA Statement of 2 June 2016: MiFID practices for firms selling financial instruments subject to the BRRD resolution regime, ESMA/2016/902.

² ESMA Statement of 2 June 2016: MiFID practices for firms selling financial instruments subject to the BRRD resolution regime, ESMA/2016/902.

framework) to carry out a suitability assessment. In this context, the company must verify and assess whether:

- the specific service or financial instrument is consistent with the investment objectives of the client;
- the client will be financially capable of bearing any inherent risk; and
- the client is able to understand the transaction or service based on their investment skills and expertise.

In order to be able to carry out a suitability assessment, legal entities will first of all have to gather relevant information about the client's investment objectives (holding period, risk preference, risk profile, purpose of investment), about their investment skills and expertise and about their financial situation. To ensure that the advice provided is appropriate for the investor, the adviser must then make an assessment based on the information available as to whether the specific transaction is suitable for the individual client.

If a financial instrument is distributed without the client receiving any advice (execution-only services), an appropriateness assessment must be carried out still. Legal entities are required to collect information from the client about their investment skills and expertise in relation to the specific type of products or services offered to or requested by the client, in order to assess whether these are appropriate for them. Companies must take into account whether the client concerned has the necessary skills and expertise to understand the risks attached to the products or services offered to or requested by the client.

Where self-placement is used to issue bail-in financial instruments, such are usually distributed in the course of investment advice. Companies must therefore evaluate their exiting procedures related to the suitability assessment, considering whether and to which extent the changes to the BRRD (removal of implicit support for bank creditors, possibility of bail-in) would have an impact on their existing internal procedures for the assessment of suitability. Specifically, the risk profile of products eligible for bail-in must be re-assessed and adapted to the new risk situation.

With respect to the distribution of bail-in financial instruments, the suitability assessment must be highly detailed, and documented as such, owing to the risk associated with such products. Investment advisers are required to evaluate whether the client has understood all components of the risk associated with the product. Therefore, during the suitability assessment further information about the client must be obtained, allowing the adviser to point out to the client the consequences of investing in bail-in financial instruments accordingly. This concerns the client's investment objectives and risk appetite as well as the intended investment period (particularly in connection with the financial instrument's possibly reduced liquidity). The investment adviser must make sure that the financial situation of the client is such that they are able to cover foreseeable future liabilities and bear any potential investment losses. The suitability assessment should also look into the skills and expertise of the client concerning bail-in financial instruments. Overall, the suitability assessment should ensure that the company only recommends transactions/products to a client that are suited to their particular circumstances. If the company does not receive the above information from the client when providing investment advice, it is not allowed to recommend any investment services or financial instruments to them.

If, in the case of an execution-only service, the company concludes as part of the appropriateness assessment that the product is not appropriate for the client, it will be required to warn them against investing in that product. The same applies if the client does not disclose all of the information required for the appropriateness assessment.

MiFID II strengthens the protection of investors within the scope of the suitability assessment. While the requirement to record investment advice in written form has been mandatory in Germany since 2010, Austria still has some catching up to do in this regard. MiFID II now explicitly stipulates that companies must specify in a written statement on suitability the results of their assessment (suitability report), and this report must be provided to the client. In this context, any type of recommendation, i.e. a recommendation to buy, sell or hold a financial instrument, must be documented in writing. Apart from the recommendation itself, the report must document the suitability of the recommendation in connection with client objectives and characteristics, the time and place of the conversation, the participants and the products recommended. In face-to-face conversations the record of the discussions must be handed over at the end of the meeting, and always before any order is executed. An official record must also be taken and handed over to the client when communication is by telephone or electronic

means. In this case, the record may be handed over immediately after order execution, provided that the client accepts later submission.

NEW SUPERVISORY POWER: PRODUCT INTERVENTION PURSUANT TO MIFIR

MiFIR gives the competent authority a new power: product intervention. Accordingly, with the MiFIR entering into force on 3 January 2018, the national competent authority (the FMA in Austria) may prohibit or restrict the marketing, distribution or sale of certain financial instruments or structured deposits as well as financial activities or practices. Where a national competent authority has not taken action to address the issue or the actions that have been taken were ineffective, the prohibition may temporarily also be imposed by the European Securities and Markets Authority (ESMA) in the case of financial instruments or the European Banking Authority (EBA) in the case of structured deposits.

Such bans or restrictions are however subject to the following strict conditions: they may only be imposed if the product or financial activity poses a significant investor protection concern or a threat to the orderly functioning and integrity of financial markets or commodity markets or to the stability of the financial system, or a derivative has a detrimental effect on the price formation mechanism in the underlying markets.

Before authorities exercise their right to intervene, they should examine whether the deficiencies could be resolved by taking less severe action. Additionally, any action must be proportionate. Aspects related to cross-border activities must also be kept in mind, particularly to ensure that the action is not discriminating against services or activities provided by companies from another Member State. Product intervention should, ultimately, only be effected for the general good.

As far as bail-in financial instruments are concerned, intervention might be considered where creditor bail-in would not be feasible due to the instruments being predominately distributed to small investors and retail clients, thus threatening the stability of the financial system. In this connection, an evaluation of the option of restricting the marketing of bail-in financial instruments to certain categories of clients might be considered.

FMA FOCUS CAMPAIGN ON BAIL-IN FINANCIAL INSTRUMENTS

An FMA analysis found that Austrian banks issued around € 88 billion in bail-in financial instruments in 2016, with as much as € 20 billion being placed with households, i.e. retail clients. The study also found that a volume of about € 20 billion will mature in 2017 and must be replaced, with this figure rising to € 67 billion by 2030. These figures do not yet consider the additional capital needs owing to the increased capital requirements and MREL ratios to be prescribed.

Therefore, Austrian banks are expected to place very large volumes of bail-in financial instruments with small investors and households over the next few years, particularly since a shift to domestic retail clients is likely, with international capital markets being made less accessible due to incurring additional costs of between one and five percentage points.

In order to avoid mis-selling of such financial instruments from the outset, the FMA will monitor and examine their proper distribution as part of a specific focus campaign, with the new MiFID II regime providing the right tools for this task.

