



FACTS AND FIGURES TRENDS **2018** AND STRATEGIES

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Helmut Ettl,
Klaus Kumpfmüller,
FMA Executive Board

FMA STRATEGY 2018–2023

A good ten years on from the collapse of Lehman Brothers and the subprime crisis in the USA that would go on to rock the global financial markets and plunge the world economy into a deep recession reminiscent of the Great Depression of the 1930s, the recent upturn in economic activity is now stabilising and beginning to gather speed. Economic experts are forecasting strong and, above all, sustained economic growth for 2018 and beyond.

Yet the more strongly the real economy and financial markets perform, the louder some voices will always become, lamenting supposed over-regulation and calling for far-reaching deregulation in a bid to stimulate the markets further.

We must take advantage of this strong upturn and do everything in our power to drive forward the reforms at a time when the financial industry continues to face huge challenges.

In our capacity as regulator and supervisor, we firmly believe in warning about old risks and new threats amidst the many, powerful voices of interest groups and lobbyists. After all, it is only thanks to the sweeping reforms to regulation and supervision across the world introduced over the past ten years that we have been able to rebuild market participants' confidence in fair and functioning markets.

We can only echo the words of Mark Carney, Chairman of the Financial Stability Board (FSB), who, in a letter to the G20 leaders on the occasion of their meeting in July 2017, expressed his views as follows: "In particular, giving into reform fatigue could erode the willingness of G20 members to rely on each other's systems and institutions and, in the process, fragment pools of funding and liquidity, create inefficiencies and frictions, reduce competition, and diminish cross-border capital and investment flows. The net result would be less and more expensive financing for households and businesses, and very likely lower growth and higher risks across the G20." Mark Carney therefore recommends following a different path, namely the path of consistent reforms and reinforced, international regulatory cooperation grounded in agreed international standards.

CHALLENGES FOR THE EUROPEAN AND AUSTRIAN FINANCIAL INDUSTRY

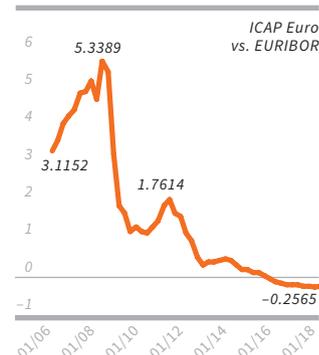
We must therefore take advantage of this strong upturn and do everything in our power to drive forward the reforms at a time when the financial industry continues to face huge challenges: consistently low interest rates, high levels of government borrowing, the uncertainty of Brexit, continued high levels of non-performing loans, an

ageing population and the digital revolution, to name but a few. And these are challenges that demand the FMA's full attention in its capacity as regulator and supervisor.

LOW INTEREST RATES

A long-term period of low interest rates provides huge relief for public finances and also ultimately helps to kick-start the real economy. At the same time, however, low rates also place a massive burden on credit institutions' business models, the profitability of which is strongly dependent on the interest margin, and they have a similar impact on life insurers and other providers of old-age pension products. Yet any excessively abrupt or dynamic turnaround in interest rates can have serious negative consequences, as this would signify an exorbitant increase in the refinancing costs faced by governments and other financial market participants. Moreover, as the rates of interest on safe financial products have remained stubbornly low, and even negative in some cases, many market participants have resorted to ever more risky investments in the search for higher returns. This not only creates an increasing level of risk among inexperienced participants and retail investors, but it often also increases the risk position of licensed and supervised companies.

Chart 1: Low interest rates (2006-2018)



BREXIT

Whether or not a smooth Brexit will be possible remains to be seen. While the impact on the Austrian economy of a hard Brexit would be negligible in light of the relatively insignificant degree of economic links between the UK and Austria, there is a risk of contagion that should not be underestimated, given that the UK's major trading partners will be severely affected.

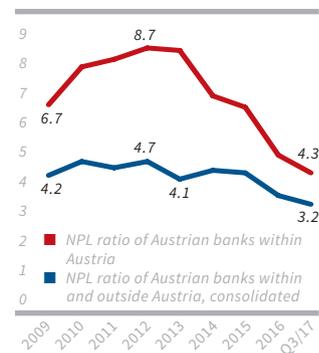
NON-PERFORMING LOANS

While Austrian banks have been working extremely hard in recent years to get rid of their non-performing loans, NPL portfolios still present a major and serious threat in some other eurozone states. This could have a huge impact on the eurozone as a whole.

AGEING POPULATION

As the population grows older, it is not just public-sector health, nursing care and pension systems that are facing great challenges. Just as challenged are the business models of many providers on the financial markets. While assets tend to be focused among the older generations, the range of financial services being offered is very strongly driven by the needs of the younger age groups. Then there is the digital divide. The younger sections of society are IT savvy, having grown up with the Internet, electronic banking, smartphones and social media. Meanwhile, older age groups have less interest, if any, in the digital world and in many cases are unable to use it. Older customers in particular are hit hard by the falling number of bank branches and reduced availability of personal service and advice.

Chart 2: NPL ratio Austria (2009-2017, as a % of all outstanding loans)



DIGITALISATION

Digitalisation is a revolutionary and disruptive technology. It affects all areas of the economy, and increasingly also financial services, creating new service providers,

A black hole of anonymity is being dug at breathtaking speed in the digital world, with no regulation or supervision whatsoever. The rapidly expanding scale of this problem has the potential to jeopardise the stability of the financial markets. Alternative currencies or cryptocurrencies and Initial Coin Offerings (ICO) are just some of the current trends.



products, trends and risk on an almost daily basis. Headlines and debate about the Panama Papers, Paradise Papers and Russian Laundromat result in calls for absolute transparency for the analogue world to address financial transactions and corporate structures that, while legal, are viewed by many as immoral. Yet, at the same time, a black hole of anonymity is being dug at breathtaking speed in the digital world, with no regulation or supervision whatsoever. The rapidly expanding scale of this problem has the potential to jeopardise the stability of the financial markets. Alternative currencies or cryptocurrencies and Initial Coin Offerings (ICO) are just some of the current trends.

We, in our capacity as regulator and supervisor, must analyse the digital revolution in its entirety, so that we can recognise the opportunities and risks, and draw the correct conclusions. How can we make sure that users of digital and other innovative technologies maintain efficient and effective access to the regulated markets, with a level playing field for all – the new and the established providers? How can we make sure that established providers can and do make use of digital and innovative technologies in their business models, where it makes sense for them to do so? How can we make sure that distributed business models (using blockchain technology, for example) and business models that only exist in the digital globalised world can be regulated and supervised in terms of risk? How can we protect the users and customers of these business models?

FUNDAMENTAL REFORMS OF REGULATION AND SUPERVISION

As big as the challenges continue to be, we, in our capacity as regulator and supervisor, can be proud of all that we have achieved since the global financial crisis, introducing fundamental reforms. A lot has been happening. Politicians, regulators

and supervisors have been analysing the causes of the crisis, learning the lessons and implementing their findings from a regulatory and organisational perspective.

The global heads of state and of government, meeting at the G20 summit in Pittsburgh, committed to the principle that no market, no provider and no product should be left unregulated and unsupervised in future.

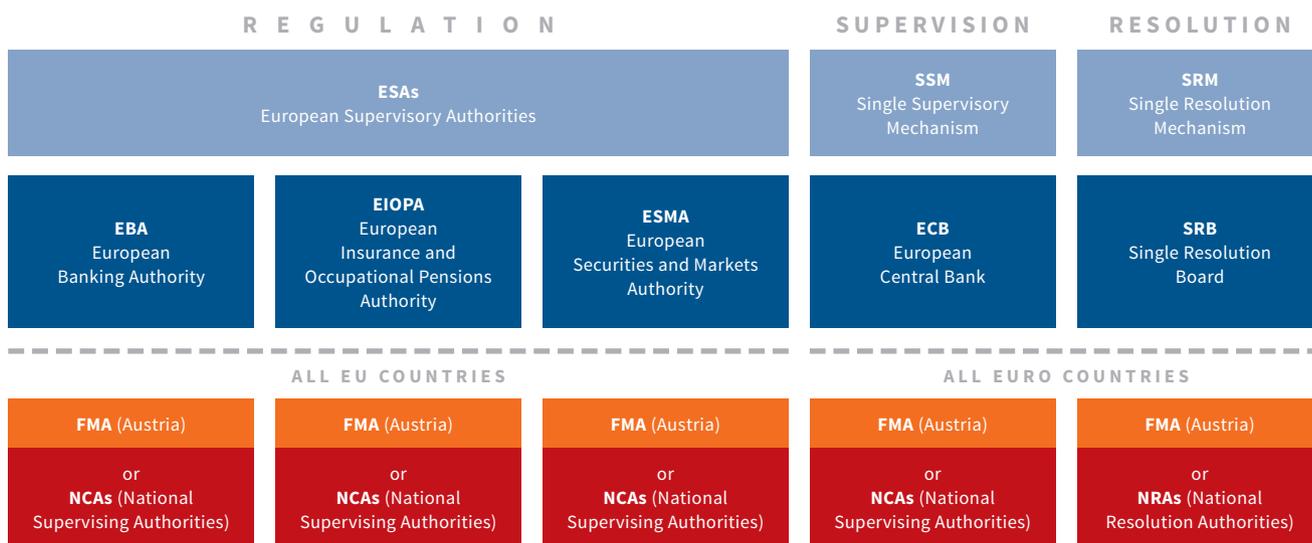
NEW EUROPEAN SUPERVISION ARCHITECTURE

The European Union has finally recognised that the single market is about more than opening up the borders between markets. Rather, it is also a matter of ensuring that cross-border markets and cross-border flows of finance and capital are controlled by a cross-border form of regulation and supervision at a European level.

As a result, Europe has equipped its single market with a single supervisory structure for the financial markets composed of the European Systemic Risk Board (ESRB), the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA). At the heart of the financial markets, namely the banks, the process of Europeanisation has been taken even further with the creation of a banking union: the Single Supervisory Mechanism (SSM), the Single Resolution Mechanism (SRM) and the European Deposit Insurance Scheme (EDIS), all based on a decentralised system. In all of these institutions, the Austrian Financial Market Authority (FMA) is the responsible and competent national supervisory authority, representing Austrian interests in the spirit of a common European approach (> Figure 1).

And this is how it should be. After all, any form of common regulation and supervision must take account of Austria's structures as they have emerged over time, in particular the small and medium-sized structure of the country's real and financial economy. It must also take account of the fact that Austria's capital market, in other words corporate finance via the stock market, plays a comparatively small role compared with finance via financial intermediaries such as banks. Basically, the Austrian economy features a credit culture that is stronger than its capital market culture.

Figure 1: European system of financial supervision



FUNDAMENTAL REFORM OF EUROPEAN REGULATIONS

Yet it is not just the supervisory architecture in Europe that has been placed on an entirely new foundation; no stone has been left unturned in regulation either. Existing rules have been subject to critical review and any regulatory loopholes consistently closed. Indeed, this was necessary, as massive deregulation in the past helped to create, if not enable, the excesses that in turn sparked the global financial crisis.

The rules and regulations are not just being tightened up and compressed. In many areas a completely new supervisory logic has been and is still being implemented, in that an often purely quantitative set of rules is being replaced by a qualitative set of rules, a strictly rule-based form of supervision is being replaced by a forward-looking principle-based form, uniform supervision is being replaced by a risk-based approach, and an ex post system of sanctions is being replaced by an ex ante approach with penalties designed to act as a deterrent.

In the form of Basel III, an entirely new supervisory and capital regime has been implemented in the banking sector, as is also the case in the insurance sector with Solvency II. For the purposes of tackling market abuse in trading with listed financial instruments, the Market Abuse Directive (MAD) and Market Abuse Regulation (MAR) have created a new regulatory framework. With the introduction of the European Market Infrastructure Regulation (EMIR), over-the-counter trading in financial derivatives, and the related infrastructure, is now regulated for the first time. And these are just a few of the most important examples.

Again in 2018 there will be numerous new pieces of legislation entering into force that will overhaul and develop the basic parameters governing the Austrian financial market in some areas but that will also equip the FMA with new supervisory tools:

- The **Markets in Financial Instruments Directive** (MiFID) and **Markets in Financial Instruments Regulation** (MiFIR) represent a clear paradigm shift, completely reshaping the markets for financial instruments, investment advice, the brokerage of financial instruments and asset management. The European Securities and Markets Authority (ESMA), for example, and the corresponding national competent authorities like the FMA are for the first time being given the tool of product intervention. They will be able to limit or even prohibit the sale of particular products where there is a risk to the stability of the financial markets or a serious negative impact on consumer protection.
- The revised **Payment Services Directive** (PSD2) lays the foundation for safe and fair payment transactions and makes it easier for new providers – such as account information or payment initiation services – to access the customers of established providers via clearly defined interfaces. This is conducive to technical progress, improves the range of financial services and boosts competition.
- The **Insurance Distribution Directive** (IDD) and **Packaged Retail and Insurance-based Investment Products Regulation** (PRIIPs Regulation) improve consumer and investor protection by ensuring transparent, standardised and comparable information for customers that is easy to understand.
- Another piece of legislation that has entered into force is the **Benchmarks Regulation**, drawn up in response to the fixing of the EURIBOR and LIBOR rates. For the first time, companies that provide a benchmark will be required to register with or

**FMA Strategy 2018–2023:
Transparent, proportional
and European supervision.
Increase synergies and take
advantage of digitalisation!**



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acquire a licence from the FMA in its capacity as the benchmark administrator and will be subject to ongoing supervision.

One of the FMA's focuses in 2018 will therefore be the embedding of these new regulations in the existing supervisory framework and the provision of support for the financial industry during the implementation phase.

FMA STRATEGY 2018–2023

We are building on the FMA Strategy 2018-2023: “Transparent, proportional and European supervision. Increase synergies and take advantage of digitalisation!”, which we the Executive Board have developed in cooperation with our staff. This concept focuses our medium-term supervisory strategy on five core areas: integrated supervision, prevention, transparency, proportionality and digitalisation.

INTEGRATED SUPERVISION

The Austrian legislator has created a supervisory system for the national financial market based on an integrated approach after carrying out international best practice analysis. This means that one single body is responsible for supervision of the entire Austrian financial market. The FMA's objective is therefore to strengthen and optimise the synergies between the various different operational areas. The package of measures for supervisory reform in 2017, developed with input from all stakeholders and adopted by the Austrian parliament, marks a key improvement in the legal framework in this regard, enabling the FMA to take action more quickly, more efficiently and more effectively. Redundancies are eliminated so that the FMA can focus on the key issues to an even greater extent than before.

PREVENTION

The supervisory reform will also see the expansion of pre-clearance tools already used by the FMA in specific areas of supervision across almost all aspects of its work. Consequently, the FMA will now be able to give the supervised entities binding legal information in response to specific practical questions raised in advance in the key areas of supervision. Consistent implementation and application will be key in helping to avoid any breaches of the law from the outset. Moreover, the sanctions applied will have a much stronger preventive effect in future, rather than following an ex post approach. The European policymakers are also increasingly focusing on the deterrent effect of penalties. As a result, the scope for penalties to be imposed under European law has been expanded on a huge scale, with the possibility of imposing fines of up to 10% of a company's annual sales or up to € 5 million. In a groundbreaking decision, the Austrian Constitutional Court announced at the end of 2017 that this type of harsh penalty may as a general rule be imposed by administrative authorities, like the FMA, and not just by the courts. The FMA's aim is therefore to avoid as far as legally possible the need for trivial ex post fines for minor offences while ensuring that there are sufficiently severe penalties in place to deter providers from committing serious and sustained breaches of the law. Now that the principle of cumulation no longer applies in administrative penal law, it is also possible to focus on punishing the more serious offences.

TRANSPARENCY

In order to strengthen understanding of regulation and supervision and what they involve, the FMA will now be publishing a medium-term supervision strategy on an annual basis. In addition, the supervisory and inspection focuses for the coming year will be published for each sector. The FMA's review process for regulatory plans is to be extended, so that any interested party will be able to comment on the draft plans in future, with all contributions being published on the FMA website.

Alongside its traditional public relations work and its website (www.fma.gv.at), the FMA has also had its own Twitter presence for some time now. Under the Twitter handle @FMA_AT or via https://twitter.com/FMA_AT the FMA provides updates on trends on the Austrian financial market, developments in international and Austrian legislation, and the latest news regarding its supervisory activity. Current warnings regarding dubious providers who are found to be offering financial services in Austria without being licensed to do so are also published on the FMA's Twitter account (using the hashtag "investor warning" – #Investorenwarnung).

PROPORTIONALITY

The FMA's risk-oriented approach to supervision is being further expanded. This means that the intensity and depth of supervision are determined by the level of risk inherent in the business model. Planned new statutory provisions as part of the supervisory reform will give the FMA additional tools for a proportionate application of the rules. For its part, the FMA will be strongly advocating the principles of subsidiarity and proportionality in the work to take European regulations forward.

It is worth highlighting one thing here, as it is an issue that can sometimes be misun-

FMA on Twitter:
Under the Twitter handle @FMA_AT the FMA provides updates on trends on the Austrian financial market, developments in international and Austrian legislation, and the latest news regarding its supervisory activity.

derstood. Applying the principles of proportionality and subsidiarity is not a covert attempt to push forward deregulation. It is rather a way of ensuring that small and less complex undertakings are able to achieve the supervisory objectives by simplified and less strict application of the rules. We will achieve this with simpler, more cost-effective measures that take better account of the fact that some business models are less complex and less risky.

DIGITALISATION

The FMA will be making the challenges faced by the financial markets as a result of the digital revolution one of its main focuses. These challenges encompass everything from digital and cost-efficient applications, to digital and IT security, to securing a level playing field for both analogue and digital problem-solving and products. The FMA will also be clearly defining its expectations and requirements as far as IT security and the supervised entities are concerned. Meanwhile, we will also be making the protection of investors and consumers a particular focus of our work.

The FMA has recently developed and launched a mobile app featuring its company database and its securities brokers and tied agents query function, which have already been available via the FMA website. This new, free app is aimed at retail investors and consumers in particular, and will help them to check directly whether financial providers are licensed or not and thereby avoid any dubious operators. The securities broker search can be used to check whether a natural or legal person is registered as a securities broker or as a tied agent. The latest investor warnings can be received as push notifications on a consumer's mobile phone or tablet, providing updates on companies that are offering services on the Austrian financial market without the necessary licence.

The FMA app features the FMA's company database, its securities brokers and tied agents query function on a mobile app.

SUPERVISORY AND INSPECTION FOCUSES 2018

Building on the FMA Strategy 2018-2023: "Transparent, proportional and European supervision. Increase synergies and take advantage of digitalisation!", we have analysed the current challenges, set out strategic objectives for 2018 and, on this basis, created and published our supervisory and inspection focuses for 2018.

The following areas are our strategic objectives for 2018:

- Strengthening the capital base of supervised companies
- Optimising internal control systems and governance structures
- Improving crisis management
- Enhancing collective consumer protection
- Increasing and broadening efforts for preventing money laundering
- Using digitalisation opportunities and managing its risks

These aims will be implemented in practice through a variety of specific supervisory and inspection focuses. The objective "Strengthening the capital base of supervised companies" will be achieved through, for example, inspection focuses on the internal models used to calculate own funds requirements, the implementation of IFRS 9, and the review of the sustainability of lending standards. The objective "Optimising internal control systems and governance structures" will be implemented by making

Please turn to page 18 for a detailed description of our inspection focuses for 2018.

This reform is an important step forward in our efforts to enhance the integrated supervisory system in Austria. It creates more transparency overall, more legal security for the supervised entities and improves cooperation with our partners in supervision.



outsourcing an inspection focus, while the “Improving crisis management” objective will be achieved by means of an inspection focus on the resolvability of banks and another on the proper functioning of the new deposit guarantee scheme. With regard to the objective “Enhancing collective consumer protection”, the supervisory focuses include compliance with the statutory rules on product transparency and customer information, on rules of conduct and on complaints handling, as well as the expansion of an efficient and effective system for monitoring the market and products. As far as the objective “Preventing money laundering” is concerned, the focuses include group compliance and the know-your-customer (KYC) principle, while the focuses in relation to the “Digitalisation” objective include the challenges facing the business models of established market participants, the supervisory and regulatory support of FinTechs and new market participants, and cyber risks. A detailed description (in German) of the 2018 supervisory and inspection focuses is available on the FMA website.

SUPERVISORY REFORM IN 2017

Regulation and supervision are not ends in themselves. Consequently, we, as regulators and supervisors, must keep asking ourselves the questions: how much regulation is appropriate and how deep should supervision go?

With this in mind, the legislator regularly analyses and evaluates the proper functioning, efficiency and effectiveness of Austria’s supervisory system. Following the major supervisory reforms of 2002 and 2008, another reform package was finalised in 2017 after two years of analysis carried out by a working group in which all of the stakeholders were represented. This entered into force on 3 January 2018. It increases the transparency of supervisory work, simplifies administrative processes, improves

legal security and takes the risk-oriented and proportionate approach to supervision a stage further. The reform marks a milestone in the development of Austria's integrated supervisory system and optimises the working relationship among the different supervisory partners, namely the Federal Ministry of Finance (BMF), Oesterreichische Nationalbank (OeNB) and the FMA. The supervisory process is more streamlined, easing the burden on smaller credit institutions in particular by boosting the principle of proportionality and having a preventive effect by means of greater transparency and optimised legal security.

PROPORTIONALITY ENshrined IN THE SUPERVISORY PROCESSES IN THE BANKING SECTOR

The concept developed by the FMA to strengthen a risk-based, proportionate supervisory approach will be applied nationally to the extent permitted by European law. As of 2018, seven Austrian banking groups will be subject to direct supervision by the European Central Bank (ECB), while approximately 550 credit institutions will continue to be supervised by the FMA. In implementation of the FMA's proportionality concept, the reform relaxes the rules for smaller institutions (total assets of less than € 5 billion) in some key areas: they will no longer be legally required to have a nomination, remuneration or risk committee at all, and their audit committees will only be required to convene once per year if the institution's assets total no more than € 5 billion. Similarly, institutions with total assets of up to € 5 billion will no longer be required to set up a dedicated, independent risk management department. In addition, the requirements relating to the organisational structure of the internal audit unit have been simplified for smaller banks and those that form part of a banking group or sector association.

The FMA's initiative to strengthen the principle of proportionality in European and international committees, in regulation and in supervision is also bearing fruit: the European Banking Authority (EBA) and the European Central Bank (ECB), as well as the Basel Committee, the global body that sets banking standards, have committed to the principle of proportionality. Meanwhile, the European institutions have also been focusing on the proportionate design of the legal basis for supervision when evaluating and reforming the supervisory regime for banks in the form of the Capital Requirements Regulation (CRR) and the fourth Capital Requirements Directive (CRD IV).

Wherever the current regulations allow, we are already consistently applying the principle of proportionality, be this in relation to the fit and proper requirements made of managers, supervisory board members or holders of key functions, or with regard to governance and control functions.

Within Austria, the supervisory reform package also creates the legal basis for simplifying and streamlining the on-site inspection process for banks: it optimises cooperation between the FMA and OeNB, speeds up the process for remedying shortcomings, and improves the flow of information between managers, bank auditors, the state commissioner and the bank's supervisory board, but also with the supervisory authority. The function of the state commissioner, a supervisory body of the FMA, is strengthened. Any outsourcing of key bank functions must now also be reported to the supervisor.

The risk-based and proportional approach to supervision is not only intended for the banking sector, but is also applicable to asset managers, investment firms and the market infrastructure.

The risk-based and proportional approach to supervision is not only intended for the banking sector, however, but is also applicable to asset managers, investment firms and the market infrastructure.

TRANSPARENCY AND LEGAL SECURITY

The FMA will be required in future to define and publish subject-specific inspection focuses for the coming year across all areas of supervision. The review process for FMA regulations, circular letters, guidelines and minimum standards is being extended: all drafts will be published on the FMA website for public consultation, with all comments received also published on the website.

Administrative decisions in response to a request for information (*Auskunftsbescheide*) create binding legal information from the FMA based on the model of the Federal Fiscal Code (BAO; *Bundesabgabenordnung*). The possibility, available under existing administrative practices, of the right to be provided with information free of charge by the FMA is not affected. Further details on the *Auskunftsbescheid* is available on the FMA website.

The supervisory reform now also provides scope for “accelerated proceedings” (in administrative cases as well as in administrative penal proceedings) if the party waives the right to appeal from the outset. Moreover, the FMA’s scope to refrain from imposing a fine in less serious cases has been significantly extended. The option of refraining from prosecuting and penalising the responsible natural person is also being extended in cases where the company concerned, in other words the legal person, has already been punished. With regard to financial market criminal law, the principle of cumulation, i.e. imposing several penalties for each individual offence on a cumulative basis, has been abolished and replaced with the absorption principle, where one single administrative penalty is imposed even in the event of more than one offence being committed. The aim here is to avoid disproportionately high penalties in the future.

OPTIMISING THE FMA’S ORGANISATIONAL STRUCTURE

Vacant positions in the second management level at the FMA must be publicly advertised in future, with an internal recruitment process to be held for managerial positions at the third management level. The only exceptions to this will be short-time deputising arrangements or reappointments.

The FMA’s supervisory board will be extended to include two further members so that it now comprises eight voting members, half of whom are appointed by the BMF and half by the OeNB, and two additional co-opted members without voting rights appointed by the Austrian Federal Economic Chamber (WKO).

OUTLOOK

Just as important as regular analysis and evaluation of the national regulation and supervision system and its further development is regular evaluation of whether European regulations have actually achieved their intended objectives and of whether and how they could be changed to make them even more efficient and even more

effective. This is why new regulations generally include provisions for an evaluation to be carried out two or three years after their entry into force.

Basel III and CRD IV have been evaluated on the basis of the experience gained so far and are about to be overhauled. The Basel Committee at the Bank for International Settlements adopted a reform package at the end of 2017 which is about to be implemented at European level. With regard to Solvency II, we are still collating information on how the practical implementation has gone since its launch in 2016. It is a matter of determining whether insurance undertakings are in fact applying the principle of proportionality and breathing life into this approach, as it is an approach that is already explicitly enshrined in Solvency II. MiFID/MiFIR only entered into force in 2018, as did PSD2.

Initial experiences show that some areas of regulation equate concepts that are not the same, and that in some cases the risk level of business models, the extent of the potential threat to financial market stability, and the need to protect investors, consumers and customers have been misjudged. Readjustments will be needed to make sure the principles of proportionality and appropriateness are upheld. The enforcement and implementation of these principles represent a major challenge for the supervisors.

With the publication of the FMA's medium-term supervision strategy and its annual supervisory and inspection focuses, we are aiming to improve transparency for the benefit of the supervised entities, the stakeholders and the public at large. This should improve understanding of regulatory and supervisory work and give the supervised entities, but other market participants too, the chance to adapt to and prepare for developments on the market and in supervision.

In our capacity as the Executive Board of the FMA, we firmly believe, together with our employees, that the implementation of our FMA Strategy 2018–2023: “Transparent, proportional and European supervision. Increase synergies and take advantage of digitalisation!” and our supervisory and inspection focuses for 2018 will make an important contribution to further developing a dynamic and flexible supervisory structure in Austria, to guaranteeing the proper functioning of markets, to improving consumer protection and to strengthening the stability of the Austrian financial market.

The FMA Strategy 2018–2023 will contribute significantly to advancing Austria's dynamic and flexible approach to supervision, enable markets to function properly, improve consumer protection and strengthen the stability of the Austrian financial market as a whole.

SUPERVISORY AND INSPECTION FOCUSES 2018

Based on the FMA Strategy 2018-2023 entitled “Transparent, proportional and European supervision. Increase synergies and take advantage of digitalisation” the Austrian Financial Market Authority (FMA) has analysed the current challenges in the global, European and Austrian financial markets and set strategic objectives for the coming year, deriving its supervisory and inspection focuses for 2018 from them.

OBJECTIVE: STRENGTHENING THE CAPITAL BASE OF SUPERVISED COMPANIES

A strong capital base is an important prerequisite for being able to withstand internal and external shocks. Interest hikes at the one end or continuous low interest rates at the other can both pose serious challenges for banks and insurance undertakings. Stress tests conducted at a national and international level have shown the enormous risk potential of both scenarios, albeit with significant differences in the impact on individual companies. In addition, during the current period of growing economic momentum, companies are expanding their business operations, meaning that new risks – particularly market and credit risk – are increasingly coming into the equation.

FOCUS: CAPITALISATION

Due to their cost structures and strong dependence on interest rates, banks and insurance undertakings tend to be particularly hard hit by macroeconomic conditions and low interest rates. This means that they must make use of the positive phases in the economic cycle to strengthen their capital base, in order to be able to fall back on reserves during a downturn.

- To maintain and guarantee stability in the Austrian financial market, it is therefore important to continue promoting strong capitalisation among banks and insurance undertakings.

FOCUS: INTERNAL MODELS

In the euro area around one half of prudential own funds requirements for banks’ credit risk is calculated using internal statistical models. Internal statistical models are also increasingly being used in the insurance industry to calculate solvency capital requirements. The availability of high-quality internal models and their consistent application are therefore indispensable to ensure a strong capital base for the Austrian and European banking and insurance industry.

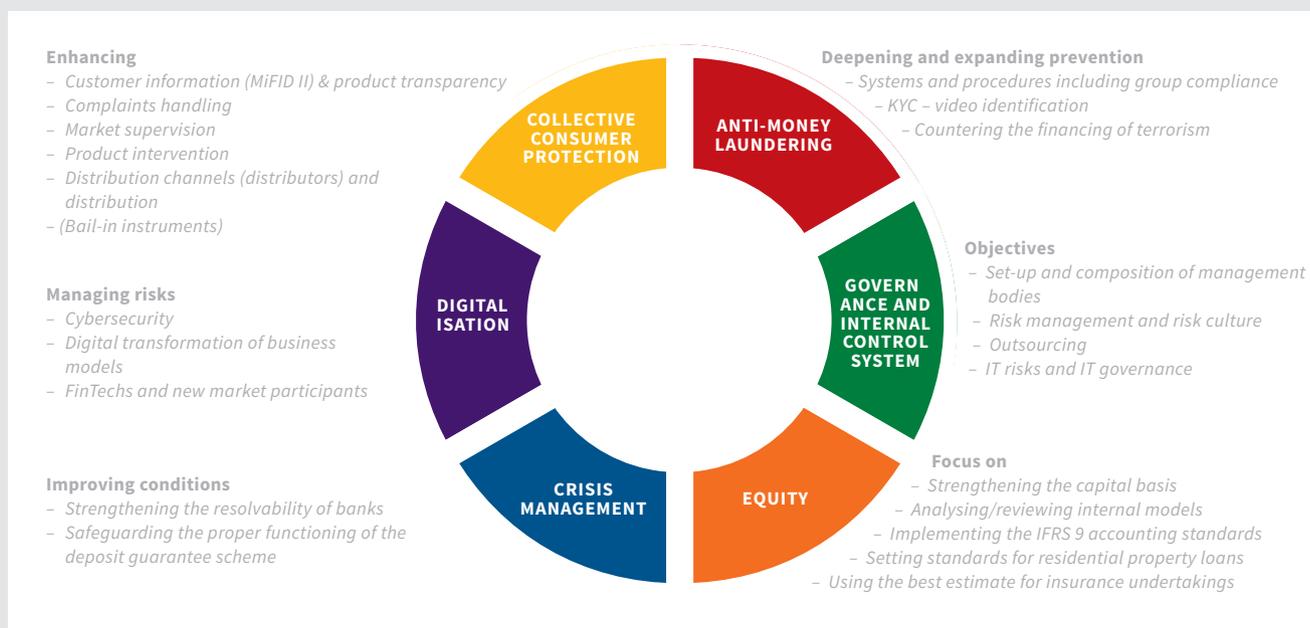
- To ensure that risks are mapped correctly and sufficient own funds are set aside, one of the FMA’s focuses is the analysis and review of these internal models. As far as banks are concerned, this review is carried out together with the European Central Bank (ECB) as part of its targeted review of internal models (TRIM) project.

FOCUS: IMPLEMENTATION OF IFRS 9

With the application of IFRS 9 Financial Instruments now being mandatory, all banks reporting under the International Financial Reporting Standards (IFRS) must now measure their liabilities on the basis of internal credit risk models. These models directly influence regulatory ratios through the impairment provisions that need be recorded.

- One of the FMA’s supervision and inspection focuses will be the proper implementation of IFRS 9. To this end, the FMA, in its capacity as the integrated supervisory authority, will pool its experiences and preventive activities related to model inspection and financial reporting enforcement in banking supervision and stay in constant contact with credit institutions, auditors and ESMA to prevent problems and mistakes.

Figure 2: Inspection focuses 2018



FOCUS: SUSTAINABILITY AND LENDING STANDARDS

An economic upswing is usually accompanied by stronger growth in lending and financing activity. Growing interest rates in turn present the risk that an increasing number of borrowers could face difficulties in repaying their loans, particularly where variable-interest loans are concerned, which would negatively impact on banks. The Authority is therefore making the quality and sustainability of credit growth one of its main focuses, thus preventing the emergence of new non-performing loans (NPLs).

- To support sustainable credit growth, the FMA will focus inspection activities on lending standards for loans used to finance residential property.
- Additionally, its supervision activities will also focus on using the economic upswing to continue reducing the volume of NPLs.

FOCUS: SOLVENCY II IN PRACTICE

The new supervisory and solvency regime for insurance undertakings, Solvency II, has been effective since 1 January 2016. The analyses and inspections related to the implementation of the new rules will be continued in 2018, focusing on the following key points:

- Under Solvency II the concept of best estimate is used to determine the amount of the obligations to beneficiaries in the solvency balance sheet. This concept therefore has a considerable impact on the solvency capital requirement and its coverage, as well as on the solvency ratio. One inspection focus will therefore be adherence to the calculation rules for the best estimate.

OBJECTIVE: OPTIMISING INTERNAL CONTROL SYSTEMS AND GOVERNANCE STRUCTURES

The financial crises of past decades have shown that financial stability is at risk if the development of internal control systems and governance structures lags behind after periods of strong business growth.

FOCUS: GOVERNANCE STRUCTURES

- One inspection focus will be the internal governance structures of the supervised companies. Corporate structures, the set-up and composition of management bodies, risk management and risk culture, key functions and business continuity management will all be focused on.

FOCUS: OUTSOURCING

Technological progress, changed customer needs and increasing competition and cost pressure mean that significant functions are frequently being outsourced to third parties in order to optimise processes. While there are obvious advantages, this also entails risks such as loss of data and control, cyber attacks and cluster risks. On 3 January 2018 a new outsourcing provision in Article 25 of the Austrian Banking Act (BWG; *Bankwesengesetz*) entered into force, which creates improved regulatory framework conditions for banks; the FMA has advocated this for a long time.

- One inspection focus for the FMA will therefore be outsourcing risks and the implementation of the new framework conditions for outsourcing.

FOCUS: IT RISKS

With digitalisation, IT risk has become a central and critical issue for financial services companies. From the supervisor's perspective, digitalisation not only creates opportunities but also poses serious risks. Attention therefore needs to focus on the effects on financial market participants, which may be huge in some respects.

- The supervisory authority will evaluate whether more far-reaching guidance on handling IT risks is required.
- One inspection focus will be IT risks and IT governance at all supervised companies.

OBJECTIVE: IMPROVING CRISIS MANAGEMENT

To be able to effectively handle crises, companies need to prepare themselves in advance and build up a resilient infrastructure. An appropriate crisis management plan plays a significant part in maintaining and boosting financial market stability. Improving the resolvability of credit institutions is an important tool for crisis management, and it is also a crisis prevention tool in that it raises awareness. Recovery plans and early intervention play similar roles in this respect. In its capacity as the competent authority for deposit guarantee schemes and resolution authority within the European Single Resolution Mechanism, the FMA's activities increasingly centre on crisis prevention and preparing institutions for potential future crises and how to efficiently and effectively manage these.

FOCUS: STRENGTHENING RESOLVABILITY

In its capacity as the resolution authority, the FMA works to improve the resolvability of Austrian credit institutions. Existing resolution plans are being expanded and institutions' capital base strengthened for the event of a crisis by way of the minimum requirement for own funds and eligible liabilities (MREL), enabling every Austrian credit institution to undergo an ordered resolution or insolvency in the event of a crisis.

- To advance resolution planning, one focus will be the development of financial and structural reorganisation strategies, the analysis of potential liquidity and financing sources and the stipulation that relevant organisational units may be separated.
- The recent crisis and resolution cases in Europe have shown that data quality and availability are core elements for a successful resolution. One inspection focus will therefore be data availability and raising the quality of the data needed for resolution.
- In the fourth quarter of 2018, the FMA will launch the definition of the MREL at those credit institutions that have the most advanced resolution plans, at the same time entering into an intensive dialogue with the banking industry. Particular consideration will be given to the business models and specific characteristics of the Austrian banking industry when developing calculation methods, assessment notices and the transitional periods needed to fulfil the MREL requirements.

FOCUS: ENSURING THE PROPER FUNCTIONING OF THE NEW DEPOSIT GUARANTEE SCHEME

An important component of an effective crisis management infrastructure is an efficient and credible deposit guarantee scheme that is embedded in the overall crisis infrastructure of banking supervision and resolution. On 1 January 2019 a uniform protection scheme will replace the previous sector-specific protection schemes. In addition, institution-related protection systems may also be recognised as protection schemes.

- One inspection focus of the FMA will be to ensure that the new deposit guarantee scheme works as intended. To this end, the FMA will examine credit institutions' preparations for a uniform or possibly sector-specific protection scheme.
- Another focus will be to inspect the preparations carried out by existing protection schemes for transferring the old into the new system, in order to be able to rectify any deficiencies with suitable supervision tools in a timely manner and to ensure that the new scheme will be able to function properly from 1 January 2019 onwards.

OBJECTIVE: ENHANCING COLLECTIVE CONSUMER PROTECTION

To strengthen consumers' confidence in the Austrian financial market, the FMA focuses its activities on three key points in relation to collective consumer protection.

FOCUS: PRODUCT TRANSPARENCY AND CUSTOMER INFORMATION

To enable customers to make informed decisions, financial services must be offered in a fair and transparent manner. The implementation of MiFID II, MiFIR, the PRIIPS Regulation and the IDD means that consumers must be provided with comprehensive, clearly understandable and standardised information on investment and insurance services. This increases transparency regarding costs, fees, commissions and incentives, and is an important step in enhancing collective consumer protection.

- The FMA will therefore place an inspection focus on the comprehensive implementation of the new requirements for financial service providers, accompanying and monitoring them along the way.

FOCUS: CONDUCT OF BUSINESS AND COMPLAINTS HANDLING

Numerous complaints and problems concerning inappropriate conduct when providing banking services show that there is a need for a supervisory focus on proper advice and customer care.

- The FMA and the Oesterreichische Nationalbank (OeNB) have added "conduct review" as a separate module to their jointly prepared on-site inspection plan for banks.
- Further inspection focuses include adherence to the EBA Guidelines on Complaints-Handling and compliance with information requirements relating to payment accounts with basic functions (Consumer Payment Accounts Act – VKZG; *Verbraucherzahlungskontogesetz*).

FOCUS: MARKET SUPERVISION

To ensure that consumers are offered suitable financial services, the FMA is stepping

up its efforts to supervise the financial instruments and insurance-based investment products available in the Austrian market. With the MiFIR and PRIIPS Regulation, which entered into force in 2018, having introduced product intervention powers for national competent authorities – and the European Securities and Markets Authority (ESMA) – the FMA is now entitled to restrict distribution of products where there is a significant investor protection concern or a threat to financial market stability, or to remove them from the market altogether.

- To guarantee collective consumer protection, the FMA will make the expansion of market supervision one of its supervisory focuses. To this end, the Authority will primarily use existing regulatory reporting and data sources from stakeholders, such as ESMA and consumer protection institutions, and interlink them to a greater extent.
- The FMA will also be focusing on financial instruments and insurance-based investment products where there is suspicion of a significant investor protection concern or a threat to financial market stability, and will make consistent use of all of its product intervention powers to exclude such products from the market altogether or to at least protect retail investors from them. In this context, the FMA must also consider any product intervention measures taken by ESMA and implement them in Austria.

Additionally, in terms of collective consumer protection, the FMA will continue to consistently combat unauthorised business operations and remove market participants acting illegally from the capital market or guide them towards conducting their operations according to the law.

- The FMA will also focus on investigating unauthorised or fraudulent selling practices on the capital market. The aim is to prevent damage to the capital market and to investors in particular. In these efforts the Authority will also actively seek to engage in further dialogue with individual sectors and stakeholders about consumer protection issues.

FOCUS: INTEGRATED SALES SUPERVISION

In order to ensure the uniform supervision of financial services provision in all sectors, the FMA will intensify its integrated supervision approach in all areas. One focus will therefore be the distribution channels that individual supervised companies use for their products. This should ensure fair competition between the various distribution channels and avoid regulatory arbitrage across all sectors.

- For the first time, on-site inspections at tied agents and securities brokers are also being made an inspection focus.
- Another inspection focus will be the distribution of bail-in financial instruments to avoid mis-selling in such instruments early on and to take preventive action.

OBJECTIVE: INCREASING AND BROADENING EFFORTS FOR PREVENTING MONEY LAUNDERING

In its fight against money laundering and financing of terrorist activities, the FMA has pursued a consistent strategy towards the companies it supervises to safeguard a clean and transparent Austrian financial market. Following the publication of the

Panama Papers and the Paradise Papers, offshore practices have received broad public attention and criticism. With such business practices being consistently monitored, Austrian banks have rethought their approaches and consequently reduced their offshore customer relationships and offshore exposures significantly.

FOCUS: GROUP COMPLIANCE AND “KNOW YOUR CUSTOMER”

TO PREVENT MONEY LAUNDERING

- In terms of anti-money laundering efforts, one inspection focus will be the systems and procedures employed to combat the financing of terrorist activities.
- Another inspection focus related to the prevention of money laundering is group compliance.
- The know-your-customer inspection focus concerns video identification.

OBJECTIVE: USING DIGITALISATION OPPORTUNITIES AND MANAGING ITS RISKS

Digitalisation as disruptive technology poses big challenges to all participants in the financial markets – to established companies as well as FinTechs, to consumers as well as regulators and supervisors. It also offers a whole world of new opportunities, and risks. New service providers, new products, and new trends emerge almost daily, and with them new risks as well. Established financial service providers are being called upon to use the opportunities that come with the new digital technologies to save costs, to offer new products and generally to survive in a globalised and increasingly digital competitive environment. Digitalisation, networking and the related “big data” are changing and redesigning financial service providers’ entire value-added chain. In Austria, the digitalisation of the financial market, its products, providers and customers is progressing inexorably but at the same time very heterogeneously. As regulator and supervisor we are required to analyse all aspects of the digital revolution and examine whether there is a need to intervene to maintain financial market stability and/or to protect consumers.

However, the technological progress, and digitalisation in particular, also offers the FMA new ways in which to increase the effectiveness and efficiency of its processes. To give one example, the FMA – in line with its “RegTech” approach – is continuously looking for new opportunities to optimise the processes between supervised companies and the Authority. Following the establishment of a fully electronic reporting and communication platform, the FMA’s Incoming Platform, prospectuses have been approved fully electronically since the beginning of 2018. In order to identify and implement other promising opportunities for the Authority, the FMA will intensify communication with partner institutions and authorities as well as industry representatives.

FOCUS: BUSINESS MODELS

- The FMA’s supervision and inspection activities will focus on the digital transformation of the business models pursued by established supervised companies.
- To create relevant conditions for digitising the financial market, another focus of the FMA is the removal of regulatory barriers hindering digitalisation, both for

established supervised companies and new market participants (FinTechs). The aim is to facilitate the advancement of technologies and business models for the benefit of customers.

FOCUS: CYBERSECURITY

As digitalisation and networking continue to move forwards, both providers and customers are faced with a huge increase in the potential cyber risks.

- The FMA has specified cybersecurity as a supervision and inspection focus across all relevant areas. To this end, the Authority will be in regular contact with supervised companies to discuss security precautions.
- To counter security risks, the FMA will develop a cybersecurity package of measures and communicate the regulatory expectations regarding security precautions and IT architecture to the supervised companies.
- Since 13 January 2018 banks and payment service providers have been required to report serious operational and security incidents to the FMA without delay.

FOCUS: FINTECHS AND NEW MARKET PARTICIPANTS

In its capacity as regulator and supervisor, the FMA takes a neutral stance on technologies. However, in order to ensure the stability of the financial market and a level playing field for all players, and in order to protect consumers in accordance with the legal provisions, it is required to monitor adherence to existing laws relevant to supervision.

- To prevent breaches of regulatory provisions, the FMA will continue to prioritise communication with new providers and market participants, in particular FinTechs. Its FinTech point of contact is available to any interested party in the form of a one-stop shop. Providers can have their business models analysed from a regulatory viewpoint and benefit from guidance through all of the regulatory issues.



PROPORTIONALITY

A regulatory and supervisory principle of integrated financial market supervision

The lessons learned from the global financial crisis and the further development of the European single market have resulted in regulation and supervision being hugely compressed and internationalised. The entities responsible for setting new standards have been focusing their regulatory analysis on the activities of large, cross-border financial service providers in particular. In some areas insufficient attention has been paid to the often very different regional structures of financial markets, which have developed historically and due to real economic influences. The result has been a regulatory contrast between those markets with a handful of very large market operators and other markets with a high number of small providers, not to mention a contrast between regional markets with a capital market focus and those dominated by credit and financial intermediaries. A further contrast has developed between markets dominated by large corporations and those with a high proportion of distributed cooperation business models.

National regulators and supervisors face the major challenge of applying and, where necessary developing, international bodies of rules in such a way that they have an appropriate impact at the level of the national real economy and the regional market structure. After all, it is neither the role nor the function of the regulatory and supervisory authorities to let structural policy in through the back door. It is up to the market to decide on its structure, with those in politics required to take action against undesired developments.

The Austrian Financial Market Authority (FMA), as the national competent authority, therefore subscribes unreservedly to the principle of proportionality in regulation and supervision, upholding this principle in its capacity as an integrated authority responsible for supervision of the entire financial market in Austria.

It is neither the role nor the function of the regulatory and supervisory authorities to let structural policy in through the back door.

Applying the principle of proportionality should not be confused with a battle cry for deregulation, however. Rather, the aim is to achieve the same objectives, namely making the financial market more stable and protecting investors and consumers, by simpler or more straightforward means.

PROPORTIONALITY – AS A LEGAL PRINCIPLE

Alongside subsidiarity, proportionality is enshrined as a general principle within the European Union: Article 5 of the Treaty on European Union states that “the use of Union competences is governed by the principles of subsidiarity and proportionality” and that “under the principle of proportionality, the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties.”

The requirement that legislative or executive state measures should always be implemented by the least severe means available to achieve the desired aim is also enshrined in the Austrian federal constitution. This is the expression of a state constitution that upholds liberal values and freedoms.

These proportionality requirements are obviously every bit as applicable in the sphere of financial market regulation and thus in supervision.

Alongside the very generally formulated basic liberal principle of proportionality, there are also more specific interpretations of the principle applicable in the context of direct financial market regulation. In the area of prudential banking supervision, for example, it is increasingly being stipulated that certain rules should be applied in a manner that is commensurate with the nature, scale and complexity of the banking business being carried out. Similar wordings are included in the relevant legal acts on insurance supervision, which stipulate that supervisory measures must always be proportionate to the nature, scale and complexity of the risks inherent in the business of an insurance or reinsurance undertaking. Finally, rules governing the capital markets, securities and money laundering also require the concept of appropriateness and proportionality to be applied, or require the application of a risk-based supervisory concept, structuring enforcement in line with material risks.

PROPORTIONALITY – AS AN ECONOMIC NECESSITY

Austria has a small and open national economy with a real economy structured on the basis of small and medium-sized enterprises. The financial structure is very decentralised, with a high number of small to medium-sized players. Moreover, the proportion

The requirement that legislative or executive state measures should always be implemented by the least severe means available to achieve the desired aim is also enshrined in the Austrian federal constitution. This is the expression of a state constitution that upholds liberal values and freedoms. These proportionality requirements are obviously every bit as applicable in the sphere of financial market regulation and thus in supervision.

AUSTRIA: A HETEROGENEOUS MARKET WITH MANY SMALL, REGIONAL PROVIDERS:

8 banking groups with significant cross-border operations generate **2/3** of the total assets.

1/3 of Austrian banking transactions are attributable to just over **500** medium-sized and small banks.

The **3** largest insurance undertakings together manage **44%** of all premiums.

The **49** small mutual associations together manage less than **0.1%** of all premiums.

of cooperative structures is very high by international standards. Consequently, applying the principle of proportionality is particularly important.

As at the end of 2017, there were 629 licensed credit institutions in Austria. Around two thirds of their aggregate total assets can be attributed to eight groups of credit institutions with significant cross-border operations (including 85 subsidiaries) and one third to more than 500 institutions (less significant institutions, non-CRR institutions, branches), some of which have very low asset levels.

The Austrian insurance market has a similar structure, with the three largest undertakings accounting for approximately 44% of all premiums written (direct gross amount); Austria's two largest insurance groups together account for more than half of the total assets in the sector. However, out of the 86 licensed domestic undertakings, 49 take the form of small mutuals, which together account for less than 0.1% of the total volume of premiums collected on the national insurance market.¹

PROPORTIONALITY – AS A COST FACTOR

If all financial service providers are required to apply all of the regulatory requirements equally and without exception, regardless of their size or exposure to risk, those market participants that are smaller or have a less complex business model face a disproportionately high cost burden, not just because they cannot benefit from economies of scale but also because they find themselves obliged to meet regulatory requirements designed to tackle risks that are completely or partially irrelevant to their specific business model.

These additional costs, as well as providing little in the way of supervisory advantage, also place an additional burden on the supervisory authority, which is then unable to deploy its resources in a risk-based and risk-optimised manner. Ultimately, from an economic perspective, this creates undesired effects and also means that resources are allocated ineffectively.

The end result is either more expensive financial services, if the costs are passed on to the consumer, or more consolidation on the market, as smaller providers struggle to be competitive. However, this type of consolidation in a sector, as shown by the example of the Austrian banking market², can have the economically undesirable effect of too few different operators. This concentration must be called into question, not just in terms of financial market stability and the concept of large players that are “too big to fail”, but also in terms of the inherent distortion of competition.

PROPORTIONALITY – AS A SUPERVISORY PRINCIPLE

The consistent application and development of the principle of proportionality is therefore an appropriate and necessary means within the FMA's integrated approach to supervision of reducing the negative impact of regulation and, at the same time, guaranteeing a robust, risk-based and consistent body of rules. Consequently, the FMA is permanently striving to make optimal use of the scope available to it, applying

¹ See the FMA's 2017 report on the state of the Austrian insurance industry.

² This consolidation process has seen the total number of credit institutions plummet from 800 in 2012 to around the 600 mark, a fall of 18.75%. While market concentration in Austria is still a long way from worrying, the consolidation trend is continuing, with the distribution of assets increasingly pointing in the direction of greater market concentration.

transparent and comprehensible criteria, while ensuring that the legal basis for their proportionate application is guaranteed whenever creating new or reforming existing rules. In this way, regulation and supervision can be geared more strongly around the relevant risks and can be targeted more effectively.

The consistent application of this proportionality concept benefits both the supervised entities and the supervisor, and therefore impacts positively on the economy as a whole.

BANKING SUPERVISION

At the instigation of the FMA, a far-reaching debate on the issue of proportionality in banking supervision has been launched at a European level. Studies conducted by the FMA itself and international studies³ initially considered the main problems facing smaller credit institutions: high compliance costs; high costs of the supervisory review and evaluation process (SREP) as the second pillar of the Basel III regime; a move away from sales and business-driven activities and the shift towards back office activities; extremely complex regulatory requirements; harmonisation that runs counter to actual market circumstances; numerous information and documentation obligations, some of which are bureaucratic⁴.

Targeted analysis was carried out on this basis to determine whether and, above all, how the rules could be relaxed for smaller institutions without substantially restricting the supervisor's options or being incompatible with effective and robust rules. Given the increasingly European approach to banking supervision, analysis also focused on the best channels for this type of policy debate.

The subject of proportionality was considered from three different angles:

- 1. Proportionality as a regulatory concept:** The principle of proportionality must be considered to a greater extent within the rules themselves, by means of simplified provisions, exceptions, exemptions, discretions and similar means.
- 2. Proportionality as an enforcement principle:** Proportionality considerations must be taken into account when exercising statutory discretionary powers. They are in any case always material where the rules themselves oblige authorities to take account of the nature, scale and complexity of the institution and/or its operations.
- 3. Proportionality as a principle in the legislative process:** What is needed is, for example, a consistent cost/benefit analysis of the legislative measures, as targeted by the European Commission itself in the form of its "Better Regulation" guidelines. The FMA is in favour of these principles being applied by all entities that are involved in the setting of standards and in law-making, including the European Supervisory Authorities, the European Central Bank, etc.

With banking regulation and supervision having a strong European and global dimension, not least on the basis of the Basel standards, the FMA strives to address the issue

³ *Expert reports prepared by the National Association of German Cooperative Banks (BVR) and the Report of the Banking Stakeholder Group of the EBA as well as the FMA case study on regulation costs based on the example of Schelhammer & Schattera. Also Andreas Dombret, Member of the Executive Board of the Deutsche Bundesbank, in his speech entitled "Banking diversity and regulation", presented at the Banking Industry Conference on 8 June 2016.*

⁴ *This also affects other areas, particularly conduct supervision and money laundering.*

via transnational channels too, particularly via the European Commission and European Parliament. The FMA's working relationship with the Federal Ministry of Finance is very successful in this regard, as a result of which key requirements at European level have been discussed, with some already being implemented through corresponding reforms. During a review of banking supervision legal matters – in the form of the Capital Requirements Regulation and Directive (CRR/CRD) – various issues were incorporated into the debate including a substantial reduction in disclosure obligations, simplified provisions for remuneration and reporting, and the maintenance of simpler standard approaches to calculating own funds requirements in certain areas. The proposals made were all positively received and are likely to take legal effect at the end of the 2019 legislative process, with the details still being negotiated. One key prerequisite for the application of the proportionality concept is the existence of a common and uniform definition of “small, less complex institutions”, with the European Parliament also working hard in this regard.

A further goal is the elimination of administrative expenses by replacing approval obligations with notification obligations. What is also still needed is a legal basis for a standardised SREP process for small comparable institutions. These points have been the subject of intense debate to date, but have at least found their way into the legislative process, with some elements being realised.

It was also important to create an awareness of the problems at the level of the European authorities, particularly the European Banking Authority (EBA) and the European Central Bank (ECB). The EBA has now also decided to develop a regulatory concept to reinforce the principle of proportionality. Meanwhile, the ECB has set up its own working groups, the aim of which is to streamline supervisory processes and make them less bureaucratic while also developing regulatory concepts for a better understanding of proportionality. Both projects were taken on board in the second half of 2017 at the instigation of the FMA, with the first specific results expected in 2018.

In light of the proportionality debate now also taking place at European level, even the Basel Committee has now announced its intention to focus to a greater extent on the proportionate design of banking regulation.

At national level too, the FMA has been advocating greater proportionality in the context of the existing regulatory framework: by way of example, the threshold for the supervisory significance of a credit institution has been increased to € 5 billion, a move linked to various simplified rules in the area of corporate governance, such as with regard to the establishment of certain supervisory board committees. The risk-based approach to supervision has also been successfully enshrined in the Austrian Banking Act (BWG; *Bankwesengesetz*).

In terms of supervisory practice, such an approach has already been applied on a day-to-day basis with, for example, the SREP process being based on a graduated system that takes account of a bank's size and complexity in determining the required frequency and level of detail. This national approach is currently also being discussed at European level in relation to the CRR/CRD amendment process, given that enshrining this approach in European law appears desirable.

The FMA has also developed internal processes to enshrine the principle of proportionality in its organisational structure and operational activities.

It was also important to create an awareness of the problems at the level of the European authorities, particularly the EBA and the ECB. Projects were taken on board in the second half of 2017, with the first specific results expected in 2018.

INSURANCE SUPERVISION

The principle of proportionality is already enshrined in regulation and supervision in several respects. Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009), the Solvency II Directive, which is the key piece of European legislation governing insurance supervision, stipulates in Article 29(3) that Member States shall ensure that the requirements laid down in this Directive are applied in a manner which is proportionate to the nature, scale and complexity of the risks inherent in the business of an insurance undertaking. The European Commission is obliged to adhere accordingly to the principle of proportionality in the context of its Level 2 implementing measures for the Directive. The Directive itself also explicitly states with regard to general governance requirements that the governance system must be commensurate with the nature, scale and complexity of the activities of the insurance undertaking concerned.

The following indicators for determining the reach of the proportionality principle can be derived from the European body of rules:

- The purpose of the proportionate application of the Solvency II rules is to ensure that they are not too burdensome for small and medium-sized insurance undertakings or for certain insurance undertakings that specialise in providing specific types of insurance or services to specific customer segments or that take the form of captive insurance undertakings.
- The Solvency II provisions are based on the concept of dual proportionality, i.e. the proportionality principle should apply to the requirements made of the insurance undertakings as well as to the exercising of supervisory powers. In practice, this results in the following:
 - The insurance undertakings must themselves assess which obligations are appropriate to them on the basis of the nature, scale and complexity of their risks and activity.
 - This self-assessment by the undertaking is then reviewed by the supervisory authorities, which exercise their discretionary powers while adhering to the principle of proportionality.⁵
- The principle of proportionality takes effect in both directions: it not only justifies less strict requirements for insurance undertakings with a simpler risk profile but also, conversely, imposes stricter requirements on those undertakings with a more complex risk profile.
- Specific examples of the principle of proportionality tend only to be provided for isolated cases, as the European Insurance and Occupational Pensions Authority (EIOPA) and the European Commission believe that it is neither possible nor necessary to regulate for every possible case and every potential exception. Rather, the

⁵ This is ultimately not anything new. For example, a measure taken by the FMA against a (re)insurance undertaking represents an intervention in the undertaking's (constitutionally guaranteed) freedom to perform commercial activities and, constitutionally, is only justified if proportionate. With regard to application of the principle of proportionality see also FMA, *Handbuch Versicherungsaufsicht [Handbook on Insurance Supervision]* – VAG 2016 (2016), p. 21 et seq., LexisNexis, and S. Saria, *Compliance nach Solvency II [Compliance after Solvency II]*, VR 11/2011, p. 21 et seq. (24); Wandt, *Prinzipienbasiertes Recht und Verhältnismäßigkeitsgrundsatz im Rahmen von Solvency II [Principle-based law and the principle of proportionality in the context of Solvency II]*, (2012) p. 23 et seq.; Ettl, *Das neue Aufsichtsregime in der Praxis [The new supervisory regime in practice]*, VR 1-2/2013, p. 32 et seq. (33).

INSURANCE AND PENSIONS: PROPORTIONALITY IN PRACTICE

SMALL MUTUALS: Taking into account the limited sphere of influence within which small mutuals operate, the FMA has advocated that these mutuals should not be subject to Solvency II, but that they should comply with specific own funds requirements, and investment and accounting rules, the details of which are specified in FMA regulations.

APPLICATION OF MEASURES: When setting an appropriate deadline for a company to implement a measure, attention is also paid to the urgency of the problem and any scope for flexibility in terms of timing taken advantage of.

ON-SITE INSPECTIONS: The principle of proportionality is taken into account both when planning an inspection and during the on-site inspection itself. Any breaches of standards are tackled in the same way for both small and large insurance undertakings (non-compliance with a standard cannot be justified on grounds of proportionality). However, as far as legally possible, account will be taken of the extent to which the statutory requirements have been appropriately implemented in the company concerned. The requirements made of larger companies with more complex products and/or risks will be higher than those made of smaller undertakings.

STRESS TESTS FOR INSURANCE UNDERTAKINGS: Simplified conditions apply to smaller undertakings with regard to implementing stress tests.

STRESS TESTS FOR *PENSIONS*KASSEN: In order to adhere to the principle of proportionality when implementing EIOPA's occupational pensions stress tests, the FMA has, for the sake of simplicity, classed all Austrian *Pensionskassen* as providers of defined contribution schemes, given that the forms of guarantee available under the Austrian pension company system are currently of little significance from an economic perspective (the stress test for defined benefit or hybrid plans would have been much more complex for Austrian *Pensionskassen*). Furthermore, only the multi-employer *Pensionskassen* were obliged to participate in the 2017 stress tests. This approach meant that the minimum market coverage of 50% of assets or 50% of beneficiaries as required by EIOPA was also guaranteed. As far as the national stress tests are concerned, the FMA only had multi-employer *Pensionskassen* calculate liability-side stress scenarios while the single-employer *Pensionskassen* were able to make do with asset-side assumptions.

KEY FUNCTIONS: The FMA accepts that one person may be responsible for more than one key function if appropriate given the size of the business and complexity of its business model. This means that one and the same person may be appointed as the head of the actuarial function while also taking on the role of responsible actuary or head of the compliance function and legal department. Obviously, this only applies in cases where the individual concerned has the required level of expertise and sufficient time for both roles. Precautionary measures to avoid any conflict of interest are also required.

REMUNERATION: A materiality threshold is applied in the case of bonus systems, according to which variable remuneration must only be paid if it exceeds 25% of the fixed annual salary or € 30 000 (gross).

national supervisory authorities should be given the freedom to make decisions on a case-by-case basis using the available information and at their discretion.

- The principle of materiality, which is also expressly enshrined in insurance supervision law, and on the basis of which only material risks are taken into account, is also an expression of the principle of proportionality. The issue of which risks should be classed as material depends on a company-specific scale. This principle has its origin in the International Financial Reporting Standards (IFRS), which stipulate such an approach in relation to disclosure obligations and measurement. On this basis, insurance undertakings are required to disclose all information the non-publication of which or incomplete presentation of which could influence the decision-making of the report's target group in relation to solvency and financial condition⁶.

During supervisory practice, therefore, the principle of proportionality is applied in a variety of ways.

SECURITIES SUPERVISION

With regard to market and securities supervision, the principle of proportionality is particularly relevant to transparency rules, rules of conduct and compliance requirements. The principle is therefore enshrined in prospectus law, investment fund regulation and in the regulatory requirements for investment services providers.

PROSPECTUS LAW

The regulatory regime in place since 2005 governing the information obligations for securities prospectuses⁷ is strictly structured in accordance with the principle of proportionality. The level of detail required in the prospectus differs according to security and issuer type. The most detailed information requirements apply to shares and other transferable securities equivalent to shares that, once acquired, make the investor a de facto co-owner of the issuing company. In contrast, debt instruments that simply securitise the investor's claim require less detailed disclosures on the part of the issuer. The information requirements made of credit institutions that are in any case subject to ongoing supervision by the supervisory authority are also less strict.

The first amendment to the Prospectus Regulation, which entered into force in 2012, also implemented proportionate schedules for the production of prospectuses. Shortened descriptions are permitted for subscription right issues and in the case of issues for small and medium-sized enterprises and for companies with a low level of market capitalisation. To date, however, these options have only been used on a small scale.

⁶ Cf. FMA, *Handbuch Versicherungsaufsicht [Handbook on Insurance Supervision] – VAG 2016 (2016)*, p. 22 et seq., LexisNexis.

⁷ *Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading, as last amended, and Commission Regulation (EC) No 809/2004 of 29 April 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements, as last amended.*

The new Prospectus Regulation⁸, which was published on 14 July 2017 and enters into force on 21 July 2019, builds on this basic framework. At its heart is the elimination of administrative hurdles that make it more difficult for companies to gain entry to the capital market. A simplified prospectus is to be permitted for secondary issues, for example. Additionally, a dedicated “EU Growth prospectus” (Article 15 of the Prospectus Regulation) is intended to give small and medium-sized enterprises (SME) easier access to the capital market. This document should be straightforward for the issuer to prepare. It should also be written in simple language and will be required to include fewer disclosure items than a standard prospectus. The European Commission is to provide a standardised template for this document.

In Austria, the principle of proportionality has also been taken into account in the national legislation on crowdfunding, in the form of the Alternative Financing Act (AltFG; *Alternativfinanzierungsgesetz*). This law entered into force on 1 September 2015 with the aim of opening up regulated yet simple access to alternative finance for new start-ups and small companies, as well as for projects created through crowdfunding. It applies to issuers that are not licensed by the FMA and are classed as micro, small or medium-sized enterprises, and that are looking to raise funds for their operations directly through a public offering.

Such issuers are generally entitled to issue alternative financial instruments provided that, for each issue:

- the total equivalent value of the publicly offered alternative financial instruments is less than € 1.5 million; and
- the sum invested by a single investor within a period of twelve months does not exceed € 5 000 (exceptions apply to professional investors as defined in MiFID).

Alternative financial instruments in this context include shares, bonds, shares in corporations and cooperatives, participation rights, silent participations and subordinated loans. With the exception of bonds, these alternative financial instruments may not, however, grant any unconditional right to repayment and must also not include any obligation to make an additional payment, except in relation to shares in a cooperative.

The following table provides an overview of the differences in the basic information required according to issue type:

<i>Maximum amounts</i>	<i>Obligatory prospectus</i>	<i>Other information obligations</i>	<i>Simplified prospectus</i>	<i>Full prospectus</i>
< € 100 000	No	No	No	No
< € 250 000 (shares or bonds)	No	Yes	No	No
< € 1 500 000 (other alternative financial instruments)	No	Yes	No	No
≥ € 250 000 und < € 1 500 000 (shares or bonds)	Yes	No	Yes	No
≥ € 1 500 000 und < € 5 000 000	Yes	No	Yes	No
≥ € 5 000 000	Yes	No	No	Yes

Table 1: **Basic information by issue type**

The “Other information obligations” refer to the preparation of a standardised information document to be made available to investors and the Austrian Consumers’

⁸ Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market.

Association (VKI) on a durable medium. The “Simplified prospectus” (in accordance with Annex F to the Capital Market Act – KMG; *Kapitalmarktgesetz*) and the “Full prospectus” for securities (shares and bonds) require FMA approval.

ASSET MANAGEMENT

Asset management is another area in which the principle of proportionality is enshrined in much of the underlying European legislation, such as in the Alternative Investment Fund Managers Directive (AIFMD), the Undertakings for Collective Investment in Transferable Securities Directive⁹ (UCITS Directive) and the Benchmarks Regulation (BMR):

- In AIFMD, the licensing and registration rules applicable to alternative investment fund managers (AIFMs) are based on the amount of assets under management and on the use of leverage. In conjunction with this, various different rules of conduct should also be applied proportionately.
- In the BMR, the licensing and registration rules for benchmark administrators and the applicable rules depend on the volume of financial contracts and instruments that are based on the benchmark concerned. They also depend on the benchmark’s relevance to the market, consumers and the real economy.
- A sound remuneration policy pursuant to the UCITS and AIFM Directives must also be applied in accordance with the guidelines set out by the European Securities and Markets Authority (ESMA), taking due account of risk profile and characteristics. In the case of UCITS management companies and alternative investment fund managers, the remuneration policy must take appropriate account of the size, internal organisation, nature, scale and complexity of the activities being carried out.

As part of its ongoing supervision in the area of asset management, the FMA also pursues a risk-based and thus proportionate approach to supervision. The frequency and main focus of on-site inspections, off-site analysis and management talks are based on the size of the company and on the complexity and risks of the business model. Allowance is also made for risks specific to the Austrian financial market.

RULES OF CONDUCT AND COMPLIANCE

The revised Markets in Financial Instruments Directive (MiFID II), which has been transposed into Austrian law in the form of the WAG 2018 applicable since 3 January 2018, bases the design of organisational rules and the application of rules of conduct on the principle of appropriateness. It is assumed that the legal entity will in principle be required to comply with all organisational requirements but may adjust these to suit its individual business model: the more complex, comprehensive and risky a business model is, the more comprehensive the measures must be that are put in place to ensure that the undertaking adheres to and implements the legal requirements.

In this way, the WAG transfers responsibility for the specific organisational structure or measures to be taken to the undertaking itself. The undertaking must, however,

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⁹ Directive 2010/43/EU implementing the UCITS Directive.

evaluate and document why its business model justifies the use of simplified rules on organisation. Key figures should be provided to demonstrate the extent of securities business as covered by the WAG in relation to the undertaking's other areas of business.

The scope and intensity of precautionary measures to comply with legal requirements may be designed on a proportionate basis in these areas in particular:

- definition of decision-making processes in the undertaking such as clear and transparent allocation of responsibilities and powers, organisation charts, department and job descriptions;
- work instructions or internal guidelines that inform employees of their obligations;
- establishment of internal control mechanisms, monitoring and measures to remedy shortcomings;
- staff recruitment, training and continuing professional development;
- guaranteeing of reporting and recording obligations;
- management of the flow of information;
- incident management;
- complaints management.

COMPLIANCE FUNCTION

Generally, the compliance function is designed to match the nature, scale and complexity of the business activities, as well as the nature and scale of the investment services and activities that are carried out. What this means in practice is that the measures needed to ensure compliance with the statutory rules will be more comprehensive for a company that focuses on investment services and, correspondingly, engages in a wide range of business activity and/or offers highly complex products and services. More (technical or staff) resources are likely to be needed for the compliance function, and the undertaking will have to introduce more comprehensive organisational measures compared with a company in which securities business is of less importance or that only offers straightforward and less risky mass products.

As a general rule, every legal entity is required to set up an independent compliance function. Indirectly, the principle of proportionality also applies here, however. In order to ensure that the compliance function is able to perform its remit properly and independently, the statutory rules make provision for a proportionate response:

- Those persons who are involved in the compliance function may not be involved in services or activities that they themselves are monitoring.
- The process used to set the remuneration of the persons involved in the compliance function must not affect their impartiality (even potentially).

In accordance with the principle of proportionality, deviations from this approach are permitted in justified cases providing that impartiality is still always guaranteed.

RISK MANAGEMENT FUNCTION

The requirement that an independent function be set up is already subject to the principle of proportionality. Credit institutions and insurance undertakings have the option of using the functions already set up in accordance with the BWG or the Insurance Supervision Act (VAG; *Versicherungsaufsichtsgesetz*).

INTERNAL AUDIT

In accordance with the terms of the WAG, all legal entities are required to set up an internal audit unit, which is subject to the highest requirements of any function governed by the WAG. The internal audit must be independent of and separate from the other functions, subject to the principle of proportionality. Here too, credit institutions and insurance undertakings may make use of functions already implemented in accordance with the BWG/VAG.

APPROPRIATE NATURE OF ORGANISATIONAL PRECAUTIONARY MEASURES

It is not just the organisational structure of the compliance function per se that is subject to the principle of proportionality. This principle should also help guide the assessment of measures implemented by the undertaking in order to comply with various organisational requirements. These include regulations covering:

- appropriate measures to avoid incriminated personal transactions;
- appropriate measures for the appointment of tied agents;
- appropriate measures for proper outsourcing;
- appropriate measures to deal with conflicts of interest.

SUPERVISION OF SECURITIES COMPLIANCE AT CREDIT INSTITUTIONS (RISK-BASED)

Given the conflict between the large number of banks whose rules of conduct and compliance the FMA is required to supervise on the one hand, and the available resources on the other, the supervisor has no option but to pursue a strictly risk-based approach to supervision. Given that it is not possible to supervise every single institution to ensure that it is complying with every regulatory provision governing rules of conduct and compliance, the available resources must be deployed in those areas where the likelihood of a supervised entity breaching the rules is the highest. Consequently, more intensive supervisory measures are aimed at those legal entities where the nature, scale and/or complexity of the business activity increases the level of compliance risk.

As a first step, the supervised market and its participants are analysed in order to gain an overview of the areas and companies exposed to a particular risk in relation to compliance with the WAG. Checks are also carried out to establish which institutions have a particular impact on the market, taking due account of the specific features and strategies of the individual institutions and sectors. Relevant key figures in this regard include the number of securities transactions, the volume of securities held in securities accounts, commission income from securities transactions, and the number of staff.

In the interests of a comprehensive and systematic approach to collecting the risk assessment data from each institution and carrying out the risk classification on this basis, significant key figures have been requested from the supervised credit institutions on an annual basis since 2016. Based on the data collated, a risk score is calculated for each credit institution taking into account the audit interval, level of detail and, where applicable, type of supervisory measure. The score also takes account of proportionality criteria (nature, scale and complexity of business activity).

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BANKING RESOLUTION

With the entry into force of the Bank Recovery and Resolution Act (BaSAG; *Bankensanierungs- und Abwicklungsgesetz*), the FMA, in the capacity of national resolution authority¹⁰, is required to prepare a dedicated resolution plan for every institution based in Austria that is not a member of a group subject to consolidated supervision¹¹. These resolution plans must generally adhere to a stipulated structure. However, in accordance with the principle of proportionality, the resolution authority may deviate from the plan content or reduce the content¹². On this basis, institutions may be subject to simplified requirements depending on various indicators such as their size, risk profile and complexity. During the resolution planning stage, this also has a direct influence on the scope of the annual data query from the resolution authority.

The resolution authority is required to stipulate the following in relation to the resolution plans:

- content and degree of detail;
- the deadline by which the first resolution plans are to be prepared, as well as the frequency with which plans are to be updated;
- content and degree of detail of the information to be submitted by the institutions;
- degree of detail applicable to the measurement of resolvability.

The resolution authority is also required to take account of specific characteristics of an undertaking as listed in the statutory provisions when planning resolution. The areas considered include the type of business activity, ownership structure, legal form and risk profile. With due regard for these factors, the authority may then impose less stringent requirements on an institution in the interests of proportionality¹³.

SIMPLIFIED OBLIGATIONS

In addition to the national rules on proportionality listed above, further rules apply at international level and these must also be taken into account by the resolution authority during the resolution planning process, in particular the Guidelines on the application of simplified obligations under Article 4(5) of Directive 2014/59/EU¹⁴ and, in future, the Regulatory technical standards on simplified obligations under Article 4(6) of Directive 2014/59/EU¹⁵.

PROPORTIONALITY IN RESOLUTION PLANNING

Applying the rules listed, the resolution authority categorises the Austrian CRR institutions using defined thresholds and criteria. This categorisation takes account of the principle of proportionality and subsequently helps to shape the scope of the plans. The categorisation of the institutions should be evaluated annually by the resolution

¹⁰ Article 3 para. 1 BaSAG.

¹¹ Article 19 para. 1 BaSAG. For the sake of completeness, it should be noted in this regard that there are currently still 15 institutions subject to direct supervision by the Single Resolution Board (SRB), with the FMA also playing a key role in the design of the resolution planning for these institutions in the capacity of national resolution authority within the Internal Resolution Team; there are currently 466 Austrian institutions in total (as at December 2017) for which a resolution plan is required.

¹² See Article 4 para. 1 in conjunction with Article 1 para. 2 BaSAG in this regard.

¹³ For the complete list see Article 1 para. 2 nos. 1–9 BaSAG.

¹⁴ EBA/GL/2015/16.

¹⁵ EBA/RTS/2017/11.

authority with any current developments being taken into account such as changes to the business model or group structure, mergers and similar transactions.

In 2017 the first credibility and feasibility tests were carried out jointly with the Oesterreichische Nationalbank (OeNB) in relation to all institutions to determine whether:

- any institution was performing critical functions as defined in Article 2 no. 37 BaSAG based on current information;
- a risk to financial market stability could be assumed were an institution to fail;
- a liquidation of an institution as part of any insolvency process, and not as part of a bank resolution, would be feasible and credible;
- investor protection would be at risk in the event of an insolvency.

The results of this analysis can be used to assess which type of resolution plan is required for an institution using a risk-based approach and in a manner that is less costly and time-consuming for the FMA and the institutions themselves. The structure of the resolution plans may also be adjusted more specifically to the individual institution.

If, for example, critical functions are identified at an institution and/or a high level of importance for financial market stability is identified and/or the fact that investor protection would be jeopardised in the event of a failing or likely to fail (FOLTF) situation, the current requirement is for a resolution procedure to be prepared, and a full resolution plan will be written up.

Simplified resolution planning requirements may be applied to other institutions. As part of resolution planning in 2018, simplified requirements apply to 433 out of the 466 CRR credit institutions for which resolution plans are required. The level of detail required also differs from one institution to another¹⁶. These are institutions with regard to which, based on current information, a liquidation in the form of an insolvency process would be the most likely measure in the event of an idiosyncratic crisis scenario. Consequently, the required scope of the resolution plans for these institutions is much less comprehensive than that required in the case of banks for which a resolution would be the likely outcome following an FOLTF.

In cooperation with the OeNB, and in keeping with the principle of proportionality, a largely automated process has been created to support the design of resolution plans with simplified requirements. This process was used for the first time this year and applied to approximately 400 institutions¹⁷. The process that has been put in place starts from a standardised template for these institutions' resolution plans. The template fulfils the requirements set out in EBA's Regulatory technical standards on the content of resolution plans and the assessment of resolvability (EBA-RTS 2014/15) and the SRB's Note on Simplified Obligations of 25 March 2016. The OeNB provides the resolution authority with the banks' individual data from the supervisory reporting system, and this is the only data used. A flexible tool was developed with the OeNB for this purpose, so that the data for these "smaller" institutions can be

¹⁶ The aim here is merely to present in more detail the particular elements involved in a resolution plan, taking into account simplified requirements. The preparation of a resolution plan for those institutions that are likely to be resolved is based in particular on Article 20 para. 5 BaSAG as well as on the SRB guide "The Single Resolution Mechanism – Introduction to Resolution Planning" (2016), <https://srb.europa.eu/en/node/163>.

¹⁷ The small size of these institutions and their relatively simple business models means that, in the event of an FOLTF, insolvency or a private measure is most likely to be the preferred solution.

retrieved automatically during the resolution planning stage and the key figures for these institutions fed into the resolution plans. This has greatly simplified the process of preparing resolution plans for the many Austrian micro banks. Moreover, the major advantage for the institutions concerned is that there is no need for any separate data retrieval process as the resolution authority can work exclusively on the basis of information/data that is already available to it.

Finally, in order to uphold the principle of proportionality, the minimum requirement for own funds and eligible liabilities (MREL), which is designed to facilitate proper bank resolution, is stipulated for those very institutions for which a liquidation in the context of insolvency proceedings is currently viewed as the most likely resolution measure, together with the regulatory minimum capital requirements including a buffer. This means that these institutions do not face any MREL-based requirements over and above the regulatory capital requirements.¹⁷

As has been highlighted here, the FMA is unreservedly committed to the principle of proportionality in regulation and supervision. In its capacity as an integrated authority responsible for supervising the entire financial market, the FMA pools its experience and knowledge from all areas, ensuring that one uniform approach applies to the whole of Austria's financial market. It is not a matter of primitive deregulation. Rather, the aim is in fact to achieve the same objectives, namely making the financial market more stable and protecting investors and consumers, by simpler or more straightforward means.

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¹⁸ Banks that comply with these regulatory requirements including a buffer automatically also comply with the MREL.

PRIIPs, MIFID II, IDD

Innovations in the distribution of insurance and financial products

The year 2018 will usher in significant progress for consumer and investor protection in the distribution of insurance and financial products. Three new European regulatory frameworks – PRIIPs¹, MiFID II² and IDD³ – extend the powers of financial market supervision, tighten organisational requirements for companies and improve the transparency of products by providing expanded, standardised and comparable information for consumers.

PRIIPs – BETTER, STANDARDISED AND COMPARABLE INFORMATION

Packaged retail and insurance-based investment products (PRIIPs) are retail investment products and insurance-based investment products that have exposure to underlying assets (stocks, bonds, etc.), provide a return over time and have an element of risk. The aim of the EU Regulation on key information documents for such financial products is to ensure that customers are informed in an understandable, standardised and comparable manner. To this end, the information documents must contain clearly defined information on the type of product, the investment objective and the essential characteristics and aspects of the product. This is meant to enable small investors to better understand the opportunities and risks associated with the product, to compare the product with others and to make an informed investment decision.

¹ Regulation (EU) No. 1286/2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs).

² MiFID II, the second Markets in Financial Instruments Directive; MiFIR, the Markets in Financial Instruments Regulation.

³ Directive (EU) 2016/97 on insurance distribution (IDD).

The PRIIPs framework is a response to the fact that the product range for retail investors and consumers who are not familiar with financial products is becoming increasingly broad and differentiated; cross-border sales – with products that are new in many markets – are becoming increasingly important and, in general, the traditional product and industry boundaries are becoming progressively blurred. This has made it more and more difficult for the general public to ascertain whether a given product is at all suitable for their personal investment objectives, as well as to determine by comparison which product on the market is best suited for their specific purposes.

Securities, investment funds and insurance undertakings are creatively linked together and too often very complex investment solutions are tailored to the special needs of small investors: investment funds are packaged as life insurance policies, usually for tax optimisation purposes; life insurance policies are not only designed for the event of death, but also feature an investment component for the event of survival. In the case of insurance-based investment products, their performance can be linked to the development of certain indices, or a choice can be made between different investment strategies, usually with a given investment fund as underlying. And these are just a few selected examples.

Even simple securities, investment funds and insurance policies are often difficult for end consumers to understand in terms of their mechanisms and effects, opportunities and risks; in complex combinations, it is virtually impossible for them to comprehend. For this reason, certain information obligations towards customers were already in place, but these were mostly industry and product-specific, not sufficiently standardised and not always mutually compatible. It was therefore difficult to compare the various packaged investment and insurance-based products.

The PRIIPs concept now transcends industry and product boundaries. It includes:

- structured financial products, such as warrants, packaged in the form of securities or bank products;
- financial products whose value is derived from reference values, such as equities or exchange rates (derivatives);
- closed and open-ended investment funds;
- insurance-based investment products (including insurance products that offer a maturity value or surrender value that is directly or indirectly, fully or partially exposed to market fluctuations, such as traditional and unit-linked life insurance or hybrid products); and
- instruments issued by special purpose vehicles.

For each such product, a uniform standardised key information document (KID) must be created and made available to the customer. 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 also prevents providers from attempting to circumvent the Regulation by selecting another legal form, name or purpose for the financial product.

The PRIIPs Regulation specifies in detail the format and content of the information to be contained in the KID for each product. This applies irrespective of whether the product is a security, a fund⁴ or an insurance-based investment product; the decisive factor is whether the product is subject to investment risk and targets end consumers

Even simple securities, investment funds and insurance policies are often difficult for end consumers to understand in terms of their mechanisms and effects, opportunities and risks; in complex combinations, it is virtually impossible for them to comprehend.

and retail investors. The KID is designed not only to facilitate comparison between insurance-based investment products, but should also allow cross-industry comparability (e.g. with structured financial products, closed and open-ended investment funds, etc.).

PRIIPs manufacturers are obliged to draw up the key information documents, regularly assess their content and to publish each KID on their website. Every PRIIPs seller must also publish the KIDs for the respective products on its website. Persons advising or selling a PRIIP must provide the KID in sufficient time to allow the retail investor – before being bound by a contract or an offer in connection with the relevant PRIIP – to properly review the document. The Delegated Regulation⁵ states that the adviser must assess the time needed by each retail investor to consider the key information document, taking into account the knowledge and experience of the retail investor, the complexity of the product and the urgency explicitly expressed by the retail investor of concluding the proposed contract or offer.

The key information document is subject to an overall maximum of three sides of A4-sized paper when printed. The topics covered, their order and the wording of the titles of each section are standardised. The key content elements are:

- the name of the PRIIP, the name of the PRIIP manufacturer incl. contact details, competent authority of the PRIIP manufacturer in relation to KID and date of production of the KID;
- the type and key characteristics of the PRIIP, including its objectives and the means used to achieve them; a description of the retail investor type targeted by the PRIIP; the maturity of the PRIIP, if known;
- the recommended and, where applicable, required minimum holding period and information on whether one can disinvest before maturity and the conditions on this;
- information on how and to whom a retail investor may lodge a complaint about the product or about the conduct of the PRIIP manufacturer or a person advising on or selling the product;
- a brief, standardised description of the PRIIP's risk and reward profile;
- disclosure of all costs associated with investment in the PRIIP.

Essential information for the customer, such as information on risks or costs, must also be presented in the form of aggregated indicators. The summary risk indicator, for example, aggregates all risks to which the investor is exposed. It is expressed by a scale from 1 to 7, where 1 represents low risk and 7 represents the highest risk. The composition of costs must be shown as a table in the KID; both the total costs and their impact on the investment return – Reduction in Yield (RIY) – must be disclosed in the key information document.

The PRIIPs Regulation also obliges the competent supervisory authorities to monitor the market and, for the first time, grants them product intervention powers. If it sees

⁴ For investment funds, the obligation to publish the key information document does not apply until the end of December 2019; by then, at the latest, the currently required UCITS KIID must be replaced by the PRIIPs KID.

⁵ Commission Delegated Regulation (EU) 2017/653 of 8 March 2017 supplementing Regulation (EU) No 1286/2014 of the European Parliament and of the Council on key information documents for packaged retail and insurance-based investment products (PRIIPs) by laying down regulatory technical standards with regard to the presentation, content, review and revision of key information documents and the conditions for fulfilling the requirement to provide such documents.

a serious impairment of investor or consumer protection in connection with a particular type of product, or if the specific type of product is likely to threaten the stability of the financial market, it may restrict or even prohibit marketing, distribution or sale. It may also prohibit or restrict certain practices associated with the product. Such prohibition or restriction can also be imposed on a precautionary basis before the product is actually marketed. In addition to the national competent authority, the European supervisory authorities may also prohibit or restrict the marketing, distribution or sale of such products or a type of financial activity or practice.

MIFID II – THE NEW REGULATORY REGIME FOR FINANCIAL INSTRUMENTS

The 2018 Securities Supervision Act (WAG 2018; *Wertpapieraufsichtsgesetz*) entered into force on 3 January 2018, implementing the European MiFID II / MiFIR⁶ regime into Austrian law. The new regime provides a completely new regulatory framework governing markets for financial products, and significantly improves investor protection. It defines clear processes for product development, increases transparency in advice, products and costs and extends the powers of the supervisory authorities.

In relation to the distribution of financial products, the following are of particular importance and described below: product governance, product intervention, types of investment advice and extended information requirements.

PRODUCT GOVERNANCE

For the first time, MiFID II introduces product-related rules for product governance, in addition to the distribution-related conduct of business regulations. Credit institutions and investment firms that issue (product manufacturers) or sell (distributors) financial instruments, including structured deposits, must set up an in-house product approval process, similar to that required for insurers. Each financial instrument is subject to this product approval process before it is marketed or distributed. Significant adjustments of financial instruments already in the market must also undergo the product approval process.

To this end, the target market must first be defined for each financial instrument. This means that the intended investor group (target market), for example, retail or professional clients or eligible counterparties, must be designated during product development. In this context, it is also necessary to determine the knowledge and experience horizon, as well as the loss-bearing capacity of the investor group in question. The risk and reward profile of the product and the recommended holding period must also be defined. Finally, it must be stated whether the product is tailored to specific customer needs, for example, customers who want to invest in sustainable finance opportunities. As part of the process of defining the target market, product manufacturers must also clarify which sales strategies are suitable for a given financial instrument, with the requirements of the target market having to be taken into account.

Credit institutions and investment firms that issue or sell financial instruments, must set up an in-house product approval process. Each financial instrument is subject to this product approval process before it is marketed or distributed.

⁶ MiFID II: Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU. MiFIR: Regulation (EU) No 600/2014 on markets in financial instruments and amending Regulation (EU) No 648/2012.

It is also incumbent on the product manufacturers to take reasonable steps to ensure that the product is subsequently only distributed to the identified target market. Therefore, they must make available to any distributor all appropriate information on the product approval process, and particularly any information on the target market definition. Distributors in turn are obliged to make adequate arrangements to obtain such product information. This information should enable distributors to better understand the products they offer and to assess, taking the identified target market into account, whether the product in question is consistent with the needs of their clients. Distributors of financial instruments must comply with product governance requirements when considering which products to offer and how they are to be marketed and distributed, and assemble their product universe accordingly. In terms of their individual business model and customer base, distributors must specify the target market identified by the manufacturer and the distribution strategy. If the manufacturer of a marketed financial instrument is not subject to MiFID II, e.g. because it is established in a third country, then the distributor must independently determine the target market and distribution strategy.

For products already on the market, compliance with product governance rules must be monitored on an ongoing basis. Particular attention must be paid to whether the original risk assessment has changed as a result of subsequent events or whether the financial instrument remains consistent with the needs of the previously identified target market. Information on events relevant to the manufacturer's identification of the target market, which may require the manufacturer to redefine the target market for a financial instrument, must be reported to the manufacturer by the distributor. MiFIR⁷ has extended the powers of the Austrian Financial Market Authority (FMA) to efficiently enforce product governance rules: if a company subject to MiFID II fails to initiate a product approval process, or if the process is not adhered to, the supervisory authority may suspend distribution of the financial instruments concerned.

PRODUCT INTERVENTION

With the introduction of product intervention, MiFIR grants the supervisory authorities new, very far-reaching powers. Any competent national supervisory authority, i.e. the FMA in Austria, may restrict or prohibit the marketing and distribution of financial instruments (including structured deposits) and financial activities/practices. Like measures may also be taken by the European Securities and Markets Authority (ESMA) in the case of financial instruments and/or the European Banking Authority (EBA) in the case of structured deposits; this is necessary in particular where questionable financial instruments are offered to retail investors predominantly on a cross-border basis, e.g. via the Internet. In such cases, action by individual national competent authorities in the EU Member States would not be sufficient to remedy the situation.

However, such restrictions or prohibitions are subject to strict conditions:

- They may be imposed when a financial instrument or financial activity addresses 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 finan-

⁷ Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No. 648/2012.

cial 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 would not be better addressed by enforcement of existing regulatory requirements under Union law.
- The action should be examined in terms of its proportionality, particularly in relation to investors who hold an affected financial instrument in a market that has previously been liquid.
- It is necessary to ensure that the action does not have a discriminatory effect on services or activities provided from another Member State.
- Product intervention actions may only be implemented if they are in the public interest.

TYPES OF INVESTMENT ADVICE

The new regulatory regime has also created a clearly defined legal framework for independent investment advice. The adviser must inform the client in advance as to whether the investment advice is offered on an independent or a non-independent basis.

Independent investment advice requires the analysis and offering of a significant range of financial instruments available on the market, which must be sufficiently diverse with regard to their type and issuers. Under no circumstances may they be limited to a company's own products or products of issuers or providers with whom the company has close legal or economic relationships.

In addition, no benefits may be accepted from product providers. Any and all benefits nevertheless provided by any third party or a person acting on behalf of a third party must be assigned and transferred to the individual client. Advice may only be remunerated through payment of fees and charges by the client.

Minor non-monetary benefits are allowed, provided that they are clearly disclosed to the client, that they are capable of enhancing the quality of the service provided and that they could not be judged, in terms of scope and nature, to impair the obligation of investment firms to act in the best interest of their clients.

In the case of non-independent investment advice, the company must be able to prove that any benefits paid or received are designed to enhance the quality of the relevant service to the client. To this end, the non-independent adviser must:

- keep an internal list of all the benefits received from a third party in relation to the provision of investment or ancillary services; and
- record how the benefits paid or received enhance the quality of the services provided to the relevant clients and the steps taken in order not to impair the adviser's duty to act honestly, fairly and professionally in accordance with the best interests of the client.

A benefit is considered to be designed to enhance the quality of the relevant service to the client if an additional or higher level service is provided to the relevant client, proportional to the level of inducements received.

EXTENDED INFORMATION REQUIREMENTS IN THE CONTEXT OF INVESTMENT ADVICE

The new regulatory framework has also significantly extended information require-

The new regulatory regime has also created a clearly defined legal framework for independent investment advice. The adviser must inform the client in advance as to whether the investment advice is offered on an independent or a non-independent basis.

ments⁸ toward clients. For example, the client must be informed in good time prior to the provision of investment advice:

- whether it is being provided on an independent basis;
- whether it is based on a comprehensive or limited analysis of various types of financial instruments; and in particular
- whether the range of financial instruments is limited to those issued or provided by entities having close links or any other close legal or economic relationship with the investment firm so close as to impair the independent nature of the advice; and
- whether the suitability of the financial instruments recommended to the particular client is regularly assessed.

Investment firms also have to explain in a comprehensible and precise manner whether and why a specific investment advice is to be classified as independent or non-independent. In addition, the range of financial instruments on which the investment recommendation is based must be presented, including the firm's relationship with the issuers or providers of the instruments.

In the context of independent investment advice, it is necessary to explain how the conditions for this are fulfilled and which factors are taken into account in the selection of the recommended financial instruments – for example, risks, costs and complexity of the financial instruments. With respect to periodic suitability assessments, the frequency and extent of such assessments must be reported and, where relevant, the conditions that trigger that assessment.

Moreover, anyone who provides investment advice to retail clients must provide the client with a declaration of suitability in a durable medium prior to the transaction, specifying the advice provided, giving an overview of the recommendation made and explaining how the recommendation was tailored to the client's preferences, objectives and other characteristics.

Proof is required that clients were informed of all costs and charges. This information must also be summarised in such a manner that clients are able to understand the total costs and the cumulative effect of costs on return on investment.

IDD – THE NEW FRAMEWORK FOR DISTRIBUTION OF INSURANCE PRODUCTS

The new Insurance Distribution Directive⁹ (IDD) was promulgated on 2 January 2016 and replaces the Directive on Insurance Mediation¹⁰ from 2002. The deadline for implementation of the IDD into national law was 23 February 2018. If the European Commission proposes to postpone application, as expected, it will enter into force beginning 1 October 2018.

The aim of the IDD is to create a level playing field for all distribution channels. Accordingly, all rules also apply to direct sales by insurance undertakings.

The IDD obliges insurance distributors to act in the best interests of their customers.

⁸ The legal basis for the information requirements for investment advice are to be found both in the WAG 2018 and in Commission Delegated Regulation (EU) 2017/565.

⁹ Directive (EU) 2016/97 on insurance distribution.

¹⁰ Directive 2002/92/EC on insurance mediation.

Every insurance contract must, therefore, always be consistent with the customer's demands and needs. According to the draft of the 2017 Insurance Distribution Act (VersVertrG 2017; *Versicherungsvertriebsgesetz*), which transposes the IDD into Austrian law, a general obligation to provide advice is specified. Each customer must receive a personalised recommendation explaining why a particular product best meets their insurance demands and needs. However, this approach presupposes that the products meet the needs of the target market. Rules relating to product approval processes, i.e. product governance requirements, are intended to ensure this.

The requirements for the product approval process are clarified by a Commission Delegated Regulation¹¹:

- **Establishment of product approval processes:** These processes must track the development of products, their monitoring, review and distribution, and must provide for corrective action for insurance products that are detrimental to customers. They are applicable not only to newly developed insurance products, but also to significant adaptations of existing insurance products. The processes are designed to ensure that products take into account the interests and characteristics of customers, that conflicts of interest are properly managed, that they should not adversely affect customers, and that customer detriment is prevented or mitigated.
- **Review of product approval processes:** The processes must be regularly reviewed to ensure that they are still valid and up to date.
- **Identification of the target market:** Insurance undertakings should only market products that are compatible with the interests and objectives of the target market. Insurance products must be designated for a specific group of compatible customers; it may also be necessary to identify groups of customers for whom the product is generally not compatible.
- **Product testing:** Before bringing a product to the market or significantly adapting it, the insurance undertaking must carry out product testing, including scenario analyses where relevant to assess whether the insurance product over its lifetime meets the identified objectives and needs of the target market. A product may not be brought to the market if it does not meet the interests of the target market.
- **Product monitoring:** Products on the market must be continuously monitored for compliance with the interests of the target market.
- **Corrective action:** If a product proves to be detrimental to policyholders during its lifetime, the insurance undertaking must take appropriate action to mitigate the situation for the policyholder and prevent further occurrences of the detrimental event.

When selecting appropriate distribution channels, the insurance undertaking must take into account the particular characteristics of the relevant product and the target market, and provide insurance distributors with the most up-to-date information on product details at all times. The insurance distributor should be able to understand the product and comprehend the identified target market. The insurance undertaking

¹¹ Commission Delegated Regulation (EU) 2017/2358 of 21 September 2017 supplementing Directive (EU) 2016/97 of the European Parliament and of the Council with regard to product oversight and governance requirements for insurance undertakings and insurance distributors.

must verify on a regular basis whether the insurance product is solely distributed on the identified target market.

The IDD:

- also enhances transparency of insurance products, in particular with regard to prices and costs;
- improves the understandability and comparability of the products by means of standardised information documents; and
- prevents conflicts of interest.

TRANSPARENCY

For the distribution of life insurance products, the IDD requires disclosure of all costs and charges, in particular relating to the distribution of the product and the cost of advice, the cost of the insurance-based investment product and any third-party payments. These must also be presented in aggregated form to allow the policyholder to understand the overall cost as well as the cumulative effect on the return of the investment. With regard to the distribution of insurance-based investment products, the policyholder may also request an itemised breakdown of the costs and charges; the policyholder must be informed of this right.

PRODUCT INFORMATION

Product information for non-life insurance products is also to be made easier to understand in the future. The two-page insurance product information document (IPID), which must include a summary of the main risks insured and the excluded risks, the insured sum and the geographical scope, among other things, serves this purpose. Each section must be headed by icons that visually represent the content of the respective section heading. To ensure easy legibility, even the font size (at least 1.2 mm) has been defined.

The life insurance product information document (LIPID) is intended for life insurance products insuring the risk of death, rather than focusing on investment (e.g. term life insurance). In order to define a standardised format for this information document, the legislator has granted the FMA a corresponding power to issue regulations.

PREVENTION OF CONFLICTS OF INTEREST

A rethinking will be necessary for insurance product distribution, as the IDD places particular emphasis on preventing conflicts of interest. An insurance distributor may no longer make any arrangement by way of remuneration, sales targets or otherwise that could provide an incentive to itself or its employees to recommend a particular insurance product to a customer even though another product would better meet the customer's needs.

Irrespective of the distribution channel – direct sales or intermediaries – chosen by the client, uniform high standards must apply. For this reason, insurance undertakings will have to adapt their information requirements, as well as their internal and distribution processes. The customer must be able to rely on the professionalism and competence of the intermediaries and employees of insurance undertakings.

Based on the IDD, as well as the PRIIPs Regulation, the FMA must ensure ongoing market supervision for insurance products beginning in 2018.

With PRIIPs, MiFID II and IDD, the integrated supervisory approach will be further strengthened at both national and international level. In response to the increasing blurring of product and industry boundaries and the massive intensification of cross-border sales of insurance and financial products, the regulation of distribution has been broadly coordinated. This has and will continue to enable consistent, integrated supervision of all industries supervised by the FMA with the overarching aim of improving investor protection.

THE RECAST DEPOSIT GUARANTEE SCHEME

A harmonised scheme for Europe

Harmonisation should provide uniform protection of savers irrespective of their home country, prevent the transfer of deposits between countries with low deposit protection to those with a high level of protection, remove distortions of competitions in the European internal market, strengthen investor and consumer protection and thus contribute to financial market stability.

The new Deposit Guarantee Schemes Directive¹, which had to be transposed into national law by 3 June 2015, completely overhauled the protection of depositors within the European internal market. Besides common banking supervision under the Single Supervisory Mechanism (SSM) and uniform resolution under the Single Resolution Mechanism (SRM), a harmonised European Deposit Insurance Scheme should make up the third pillar of the European banking union. Harmonisation should provide uniform protection of savers irrespective of their home country, prevent the transfer of deposits between countries with low deposit protection to those with a high level of protection, remove distortions of competitions in the European internal market, strengthen investor and consumer protection and thus contribute to financial market stability.

In a first step, existing deposit guarantee schemes (DGSs) in the European countries are being harmonised. The Directive lays down rules relating to the organisation and operation of DGSs, the establishment of a DGS fund to be financed ex ante, the procedures for reimbursing depositors in a payout event as well as official supervision. The European Commission's proposal to replace the national schemes with a common European Deposit Insurance Scheme (EDIS) is still the subject of intense political debate (Info box on page 54).

RECASTING NATIONAL DEPOSIT GUARANTEE SCHEMES

In Austria, the European DGS Directive was transposed into national law by means of

¹ Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes.

BANK



the Deposit Guarantee Schemes and Investor Compensation Act (ESAEG; *Einlagensicherungs- und Anlegerentschädigungsgesetz*), which entered into force on 15 August 2015. The Act transferred competence for the supervision of DGSs to the Financial Market Authority (FMA) and granted the Authority numerous new supervisory powers, comparable to those held for the supervision of credit institutions. For instance, the FMA was given the power to obtain information, to issue official instructions following ESAEG breaches, to carry out on-site inspections and to issue approvals in relation to the supervision of DGSs.

In Austria, there are currently five DGSs, one for each of the five sectors:

- Einlagensicherung der Banken & Bankiers GmbH (DGS for the Austrian commercial banks)
- Volksbank Einlagensicherung eG (DGS for the Volksbank sector)
- Hypo-Haftungs-Gesellschaft m.b.H. (DGS for the regional mortgage banks)

EDIS – THE EUROPEAN SCHEME

The European Commission has already submitted a proposal to set up a European Deposit Insurance Scheme (EDIS) in the euro area. This legislative proposal is based on the DGS Directive and envisages the establishment of a common European Deposit Insurance Scheme in two stages, starting with a reinsurance phase and subsequently evolving to co-insurance. However, transition to the second phase is subject to the condition that significant progress be made in reducing the risks resulting from bad debts:

- Reinsurance phase: Between 2019 and 2021 EDIS will only provide liquidity protection for national DGS, i.e. EDIS will provide liquidity for a limited time period if a national DGS has been exhausted. However, these funds must subsequently be paid back. In 2019 EDIS may only cover 30% of the liquidity gap, in 2020 no more than 60% and from 2021 a maximum of 90%. A minimum of 10% must therefore always be covered by additional ex-post contributions to the national DGS made by the national banks.

In the reinsurance phase national DGS must always pay back EDIS funds and ensure that any losses are covered at the national level.

- Co-insurance phase: This phase will enter into force no earlier than in 2021 and presupposes that bad debts have been settled to a minimum extent that has yet to be defined. To this end, those debts, and non-performing loans (NPLs) in particular, must be determined and analysed by means of a dedicated asset quality review (AQR). The NPLs must have been reduced to a significant extent. Legal risks must be consistently managed and removed. The whole process must be monitored by the SSM, with the Commission confirming that sufficient progress has been made. If all of these conditions are met, EDIS may cover 100% of the liquidity gaps from 2021 onwards and gradually cover actual losses, i.e. safeguard national deposits without the need for repayment.

Ultimately, EDIS is to guarantee the full payment of all secured deposits in the event of an euro area institution hitting a crisis and ensure that all depositors enjoy the same level of protection within the banking union irrespective of where they live.

This Commission proposal is still the subject of heated political debate. Some Member States fear that they would have to bear the bad debts of banks in other states unless they were settled beforehand. Additionally, the default risks still vary greater from one state to another, despite common supervision.

- Sparkassen-Haftungs Aktiengesellschaft (DGS for the savings banks sector)
- Österreichische Raiffeisen Einlagensicherung eGen (DGS for the Raiffeisen sector)

Together they guarantee covered deposits totalling € 212.92 billion (as of 31 December 2017).

From 1 January 2019 the Austrian deposit guarantee system will be completely overhauled, implementing the new European regime. The uniform deposit guarantee scheme will take the place of the former deposit guarantee schemes. This new scheme will cover all depositors at Austrian credit institutions, unless the institution belongs to an institutional protection scheme (IPS), which must however have been recognised as a deposit guarantee and investor compensation scheme.

In accordance with the ESAEG, the Austrian Federal Economic Chamber (WKO) must establish the uniform DGS. As this is done according to legal stipulations, the competent authority FMA is not required to recognise the DGS by way of a separate administrative act.

In contrast, however, institutional protection schemes must also be recognised by the FMA as deposit guarantee and investor compensation schemes, in line with ESAEG provisions. In this context, the ESAEG requires the IPS to fulfil a number of conditions, particularly that its member institutions (credit institutions) together hold covered deposits amounting to at least 15% of the covered deposits of all CRR credit institutions incorporated in Austria.

UNIFORM DEPOSIT GUARANTEE SCHEME

The process to establish a uniform DGS was launched on 1 January 2018, the deadline by which a liability company had to be set up pursuant to the federal act. Company directors now have to take any preparatory steps to enable the uniform DGS to assume all responsibilities from the former DGSs, ensuring that it is fully functional as of 1 January 2019. This also requires close cooperation between the DGSs and the FMA, in line with the legal rules. The available financial means of the deposit guarantee funds of the former DGSs are to be transferred to the uniform DGS or, where applicable, to the DGS of a recognised IPS.

The FMA's core responsibility in connection with uniform protection is to ensure that the schemes are set up according to the legal requirements and are fully functional as of 1 January 2019. The FMA will therefore stay in close contact with the existing DGSs during 2018, demand information on the status of their preparations and actively check progress and ability to function. The core focuses include establishment of an appropriate early warning system, securing data quality in terms of a single customer view (SCV file), processes related to the raising and use of financial means for the purpose of reimbursing depositors, as well as the orderly transfer of the deposit guarantee funds' available financial means to the new deposit guarantee scheme(s).

INSTITUTIONAL PROTECTION SCHEMES

As part of the procedure to recognise an IPS as a deposit guarantee and investor compensation scheme, the FMA must carry out a thorough check to determine whether all of the criteria stipulated in the ESAEG have been fulfilled. In this context, the FMA must particularly look into the interplay between the scheme's function as a support instru-

ment to prevent a member institution (credit institution) from defaulting and its function as a protection scheme for the reimbursement of depositors. This is of particular importance considering that the financial means of a DGS fund may also be used to support credit institutions under certain conditions. Naturally, the establishment of an appropriate early warning system and the securing of data quality in terms of a single customer view (SCV file) must also be examined, as must the processes related to the raising and use of financial means for the purpose of reimbursing depositors, and the orderly transfer of the deposit guarantee funds' available financial means.

ORGANISATIONAL REQUIREMENTS FOR DEPOSIT GUARANTEE SCHEMES

The ESAEG stipulates extensive organisational requirements for DGSs:

Directors must be professionally and personally qualified. Proof of these qualifications must be submitted to the FMA in the form of CVs and other relevant documents, and will be checked in the course of a fit and proper assessment including an expertise interview. This ensures high standards of management.

DGSs must have appropriate strategies, procedures and systems in place to be able to fulfil their task of reimbursing depositors in a payout event in the best possible manner. To this end, each DGS is required to implement a suitable early warning system, and to systematically exchange information and work closely with all other DGSs. Stress tests must be carried out at regular intervals to check DGSs' ability to function properly in the event of a crisis. The results of these tests must be submitted to the FMA.

The FMA will quality-check all of the implemented processes and procedures, doing so in the course of on-site inspections or by means of other suitable supervision tools.

KEY CONTENTS OF DIRECTIVE 2014/49/EU ON DEPOSIT GUARANTEE SCHEMES

The new deposit guarantee scheme means that savers and depositors will benefit from significantly improved access to DGSs, thanks to a broadened and clarified scope of coverage, faster repayment periods, improved information and robust funding requirements. This will considerably improve consumer confidence and financial market stability throughout the internal market. Accordingly, uniform rules apply across the Union:

- Each credit institution must be part of a DGS.
- The key task of a DGS is to protect depositors against the consequences of a credit institution's insolvency.
- The coverage level has been fixed at € 100 000 (up to € 500 000 in special cases) and is the same for all depositors regardless of whether a Member State's currency is the euro.
- The upper limit is per depositor and credit institution rather than per deposit.
- The repayment period has been reduced to seven working days.
- Depositors must be informed about their coverage and the responsible DGS in writing.
- The cost of financing DGSs must be borne by credit institutions themselves. A fund must be established, financed ex ante, and reach a target level of 0.8% of the amount of the covered deposits of its member institutions by 2024.

CREDIT INSTITUTIONS' MEMBERSHIP OF A DEPOSIT GUARANTEE SCHEME

Credit institutions that accept deposits as defined in ESAEG must belong to a DGS. In the widest sense, membership of a DGS is therefore a licensing requirement. If this membership ends, the licence for the deposit business will expire as a matter of law.

Membership of a DGS may end in a variety of ways. It may be renounced voluntarily, by relinquishing the licence, or officially due to serious breaches of the Austrian Banking Act (BWG; *Bankwesengesetz*) or the ESAEG.

Credit institutions are obliged to inform their depositors of the DGS that they belong to. This information must be provided in the form of an information sheet, and prior to any contract regarding the acceptance of deposits being concluded. This sheet is a compilation of information for the depositor, detailing, for example, the amount of the covered deposits, the competent DGS and the time allowed for reimbursement in the event of a payout. The FMA will pay particular attention to ensuring that credit institutions duly meet these information requirements.

RAISING AND USE OF FINANCIAL MEANS TO REIMBURSE DEPOSITORS

The new European deposit guarantee scheme fundamentally changes how the financial means to reimburse depositors in a payout event are to be raised. The previous system of ex post financing is replaced with a system of ex ante financing. Accordingly, a so-called deposit guarantee fund must now be built up in advance.

The target level for this fund, which must be reached by 3 July 2024, amounts to 0.8% of the covered deposits of the member institutions. Each institution's contribution is calculated depending on the amount of its covered deposits and the risk associated with its business activities. The method for calculating contributions must be approved by the FMA, taking EBA guidelines into account. The FMA's responsibility is to ensure that while the risk-oriented approach (high-risk credit institutions must pay proportionally higher contributions to the fund than those with a low risk) must be properly applied by the DGS, the deposit guarantee fund must also be continuously built up to reach the target level by the target date. Approximately € 469.57 million was paid into the deposit guarantee fund between 2015, when it was first established, and 31 December 2017. Based on the current volume of deposits, the target amount required to protect investors by 2014 will have increased to around € 2 billion. The FMA regularly checks the level of funding as well as the correct investment of the money received in low-risk assets.

The DGS fund to be funded ex ante constitutes just one of the three pillars supporting the protection of depositors in a payout event. If the fund's means are insufficient to repay depositors, the second pillar allows the collection of additional, so-called extraordinary contributions from the member institutions. The FMA must approve these higher extraordinary contributions, taking the financial position of the member institutions into account. The third pillar is borrowing between DGSs in order to raise any financial means that is still outstanding. This three-pillar system guarantees the reimbursement of depositors to the extent laid down by law.

Chart 3: Covered deposits pursuant to Article 7 para. 1 no. 5 ESAEG by amount (in %)

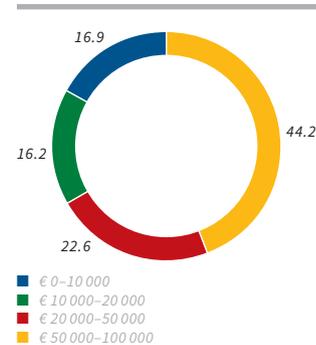


Chart 4: Covered deposits pursuant to Article 7 para. 1 no. 5 ESAEG by banking sector (in %)

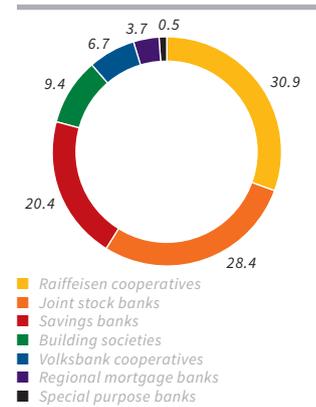
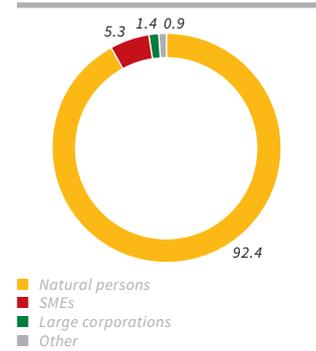


Chart 5: Covered deposits pursuant to Article 7 para. 1 no. 5 ESAEG by depositor (in %)



In the course of the fundamental overhaul of the Austrian deposit guarantee scheme from 1 January 2019 onwards, the FMA will re-approve the method used to calculate contributions. In so doing, it will also obtain an expert opinion from the Oesterreichische Nationalbank (OeNB).

REIMBURSEMENT OF DEPOSITORS IN A PAYOUT EVENT

In the event of a payout, the DGS concerned must take all necessary steps to reimburse depositors. The coverage level for the aggregate deposits of each depositor has been set at a maximum of € 100 000, and the DGS must repay depositors on this basis within seven working days. The law also clearly specifies special cases in which reimbursement of up to € 500 000 is permitted.

In its capacity as supervisor the FMA is required to monitor the reimbursement process and ensure adherence to the provisions laid down in the ESAEG.

The establishment of a European deposit guarantee scheme as the third pillar of the banking union is a long and arduous task. Recasting the Austrian scheme by 1 January 2019 in line with the European Deposit Guarantee Schemes Directive is, however, a further important step. In supervising the protection schemes, the FMA makes a significant contribution to the DGSS' credibility, strengthens savers' and depositors' confidence in the financial system, and thus helps secure financial market stability.

PSD2

The new regulatory regime for payment services

Since 2009, when the first Payment Services Directive (PSD1)¹ was transposed into Austrian law by means of the Payment Services Act (*ZaDiG; Zahlungsdienstegesetz*)², the payments sector and its products have changed significantly, from a technological viewpoint. While advancing digitalisation is continually creating new business models and innovative solutions for the payments sector, the numerous technological innovations have also led to increased security risks for electronic payments. Since these developments had not been sufficiently included in the legal provisions of the first PSD, the European lawmakers have overhauled the regulatory and supervisory regime and replaced PSD1 as of 12 January 2016 with PSD2³, which provides for a two-year period for transposing the requisite rules into national law. In Austria, PSD2 is being implemented through the 2018 Payment Services Act (*ZaDiG 2018*).

OBJECTIVES OF PSD2

The revised Directive aims to achieve various objectives: the integrated internal market for payment services should be pushed forward, consumer protection improved, risks associated with retail payments reduced and technological innovations in the payments sector incorporated into the regulatory framework. European lawmakers

PSD2 aims to achieve various objectives: the integrated internal market for payment services should be pushed forward, consumer protection improved, risks associated with retail payments reduced and technological innovations in the payments sector incorporated into the regulatory framework.

¹ Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market amending Directives 97/7/EC, 2002/65/EC, 2005/60/EC and 2006/48/EC and repealing Directive 97/5/EC; OJ L 319, 5.12.2007.

² Federal Law Gazette I No. 2009/66.

³ Directive 2015/2366/EU of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC; OJ L 337, 23.12.2015, p. 35.

have at the same time pointed out that they not only wish to avoid disadvantaging these new business models and products for payment services from a regulatory standpoint but are also looking to explicitly promote them, as they consider them as a source of vast investment opportunities for European providers and as more favourable alternatives to existing card payments.

All of this should guarantee fair competition, i.e. a level playing field, within the European payment system. For instance, PSD2 contains fully harmonised provisions applicable in the whole Union. Accordingly, Member States are not allowed to derogate from these provisions when transposing the Directive, and in particular may not prescribe additional requirements or limitations.

PROVISIONS INTRODUCED BY PSD2

PSD2 closes regulatory gaps, for example by clarifying the legal status of certain new payment service providers such as account information service providers and payment initiation service providers.

PSD2 closes regulatory gaps, for example by clarifying the legal status of certain new payment service providers such as account information service providers and payment initiation service providers. With regard to those third party providers (TPPs), provisions have been adapted – particularly with respect to exclusions – to reflect the rapid development in the payment services market while at the same time ensuring legal clarity.

FINTECHS

PSD2 creates a proportional regulatory and supervisory regime for new providers, such as payment initiation and account information service providers. Since these providers do not themselves hold any client funds, the licensing requirements applicable to them are less stringent. Although the providers now operate within a regulatory framework for the first time, they will now benefit from the fact that banks may no longer deny them access to customer accounts, or limit or prohibit data transfer to FinTechs by way of specific provisions in their general terms and conditions. This will open up new opportunities in these markets for FinTechs, and force banks to respond to the new service offerings.

FinTechs will continue to carry out a diverse range of tasks as technical service providers outside the regulatory regime, such as in the capacity of cooperation partners to banks. However, technical service providers that work with banks will also have to familiarise themselves with the new rules contained in the Directive as bank partners will be required to comply with data protection rules and outsourcing provisions.

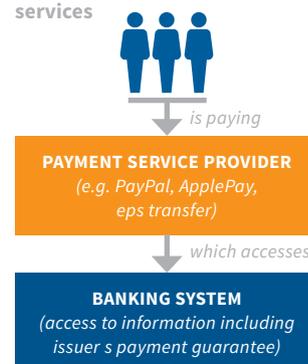
The Financial Market Authority (FMA) acknowledges regulators' and supervisors' technology neutrality. Accordingly, it has set up a "FinTech point of contact" as a single point of contact for technology start-ups in the financial market to clarify any regulatory issues. Since January 2018 providers have been able to submit any open legal questions to the FMA, which will then issue a legally binding administrative decision in response to the request for information.

EXTENDED CATALOGUE OF PAYMENT SERVICES

The catalogue of payment services is extended in ZaDiG 2018 to include payment initiation and account information services. Payment initiation services are an alter-

native to card-based payment transactions. With this service a payment order is initiated at the request of the payment service user with respect to a payment account held at a third payment service provider (> Figure 3). Account information services are online services used to provide consolidated information on payment accounts held by the payment service user with other payment service providers. The service of digital payment transactions (online purchases of goods and services), which previously required a licence, has been deleted. Account-servicing payment service providers, usually banks, are now obliged to grant payment initiation and account information service providers online access to their customers' accounts (Access to Account, or XS2A).

Figure 3: Payment initiation services



CATALOGUE OF EXCLUSIONS

ZaDiG 2018 restricts previous exclusions contained in ZaDiG:

- The exclusion for limited networks of goods or retailers (e.g. certain public transport cards, membership cards, vouchers) is defined in greater detail: limited networks must now be reported to the FMA where the total value of payment transactions in the previous twelve months exceeded the amount of € 1 million.
- The telecoms exclusion has been completely re-defined: henceforth it applies to providers of electronic communication networks or services that perform payment transactions in connection with the purchase of digital content and voice-based services, the purchase of tickets or as part of a charitable activity in addition to electronic communications services.
- Furthermore, a new amount threshold has been introduced: single payment transactions may not exceed € 50 and the cumulative value of payment transactions must not exceed € 300 per month. Companies wishing to make use of the exclusion must notify the FMA accordingly.

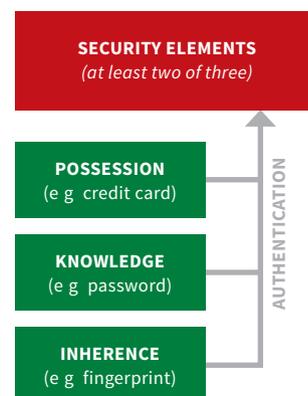
STRONG CUSTOMER AUTHENTICATION

To improve the security of payment transactions, payment service providers are required to apply strong customer authentication (SCA) for authenticating payers in certain cases (> Figure 4). Such authentication is based on the use of at least two of the following three elements:

- possession – something only the payer possesses, e.g. a credit card;
- knowledge – something only the payer knows, e.g. a password;
- inherence – something that can be exclusively attributed to the payer, e.g. a fingerprint.

Each of these elements must also be wholly independent from the others. The European Banking Authority (EBA) has been mandated to specify the SCA requirements in greater detail by issuing regulatory technical standards, particularly also regarding any exemptions (such as for small payments) from the application of SCA.

Figure 4: Strong customer authentication (SCA)



CONSUMER PROTECTION

The ZaDiG 2018 improves the payer's legal situation in the case of unauthorised payment transactions. Payers will now only be held liable for misappropriation of a payment instrument if they were in a position to become aware of the loss, theft or mis-

appropriation of the payment instrument. The maximum amount for which slightly negligent payers will be liable is lowered from € 150 to € 50.

IT SECURITY

The Network and Information Security (NIS) Directive also applies to payment service providers. In this context, ZaDiG 2018 prescribes additional obligations for payment service providers in relation to security requirements, notification of certain incidents and regular reporting. Conditions for the establishment, implementation and monitoring of the security measures, including certification processes, have now been laid down too. Major security incidents must be reported to the competent supervisory authority in a standardised form. The EBA must prepare the regulatory framework for this reporting requirement. All payment service providers must adhere to the criteria and conditions for the establishment and monitoring of security measures. This should ensure that any damage to users, other payment service providers, or national and international payment systems, such as a substantial disruption of a payment system, is kept to a minimum. Furthermore, payment service providers are from now on required to submit to the FMA annually updated reports on the assessment of the operational and security risks relating to the payment services they provide.

EBA MANDATES

Supervision of payment service providers now also involves the European Banking Authority (EBA), which has been mandated to specify the new data protection rules by developing guidelines and regulatory technical standards and which is to support national competent authorities in supervising payment institutions within the framework of the passporting regime. The EBA is to issue regulatory technical standards and guidelines on the following topics in particular:

Regulatory technical standards:

- Specification of authorisation procedure – Article 5(6) PSD2
- Electronic central register – Article 15(4) PSD2
- Notification process – Article 28(5) PSD2
- Central contact point – Article 29(5) PSD2
- Cooperation between Member States – Article 29(6) PSD2
- Security measures – Article 95(4) PSD2
- Authentication and communication – Article 98(1) PSD2

Guidelines:

- Professional indemnity insurance or other comparable guarantee for TPPs – Article 5(4) PSD2
- Authorisation procedure – Article 5(5) PSD2
- Security measures and certification processes – Article 95(3) PSD2
- Classification/notification/assessment of major incidents – Article 96(3) PSD2
- Complaints procedures – Article 100(6) PSD2

PSD2, and its implementation into Austrian law by way of the ZaDiG 2018, will promote innovations in the payments sector, improve the security of payment transactions, strengthen consumer rights and ensure fair competition across borders in this field of business – at least within Europe.

FIVE YEARS OF RECOVERY PLANNING AT AUSTRIAN CREDIT INSTITUTIONS

A retrospective

The idea of better preparing banks for crises by requiring them to create recovery plans is, like many recent regulatory innovations, a lesson learned from the 2007/08 financial crisis. It is a well-known fact that, at the time, many banks around the world had to be bailed out using huge sums of taxpayer money. Although these state rescue measures were useful in stabilising the situation, they increasingly drew criticism for several reasons. For instance, a number of poorly capitalised banks, which were no longer really viable, were also kept alive by state intervention. Furthermore, massive state funding led the crisis in the financial sector to develop over time into a budgetary crisis for many states. For the eurozone, the European Commission went so far as to identify a vicious cycle between bank debt and public debt, which needed to be broken in order to counteract the increasing fragmentation of the internal market for credit and financing.

The resulting framework for crisis management at banks has two main thrusts: first, the probability of insolvency must be reduced and, second, credit institutions and banking groups must be structured in such a way that the consequences are containable in the event of insolvency.

The purpose of recovery planning is to prevent bank insolvencies through preparation for potential crisis scenarios. To this end, banks must create their own contingency plans, so-called recovery plans, in which various crisis scenarios are considered in depth and measures designated to stabilise the financial situation of the institution in such crises. The recovery plan thus forces banks to prepare for serious crises, even if their occurrence is considered – rightly so, it is hoped – unlikely.

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FORM AND CONTENT OF THE RECOVERY PLAN

The recovery plan of an Austrian credit institution may be drafted in German or English¹ and comprises between 80 and 400 pages, depending on the size and complexity of the bank. It is usually supplemented by additional text and table documents. A recovery plan must be a living document that is adapted to changing circumstances. Regular updates, at least annually (every two years for very small banks) are mandatory, and adjustments must be made whenever significant organisational, legal or financial changes within the bank make this necessary.

Recovery plans are roughly divided into five chapters:²

1. First is a **Summary**, which is typically in form of a PowerPoint presentation in the style of a board proposal.
2. The chapter **Corporate Governance** contains a description of how the recovery plan was created and which departments of the bank are responsible for keeping the plan up to date. This chapter must also describe the internal escalation process to ensure that the institution takes timely action in the event of a crisis.
3. The **Strategic Analysis** chapter generally accounts for the bulk of the recovery plan. It starts with a description of the bank or group, its critical functions and its interdependencies with the financial system. Then, the available crisis recovery measures are described. These recovery measures typically exceed the intensity of normal management measures and may include, for example, the sale of material assets or discontinuation of activities. The measures are described in detail in the recovery plan and their effects are assessed quantitatively. The institution must also include stress scenarios, designed in accordance with its own business model, demonstrating that the range of available recovery measures is sufficient to stabilise it in the event of a severe crisis.
4. The **Communication and Disclosure Plan** contains information on internal and external communications required for the implementation of individual recovery measures. A major focus here is on dealing with negative market reactions.
5. The chapter **Preparatory Measures** concludes the recovery plan and contains those measures which the bank still has to take to facilitate implementation of the recovery plan or improve its effectiveness.

HISTORICAL DEVELOPMENT IN AUSTRIA

The FMA recognised early on how important recovery planning would be to increase the crisis resistance of the financial market; therefore, it did not wait for adoption of the relevant EU Directive.

The Austrian Financial Market Authority (FMA) recognised early on how important recovery planning would be to increase the crisis resistance of the financial market; therefore, it did not wait for adoption of the relevant EU Directive.

As far back as March 2012, it published the “Supervisory guidance on the strengthening of the sustainability of the business models of large internationally active Austrian banks”, which required the then three largest Austrian banking groups – Erste Group Bank AG, Raiffeisen Zentralbank Österreich AG and UniCredit Bank

¹ *Internationally active banking groups in particular, as well as banks working in English, have made avid use of the opportunity offered by the FMA to draft the recovery plan in English.*

² *Article 3 et seq. of Commission Delegated Regulation (EU) 2016/1075.*

Austria AG – to draw up recovery plans for their groups and submit them to the FMA. On 1 January 2014, the Banking Intervention and Restructuring Act (BIRG; *Bankeninterventions- und -restrukturierungsgesetz*) came into force in Austria, which obliged all Austrian banks, banking groups and institutional protection schemes (IPS), with total assets in excess of € 30 billion, to submit recovery plans to the FMA by the end of 2014. In 2014 the number of banking groups required to prepare recovery plans increased from three to eight.

On 12 June 2014, the Bank Recovery and Resolution Directive (BRRD) was published at EU level. This Directive created a new comprehensive crisis management framework for credit institutions and investment firms to be implemented in all EU Member States.

The BRRD was implemented into Austrian law through the Bank Recovery and Resolution Act (BaSAG; *Bankensanierungs- und Abwicklungsgesetz*) which came into force on 1 January 2015 and replaced the BIRG in recovery planning. Since 2015 all banks and banking groups have been required to prepare recovery plans under the BaSAG legislation. The transition to the new legal basis proved unproblematic as Austrian lawmakers had already taken European developments into account in the conception of the BIRG, as did the FMA in its application, so that the banks were optimally prepared for the changeover.

RECOVERY PLANNING AT THE FMA

PREPARATION AND SUPPORT OF CREDIT INSTITUTIONS

As early as 2012, it was clear to the FMA and the Oesterreichische Nationalbank (OeNB) that the new recovery planning project would require extensive preparation, most of which would have to be carried out in an iterative process with the banks. Therefore, regular feedback meetings with the individual institutions were held from the outset. With the enormous increase in the number of recovery plans, individual bank meetings were no longer efficient, which is why a major annual information event for banks was established in cooperation with the Bank and Insurance Division of the Austrian Federal Economic Chamber (WKO). This event has been held every spring since 2015, and serves to inform banks about new developments as well as to jointly reflect on the development status of recovery plans and clarify open questions. In addition to this regular event, the FMA has remained available to banks on an ongoing basis to address specific questions in brief, bilateral dialogues.

The supervisory authority's expectations with respect to the content of the recovery plans are further clarified by the annually updated FMA/OeNB Recovery Planning Guidelines. This document is oriented on the guidelines of the European Banking Authority (EBA) and the European Central Bank (ECB) within the framework of the Single Supervisory Mechanism (SSM). However, the FMA and the OeNB also draw on their own experience from national application and implementation, and provide many practical tips on how to structure individual recovery plan chapters. The two national authorities also developed their own templates and made them available to credit institutions in order to ensure needed comparability in the core elements of the recovery plans. In this context, the FMA and the OeNB have been careful to see that all

The FMA fully supports close cooperation between the supervisory authority and the resolution authority as provided for by law, which is optimally structured in Austria since both functions are combined under the integrated supervision of the FMA.

relevant information is included in recovery planning without creating an undue burden on the banks. The guidelines and templates are sent to the banks at each annual information event, but can also be downloaded from the FMA website.

The FMA fully supports close cooperation between the supervisory authority and the resolution authority as provided for by law, which is optimally structured in Austria since both functions are combined under the integrated supervision of the FMA.

In particular, the recovery plan to be assessed by the banking supervisor contains a large amount of information that is essential for the resolution plans to be drawn up by the resolution authority. The recovery plans are therefore forwarded to the resolution authority immediately upon receipt by the FMA. It is also important to obtain the necessary data from banks with a minimum of resource intensity and to take advantage of potential synergies. For this reason, the banking supervision and resolution departments at the FMA use a common template, e.g. to track critical functions and other information relevant for both recovery and resolution planning. The templates are filled in and transmitted by the bank as part of resolution planning, but can also be used for the purpose of the recovery plan, thus substantially alleviating the necessity of information retrieval by the supervisory authority in this respect.

PROPORTIONALITY

Given that the Austrian banking market is characterised by a very large number of small banks, the FMA attaches particular importance to appropriate proportionality when applying regulations, including recovery planning. In February 2015, the FMA therefore adopted the Bank Recovery Plan Regulation (BaSaPV; *Bankensanierungsplanverordnung*), which classifies banks into several categories on the basis of various criteria such as size, complexity and interdependence with the financial system. Using these categories, the BaSaPV enables a progressive application of simplified requirements in recovery planning. This means that small banks with less complex business models and risk profiles are not subject to the same requirements in terms of content, level of detail and frequency of updating as large banks that present greater risks for the financial system.

The BaSaPV was amended in April 2016 to bring it into line with European standards.

INTERNATIONAL COOPERATION

Rules for recovery planning require concrete legislative measures in numerous areas, drafted by the European Banking Authority (EBA). Due to its extensive practical experience, the FMA, which as a national competent authority has a seat and vote in the EBA and all its committees and expert groups, has been able to make valuable contributions in this respect, and has given voice consistently to the concerns of Austrian banks. Maintaining and anchoring the principle of proportionality in international legal acts and standards has been a particular focus of the FMA.

It has also been actively involved in the groups and committees of the Single Supervisory Mechanism (SSM), the joint system of banking supervision between the ECB and the euro area's competent national supervisory authorities, representing Austrian interests as a voting member for many years to the benefit of Austrian banks. For instance, decisive initiatives have been set in motion by FMA specialists within the

ECB's Crisis Management Groups. The Austrian supervisory authority has contributed significantly to the resulting standards for significant and less significant banks in the SSM.

RECOVERY PLAN ASSESSMENT

The first steps toward the establishment of recovery planning in Austria, as described above, concerned the largest banking groups. The plans of these groups were developed over three years in an intensive feedback process between the FMA, OeNB and the banks, before responsibility for assessing the plans was transferred to the ECB upon the launch of the SSM.

In autumn 2015, recovery plans of small and medium-sized banks and banking groups were submitted to the FMA for the first time. Where the FMA identified any deficiencies or obstacles to the implementation of a recovery plan, it instructed the bank to improve the plan and, if necessary, specified concrete changes. The improvement of major deficiencies had to be carried out within a period of three months. Rectification of non-material deficiencies was required by the next annual update of the recovery plan.

Improvement orders had to be issued for nearly all of the 169 recovery plans submitted to the FMA in 2015. But despite the necessary improvements, the plans were generally in line with the supervisory authority's expectations, especially considering that these were the first attempts at recovery plans by the respective institutions.

In 2016 the FMA received 42 updated and improved recovery plans for medium and large banks.³ Overall, there was a clear improvement in key chapters compared to the first recovery plans in 2015. Nevertheless, the FMA considered a further increase in quality to be necessary and therefore again issued improvement orders in all cases. In autumn 2017, a total of 146 banks and banking groups were obliged to submit updated recovery plans.

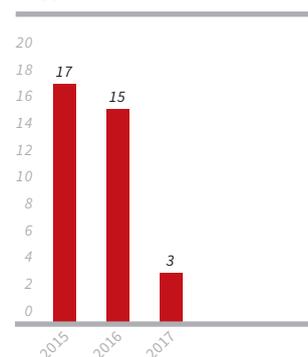
PRACTICAL USE OF RECOVERY PLANS

A key objective of the FMA/OeNB concept for recovery planning was to design plans in such a way that they are living documents which are also used for credit institutions' risk management. The success of this has been demonstrated by the fact that a considerable number of banks have actually used their recovery plans since 2015.

The FMA has been notified 35 times over this period that one or more of the recovery indicators defined in the relevant plans had been triggered by a deterioration in the banks' financial situation (> *Chart 6*). Broken down by type of indicator, profitability indicators were the most frequently hit (22 times), followed by capital indicators (ten times) and indicators of asset quality (nine times). Liquidity indicators were reported in only two cases (> *Chart 7*).

The triggering of a recovery indicator does not necessarily lead to implementation of recovery measures. Rather, it is incumbent on the management of the institution to ascertain whether measures to stabilise the financial situation are necessary and, if

Chart 6: Reports of one or more recovery indicators being triggered



³ Small banks with total assets of up to € 350 million are required to update their recovery plans every two years. Therefore, only the recovery plans of the banks and banking groups exceeding this threshold were submitted in 2016.

Chart 7: Triggered recovery indicator by type

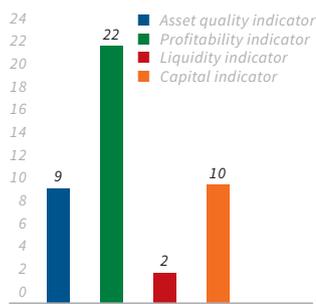
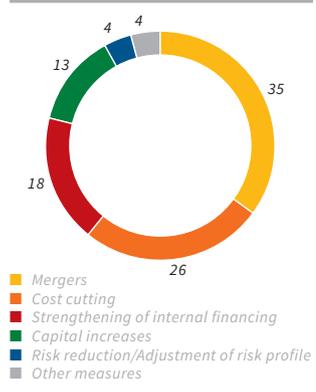


Chart 8: Type of recovery measures applied (in %)



so, to implement appropriate measures. These may be recovery measures or other measures that appear more appropriate in the specific case.

Since 2015 one or more recovery measures have been implemented in 20 cases due to recovery indicators being hit. The most frequently employed measures were bank mergers (35%) and cost cutting measures (26%). In addition, measures to strengthen internal financing (18%), capital increases (13%), restructuring measures to improve or adjust the risk profile (4%) and other measures (4%) were implemented. Only in one of these cases was it also necessary for the FMA to intervene through the early intervention mechanism (> Chart 8).

As the figures show, recovery planning has become a key pillar of the new crisis management framework for banks. Recovery plans are a highly effective instrument to increase the crisis resistance of banks, as they force them to deal with potentially serious crises in a timely manner. In the event of a crisis, they already have a range of available recovery options to stabilise the bank, in particular its financial position. Developing optimal recovery plans requires a process of continuous improvement over many years, in which the supervisor and the banks must work well together. By approaching Austria’s banks at a very early stage, the FMA ensured that the country’s credit institutions are now well positioned by international standards. But there is still much to be done. The supervisory authority will continue to press for continuous improvement – and in particular an expansion of the recovery toolbox – in order to ensure that Austrian banks can react even more flexibly to future crises.

SUCCESS FACTORS IN BANK RESOLUTION

HETA, immigon and KA Finanz

The global financial crisis provided a dramatic illustration of the effects that the failure of systemically important banks can have on financial markets and the real economy. Back in 2008 there was no appropriate legal framework in place for an orderly withdrawal of large banks so that governments had to step in and bail out the failing banks with enormous amounts of taxpayers' money. This in turn triggered government debt crises and further exacerbated the global financial crisis.

Systemically important banks were considered “too big to fail” back then, i.e. too large to be declared bankrupt or to be resolved. Governments had no option but to save these banks, coming to the rescue of their owners, creditors and management. This forced bail-out, based on realpolitik considerations, was taken to be an implicit government guarantee for those institutions. Consequently, the banks in question were able to refinance under more favourable conditions, thereby distorting competition. At the same time, these misaligned incentives often triggered irresponsible and careless behaviour in bank managers, thus massively increasing risk (moral hazard problem).

Having learned its lesson from the global financial crisis, the European Union has drawn up, adopted and implemented a uniform regime to resolve banks, the Single Resolution Mechanism (SRM). Its regulatory centrepiece is the Bank Recovery and Resolution Directive (BRRD), which has been transposed into national law in Austria through the Bank Recovery and Resolution Act (BaSAG; *Bankensanierungs- und Abwicklungsgesetz*). The BaSAG entered into force on 1 January 2015, making Austria one of the first countries to fully implement and apply the BRRD.

Having learned its lesson from the global financial crisis, the European Union has drawn up, adopted and implemented a uniform regime to resolve banks, the Single Resolution Mechanism.

Since Austria was one of the first countries to implement the new resolution regime, the FMA has also been something of a pioneer, operating in uncharted regulatory waters.

THE FMA AS NATIONAL RESOLUTION AUTHORITY FOR BANKS

The Austrian legislator assigned the newly created function of national resolution authority for banks and investment firms to the Financial Market Authority (FMA). The new function has been set up as a separate organisational unit, and operates independently from all other organisational units at the FMA. However, the FMA also assumes duties and powers related to bank recovery and resolution in its capacity as bank supervisor. The main duties of the resolution authority are: resolution planning, analysis and removal of impediments to resolvability, management of resolution processes and supervision of resolution units.

Since the FMA was awarded the duties and powers related to resolution, the Authority has applied them in three specific cases to date: at HETA ASSET RESOLUTION AG, the wind-down unit for the former Hypo Alpe Adria group; at immigon portfolioabbau ag, the wind-down unit for the former Österreichische Volksbanken AG (ÖVAG), and, thirdly, at KA Finanz AG, the wind-down unit for the former Kommunalkredit AG. Since Austria was one of the first countries to implement the new resolution regime, the FMA has also been something of a pioneer, operating in uncharted regulatory waters – particularly in relation to the supervision of wind-down units and the application of the bail-in resolution tool. Today, the FMA is able to share the experiences it gained with its European partners.

RESOLUTION ACTIVITIES IN PRACTICE

HETA ASSET RESOLUTION AG

HISTORY

HETA was founded in 1896 as a provincial mortgage lending institution and operated as a classic Carinthian regional bank for nearly 100 years. In the 1990s the bank started to tap into new markets in the Alps-Adriatic region and developed from a regional bank to an international finance group, known as Hypo Alpe-Adria-Bank International AG (HBIInt); its liabilities were to a large extent secured by the state of Carinthia.

As a consequence of the global financial crisis, the Hypo Alpe-Adria group started to struggle and was finally nationalised under an emergency procedure in 2009. Between December 2008 and April 2014 the Republic of Austria had to provide capital in the amount of € 5.55 billion to HBIInt. Taking account of the European Commission decisions pertaining to state aid and implementation of the prescribed resolution strategies, the wind-down process was started in the summer of 2014 upon the Act on the Creation of a Wind-down Unit (GSA; *Gesetz zur Schaffung einer Abbaueinheit*) entering into force (Federal Law Gazette I No. 51/2014).

On 30 October 2014, the FMA issued an administrative decision revoking the banking licence granted to HBIInt pursuant to the Austrian Banking Act (BWG; *Bankwesengesetz*). The company has since been managed under the name of HETA ASSET RESOLUTION AG (HETA) as a partly regulated wind-down unit pursuant to the GSA, and its purpose of business is to ensure the orderly and active disposal of all of its assets on the best possible terms (portfolio wind-down). Following this, HETA is to be liquidated.

In the course of the transformation into a wind-down unit pursuant to GSA, a group-wide asset quality review was carried out, assuming that the portfolio wind-down is performed as quickly as possible. On 27 February 2015, HETA informed the FMA that this asset quality review had revealed a preliminary capital shortfall of between € 4.0 billion and € 7.6 billion. Subsequently, the Republic of Austria determined that it would grant no further capital or liquidity support for HETA.

As all conditions for a resolution pursuant to the BaSAG were fulfilled at the same time, the FMA, in its capacity as resolution authority, issued an emergency administrative decision on 1 March 2015, deferring payment of all of HETA's eligible liabilities for a limited period to 31 May 2016 (moratorium), allowing time to prepare for application of the bail-in tool.

On 10 April 2016, the FMA issued an administrative decision in relation to the challenge procedure, confirming the moratorium it had imposed through its emergency administrative decision of 1 March 2015. On the same date as the administrative decision in relation to the challenge procedure, the FMA issued another additional emergency administrative decision to apply the resolution tool of bailing in creditors, among other things.

SUCCESSFUL WIND-DOWN

The wind-down of HETA assets has been in progress since 1 March 2015 in line with BaSAG rules. Originally, it was planned to have all assets wound down by 2020, with around 80% of assets scheduled to be realised in 2018. Given that the wind-down process has been highly successful so far, it is expected that as much as 95% of assets will have been realised by the end of 2018. In a little more than two years, € 5 billion of the assets on hand in March 2015 (excluding money holdings) had been realised for € 7.1 billion. The effective performance in relation to the wind-down of the HETA portfolio is apparent from the cash balance at Österreichische Nationalbank (OeNB): it jumped

STATUTORY DEFINITION OF TERMS

The BaSAG uses two different terms for companies under resolution: wind-down unit and wind-down entity.

- **The wind-down unit** is a company that is established upon an order from the resolution authority to apply the asset separation tool (Article 82 et seq. BaSAG). A wind-down entity comes into existence where the FMA approves a CRR credit institution's or CRR investment firm's (Article 2 no. 23 BaSAG) decision henceforth to operate as a wind-down entity (Article 162 para. 1 BaSAG), provided other prerequisites are also met. All provisions pertaining to wind-down units are equally applicable to wind-down entities.
- The only credit institutions that could be transformed into a **wind-down entity** were those that had been operated under a resolution or restructuring plan with state aid approved by the European Commission before 31 December 2014. Consequently, the existing legal provisions do not permit the creation of any further wind-down entities in addition to immigon and KA Finanz.

In accordance with its Rules of Procedure, the FMA consistently uses the term "wind-down unit" both for wind-down units and wind-down entities.

from € 2.5 billion on 1 March 2015 to € 6.2 billion at the end of 2016, before increasing again to € 8.5 billion as at 31 May 2017. Owing to this favourable liquidity position, HETA was able to distribute € 5.8 billion of its realisation revenues to the creditors of eligible non-subordinated liabilities before they fell due.

IMMIGON PORTFOLIOABBAU AG

HISTORY

Unlike HETA, immigon portfolioabbau ag was transformed from an active bank to a wind-down entity under private law. immigon emerged on 4 July 2015 when Österreichische Volksbanken-AG (ÖVAG), which had been part-nationalised in 2012, was split up on the basis of its closing balance sheet for 2014.

Since its part-nationalisation in April 2012, ÖVAG had been undergoing a process of transformation, based on a restructuring plan and conditions imposed by the European Commission and the Republic of Austria. In October 2014, the Executive Board decided to restructure ÖVAG. Those tasks that ÖVAG was legally required to perform in its capacity as the central organisation for the affiliation of Volksbank cooperatives, as well as service functions which ÖVAG provided to the affiliation and which are necessary for operating a bank in an orderly manner, were transferred to Volksbank Wien-Baden AG. The remaining ÖVAG was mandated to proceed with the swift implementation of the wind-down process, which had been successfully initiated in 2012, in order to repay creditors' liabilities on the relevant maturity dates and, finally, to liquidate ÖVAG.

At the annual general meeting of 28 May 2015, ÖVAG shareholders adopted a spin-off and takeover agreement: that part of the business that functioned as the central organisation and central institution was spun off and transferred to Volksbank Wien-Baden AG as the acquiring company. This was carried out with retrospective effect from 31 December 2014, with the transferor company continuing to operate in return for shares. At the same time, the share capital and participation capital were lowered to cover losses.

In a letter of 2 July 2015, the European Central Bank (ECB) approved the new affiliation of Volksbank cooperatives pursuant to Article 30a BWG with Volksbank Wien-Baden AG as the central organisation. Also on 2 July 2015, the FMA issued an administrative decision, approving the operation of the former ÖVAG as a wind-down entity pursuant to Article 162 BaSAG and, in its capacity as resolution authority, also approved the entity's strategy and risk profile. ÖVAG thus ceased to be a credit institution and withdrew from the affiliation and its joint liability scheme. The company name was changed from ÖVAG to immigon portfolioabbau ag. immigon has been a wind-down entity pursuant to Article 162 para. 1 BaSAG since that date.

SUCCESSFUL WIND-DOWN

immigon's business purpose is to manage the assets and liabilities of the company with the aim of achieving an orderly and active disposal of its assets on the best possible terms. The portfolio is being wound down on the basis of a wind-down plan, which the supervisory board approved. This plan had to be submitted to the reso-

lution authority and compliance with the plan has been supervised by the authority from the beginning. Additionally, the wind-down entity must draw up an annual liquidation report detailing the liquidation progress made compared against the wind-down plan.

As at 31 December 2014, total assets amounted to € 15.1 billion. Total assets were reduced from € 11.3 billion to € 3.8 billion in the first year, although this was only partly due to a successful wind-down process. The reduction had more to do with the central organisation being spun off. As at 30 June 2017, total assets amounted to just € 2 billion. The successful wind-down of immigon is reflected in its cash reserves of € 1.2 billion, exceeding the sum total of all liabilities and provisions for the first time.

The following wind-down measures, among others, were taken in order to reduce the asset side: premature repayment or refinancing of granted loans, sale of former leasing projects, securities and investments, as well as selling a block of shares to Raiffeisen Bank International, which accounted for the largest measure.

By the end of 2017 all of the substantial economic risks associated with immigon had been eliminated. The Executive Board is assuming that it will also be possible to quickly liquidate the remaining loans and securities with contractual maturity dates after this date by taking appropriate wind-down measures.

KA FINANZ AG

HISTORY

Like immigon, KA Finanz AG (KF) also voluntarily submitted an application for continued operations of its business in the form of a wind-down entity pursuant to the terms of the BaSAG.

KA Finanz AG is the legal successor to Kommunalkredit AG and was established on 28 November 2009 through a demerger. In accordance with the restructuring plan approved by the European Commission on 31 March 2011, KF is responsible for the structured wind-down of the non-strategic portfolio. With effect from 18 September 2010, Kommunalkredit International Bank Ltd. (Cyprus) was merged with KF. On 26 September 2015, the part of Kommunalkredit remaining after the demerger for new incorporation was merged with KF.

The following preparatory measures were taken to install KF as the wind-down entity as defined in the BaSAG:

On 8 June 2017, the supervisory board of KF approved the conclusion of a framework agreement with the Abbaumanagementgesellschaft des Bundes (ABBAG), which is solely owned by the Republic of Austria, for the future refinancing of KF by ABBAG. This framework agreement provides for refinancing facilities totalling € 8.2 billion. These facilities are intended to replace the entire current refinancing of KF with refinancing from ABBAG. Obligations of KF under existing bonds and private placements should continue to be satisfied, including redemption at full nominal value when due. Following the KF supervisory board's approval, the annual general meeting of KF resolved that the company – subject to the required approval of the FMA – be operated as a wind-down entity pursuant to Article 162 BaSAG. To this end, KF filed a corresponding application with the FMA on 9 June 2017. The FMA approved the operation

of the company as a wind-down entity pursuant to Article 162 BaSAG on 6 September 2017 by issuing an administrative decision. Upon the FMA's approval of the application, the banking licence of KF expired. The resolution authority also approved the strategy and risk profile of the wind-down entity on the same day.

SUCCESSFUL WIND-DOWN

KF's business activities focus on the targeted reduction of risks with minimal use of public resources, utilising the potential related to the reversal of impairments, with the best possible own contributions being made in accordance with EU state aid rules.

The total KF exposure amounted to € 8.7 billion as at 30 June 2017, comprising loans in the amount of € 4.4 billion and securities of € 3.4 billion. According to the current strategy, the wind-down process should be largely completed by 31 December 2026.

KA Finanz AG was the third Austrian bank that had fallen into serious difficulties threatening its existence during the global financial crisis. Following the progress made in the resolution of HETA and the successful resolution of immigon under private law, the final phase in the bank's orderly resolution was initiated upon the approval of KF's role as wind-down entity.

THE AUTHORITY'S ROLE IN RESOLUTION

RESPONSIBILITIES

The FMA acts in the capacity of resolution authority in addition to its responsibilities as banking supervisor. The BaSAG consistently differentiates between "FMA" and "resolution authority", making a clear distinction between the duties that the FMA carries out in its capacity as supervisory authority and those fulfilled in its capacity as resolution authority. The organisational separation of the two areas, as stipulated in the BaSAG, has been implemented in the FMA's Rules of Procedure.

The resolution authority's responsibilities have also been specified in the Rules of Procedure. Accordingly, the resolution authority is required to manage the official resolution process pursuant to the BaSAG and is responsible for ongoing supervision and monitoring of wind-down entities, wind-down units and institutions under resolution including bridge institutions.

Whenever a specific resolution case arises, the supervisory competence of the resolution authority is established by way of an official legal act:

- In relation to HETA, this supervisory competence began upon the application of resolution measures as detailed in the emergency administrative decision of 1 March 2015.
- In relation to immigon and KF, the authority's period of responsibility commenced when the administrative decisions approving the transformation into a wind-down entity became final and with approval of the strategy and risk profile.

A wind-down unit is responsible for managing the assets transferred to it with the aim of ensuring an orderly and active disposal on the best possible terms.

APPROVAL OF RESOLUTION STRATEGY

A wind-down unit is responsible for managing the assets transferred to it with the aim of ensuring an orderly and active disposal on the best possible terms (portfolio wind-down). The BaSAG includes detailed provisions on the portfolio wind-down, such as

that it must be conducted in accordance with a wind-down plan, which is to be drawn up by the directors, to be approved by the supervisory board and then submitted to the resolution authority without delay. Since a wind-down entity's (immigon, KF) strategy and risk profile must be approved by the resolution authority, the wind-down plan can only specify implementation of said strategy and risk profile and does not itself need to be approved. Any resolution strategy must consequently be long-term. Where the specific resolution activity or changes in the wind-down plan impact on the strategy and risk profile, the approval granted might become invalid owing to material changes in the underlying circumstances. This is a matter to be checked and determined by the resolution authority.

MONITORING OF RESOLUTION

Where wind-down units are the result of a resolution measure, i.e. in the case of a legal entity under resolution (HETA), the law prescribes that the resolution authority must make sure during the resolution process that the resolution objectives are achieved and the resolution principles adhered to. Accordingly, it is also necessary to monitor the wind-down unit's economic business practices.

CONTROLLING OF WIND-DOWN UNIT

The BaSAG expressly stipulates that a wind-down unit will be exclusively controlled by the resolution authority. This may be done by way of contractual or company law avenues of influence or by taking over the controlling of the unit. These forms of intervention differ significantly in their gravity. However, the lawmakers have not provided for any hierarchy, leaving it up to the resolution authority's extensive discretion to choose the means used to control the unit.

Moreover, the resolution authority is also entitled to take part in the wind-down unit's supervisory board and committee meetings. Amendments to the articles of association and the company agreement require the resolution authority's approval to become effective. The authority is therefore in a position to obtain information without delay about any essential decisions taken by the wind-down unit's bodies as well as about ongoing operations, and able to take any official measures should the need arise.

LEGAL ENFORCEMENT

The resolution authority may order individual measures in relation to a legal entity under resolution if provisions of the BaSAG are breached. These measures are ordered under threat of a coercive penalty to establish compliance with statutory provisions within an appropriate period of time. For instance, a wind-down plan that deviates from the risk strategy or a wind-down activity contrary to the resolution objectives and principles may not be compatible with the statutory requirement that the portfolio should be wound down on the best possible terms.

INSOLVENCY PETITION

Ultimately, it is the resolution authority's responsibility to file an insolvency petition for a wind-down unit when certain conditions apply.

In the case of a wind-down entity (immigon, KF), it is only the resolution authority that is entitled to file an insolvency petition. To this end, detailed knowledge of the portfolio wind-down, as can only be obtained through supervisory activities, is indispensable.

GOVERNANCE STRUCTURES

The FMA in its capacity as resolution authority initially did not take over the controlling of any of the three wind-down units. The companies have continued to operate as corporations under company and stock corporation law and are not any kind of special undertaking (*societates sui generis*). Despite ongoing resolution pursuant to the BaSAG, all three companies continue to be managed by the bodies required under company law, i.e. management board, supervisory board and general meeting. With its emergency administrative decision of 10 April 2016, superseded by its administrative decision in relation to the challenge procedure of 2 May 2017, the resolution authority has however taken over control of HETA. The authority performs the control function by exercising ownership rights at the general meeting, and particularly also by appointing the members of the supervisory board.

Since the companies continue to operate under company law, internal control structures as defined in company law continue to apply. In accordance with rules of procedure, the management and supervisory boards must meet certain requirements in relation to decisions, voting and presentation of documents. In relation to internal auditing and compliance, the special provisions applicable to credit institutions continue to apply unchanged. This finely attuned system of executing and controlling bodies within the company constitutes the first barrier in preventing or unearthing breaches of rules, and will be referred to as internal governance. Internal control systems that work well are an important and effective barrier against breaches of rules and negative developments. In the financial market regulator's experience, most institutions that have fallen into difficulties previously encountered problems in internal governance.

The resolution authority is given extensive information rights in order to be able to verify that the wind-down unit pursues only such business activities that are in line with the resolution objectives; the bodies of wind-down units are required to provide any necessary support in this context. For example, all important documents such as agendas and minutes of meetings of the supervisory board or its committees must be provided. Where there is an indication in these documents that the resolution objectives have been breached, the resolution authority can step in quickly.

The wind-down unit continues to reach any corporate decisions itself. The resolution authority does not make any economic decisions. If, however, the resolution authority concludes in the course of its supervisory duties that certain business decisions run counter to a resolution objective, it is required to inform the management accordingly. If the directors then continue to pursue the decision despite the resolution authority's negative assessment, the authority may prohibit the planned measure by administrative decision, or even take over control, to ensure that no related actions are executed. This applies to all decisions adopted by the wind-down unit's bodies that are contrary to a resolution objective.

In the case of the wind-down unit (HETA), the authority can exercise preventive influence under company law, in particular by helping to develop the articles of association or the rules of procedure for the management and supervisory boards, granting the resolution authority, or a representative, a right to give instructions, to give its consent, to obtain information and ask questions, as well as a right to be heard in the mentioned bodies. Although stock corporation law provides for autonomy for members of the management and supervisory boards, the specific provisions of the BaSAG take precedence over provisions in company law where the application of resolution measures is concerned. Provisions under company law are only applicable as long as they are compatible with the BaSAG. The wind-down unit must therefore accept any intervention in their internal rules as instructed by the resolution authority.

PRINCIPLE OF PROPORTIONALITY

The FMA pursues a risk-based approach when carrying out its supervisory duties and respects the principle of proportionality. The resolution authority takes the same approach, which is mirrored in the varying intensity of the supervision of the three wind-down units. immigon and KF are being wound down as former credit institutions in an orderly manner in accordance with the BaSAG; they did not require any resolution measures or other support from the resolution authority for their activities. In contrast, the situation with regard to HETA was such that resolution measures were necessary. Naturally, in such a case the resolution authority's supervision of business activities is more intensive. The BaSAG's holistic approach encompasses all areas of activity and all business operations of the institution under resolution. This includes obligations under private law, aspects of labour law, tax considerations, and basically everything that forms part of operating a complex undertaking such as a former bank. Based on how vast a field this is, the FMA may also use external experts as a source of support and to supplement its own expertise in these matters.

SPECIFIC CHALLENGES IN RESOLUTION PRACTICE

FROM BANK TO WIND-DOWN UNIT – A CHANGE OF IDENTITY

From a formal perspective, a credit institution is transformed into a wind-down unit as at a certain date. However, practical implementation is a protracted process requiring appropriate change management.

A bank aiming to attract new business and customers must become a company whose sole purpose is its own liquidation. This can only be achieved by profound change processes that encompass every area of the institution but group organisation, IT, reporting and personnel management in particular.

While a bank's focus as a going concern is on maximising profits, the focus of a wind-down unit as a "gone concern" is on liquidation. The whole endeavour is no longer about profit maximisation and avoidance of loss but about managing assets with the aim of ensuring an orderly and active disposal on the best possible terms which, at the same time, should be achieved as quickly as possible and in line with the resolution objectives. Even though they are no longer allowed to be engaged in the deposit and lending business or to perform other banking transactions, wind-down

Practical implementation is a protracted process requiring appropriate change management. A bank aiming to attract new business and customers must become a company whose sole purpose is its own liquidation.

units still hold a licence entitling them to carry out banking transactions to the extent necessary in relation to the liquidation process.

The BaSAG includes principles of resolution that do not apply to normal banking operations. For instance, creditors may not be treated less favourably than in insolvency proceedings. All of this must therefore be considered during the strategic implementation of the liquidation. To enable the most favourable realisation of assets, which will often only mature after the date of the planned wind-down, objective methods must be applied to assess risks and to plan the optimum timing and technical method for the realisation process, while taking both collateral and the net book value into account.

During the bank's resolution the bodies under company law must continue to ensure proper management and clear responsibilities, full transparency and functioning internal control systems. These duties apply in particular with regard to those statutory provisions that must still be observed and applied, such as in the area of money laundering and terrorist financing. Under the risk-based approach, the unit must always consider the protection these standards provide when taking any wind-down actions: when a credit claim is sold, for example, the buyer of that claim is also a customer, just like the borrower, and a KYC check must therefore be conducted for both.

CROSS-BORDER LIQUIDATION WITHIN THE EU AND IN THIRD COUNTRIES

Both HETA and immigon, former international companies, continue to hold interests in group companies in Austria and abroad. These companies were usually established as limited liability companies under local law. In most cases, these companies are not subject to regulation. However, there are also some, being partly regulated, that must adhere to local legal provisions of the respective supervisory authority, e.g. in relation to leasing activities.

Local companies must be involved in any wind-down activities, either because they are the owners of the assets to be realised or because they have in-depth knowledge of the local market. As soon as all assets of the local company have been realised, liquidation must begin. In this context, local requirements must be met, which might result in a liquidator being appointed by the local supervisory authority or have an impact in terms of timing or economic aspects.

In the past few years, many countries have adopted laws that can have a retroactive effect on business activities but also on resolution: for example, in some countries the laws pertaining to security for loans or to foreign currency loans have been changed, with a view to retroactively rectifying a potential disadvantage for its citizens or consumers; in most cases the costs of these changes have had to be borne by the – mostly foreign – financial service providers.

Pending or threatened legal proceedings may also seriously hinder the optimum realisation of assets. Actions brought against the wind-down entities often delay the wind-down process; sometimes considerably owing to the extremely long time legal proceedings takes in some countries. If the duration of those proceedings exceeds the planned wind-down period, legal actions impede liquidation and thus jeopardise adherence to the wind-down plan. Moreover, since the wind-down period is publicly known the wind-down unit finds itself in an unfavourable situation: it does not have

much leeway when court proceedings are intended to be ended by settlement, as any delay would be disadvantageous.

The new resolution law can also result in further issues. The term “resolution” and the status “under resolution” entail legal consequences, not all of which have been addressed clearly by all legal systems. Repeatedly, the question is being posed as to whether or not resolution is a legal institution comparable to insolvency proceedings, entailing the related legal consequences. In an insolvency, rights of termination may often be exercised, to cite just one example; it is unclear whether the same rights apply to a resolution.

We have also found in individual cases that foreign courts are ignoring decisions made by the Austrian resolution authority, based on European legislation, even within the European Economic Area. Whether this is due to ignorance of European legislation or due to a court’s rejection of an authoritative administrative decision remains to be seen.

SUCCESS FACTORS IN RESOLUTION

As explained, resolutions of banks are usually conducted under highly varying conditions and may have serious – and also negative – effects. The FMA has several years of experience as a resolution authority and specific practical experience gained in three cases, which is why it is able to identify several factors that can help achieve an orderly resolution.

ONE-STOP SHOP

The FMA is not only an integrated supervisory authority, uniting supervision of the whole financial market under one roof, it also acts in the capacity of resolution authority. In addition, it can draw on the institutional expertise of Oesterreichische Nationalbank (OeNB), where necessary, for its supervisory and resolution activities.

The organisational structure offers several advantages: supervisory authority and resolution authority are linked to each other in terms of organisational structure and are obliged by law to work together. Due to this legal prerequisite, full information is regularly transferred by the supervisory authority to the resolution authority. This way, cooperation does not just start whenever resolution measures are ordered but at a much earlier stage. With the resolution authority being involved from an early stage in the event of a crisis, it does not lose any valuable time by first having to gather information but can immediately fully focus on all necessary steps and measures.

Cooperation is also paramount when a credit institution is being transformed into a wind-down entity, as the BaSAG provides for two approvals: first of all, the FMA will need to authorise the operation of an institution as a wind-down entity pursuant to Article 162 para. 1 BaSAG. The licence granted pursuant to the BWG for conducting banking transactions ceases to exist following the administrative decision entering into force, with the institution then operating as a wind-down entity. Second, the resolution authority must also approve the wind-down entity’s strategy and risk profile. To guarantee a smooth transition, the resolution authority closely coordinates the content and timing of any of its actions with the supervisory authority.

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Another benefit of the one-stop shop approach is related to the supervision of the provisions of the BWG, the Securities Supervision Act (WAG; *Wertpapieraufsichtsgesetz*) and other relevant laws that continue to apply to the wind-down unit. The transition from an institution aiming to attract business to a wind-down unit also impacts on the application of these statutory provisions. Owing to the special status of a resolution authority when resolving an institution (both elements of the administrative receiver and the insolvency court are included), the resolution authority is involved in daily business operations to an exceptionally large extent, compared with supervision. In order to monitor compliance with the resolution principles, any cases of asset realisation must be presented to the resolution authority for approval, similar to the supervisory board. To supervise these provisions in a proportionate and risk-based manner, the resolution authority needs to know, and does know, about the wind-down unit's operational activities and progress made, in all of the necessary detail.

FLEXIBILITY AND INDIVIDUAL SOLUTIONS

Each resolution is different, and each institution to be resolved is different too. There are differences between a wind-down unit and a wind-down entity. The assets to be realised differ in terms of type, geographical distribution, maturities, etc. All these differences need to be considered by the resolution authority when supervising the portfolio wind-down.

Supervisory actions taken by the resolution authority in relation to a wind-down unit are more detailed and have more immediate effects on the wind-down activities and success, given that the authority is more strongly involved in the unit's business activities. For instance, an opportunity for concluding a favourable deal might come up at short notice, requiring a rapid reaction. Or the circumstances specific to a transaction might require it to be tackled and solved in an innovative way.

Flexibility ends where legal requirements begin. Generally, these are abstract and need to be made applicable to the individual case. It might be necessary to weigh various interests, e.g. to contrast short-term losses with large, long-term profits or the probable outcome of litigation with the risk of litigation.

EXTERNAL EXPERTS

The resolution authority has many ways to shape the wind-down process, in the course of which it will encounter areas beyond its own expertise, such as liquidation rules in foreign legal systems, issues of tax and liquidation law, or M&A transactions, to name but a few examples. The same applies to the wind-down unit. External experts need to be involved in these cases; any related costs are justified because of the scale of the transactions or its strategic consequences.

In the context of HETA, the FMA also appointed an expert body to advise HETA in complex transactions. Members of this body are completely independent in their assessment of technical and legal issues, which is then used for official decision-making.

COMMUNICATION

Communication is another important factor in successful resolution. Communicating

proactively avoids the problem of insufficient information, which might lead to misunderstandings.

When the resolution authority started the first resolution process in Europe in March 2015 under the new rules, both HETA and its creditors were uncertain about the new legal situation. Depending on the side on which they stood, the BaSAG was interpreted differently, an understandable reaction. It is therefore paramount to actively answer any questions about the new (legal) situation and thus avoid misinterpretations.

The resolution authority has pursued an offensive communications strategy, publishing administrative decisions, explaining them in language that can be generally understood and actively communicating them. Questions that seem obvious or have been asked a lot are answered in an FAQ section on the FMA website.

The communications policy of the wind-down units is also worth mentioning. Their direct information to creditors and investors contributes to necessary actions being accepted, even if they are not understood. Obviously, the thin line between transparency and the need to provide information on the one hand and confidentiality in order to guarantee the best possible realisation on the other must be considered.

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THE FIRST THREE YEARS OF RESOLUTION

Since the BaSAG entered into effect on 1 January 2015, the FMA has held the additional function of national resolution authority. The Authority has since accompanied the resolution of three, formerly systemically important banking groups. In one case, HETA, it imposed resolution measures pursuant to the BaSAG/BRRD (moratorium, bail-in) and has taken over control of the wind-down unit. In two cases, immigon and KA Finanz, it approved the strategy and risk profile of credit institutions that had applied for transformation into wind-down entities, and has since monitored their compliance.

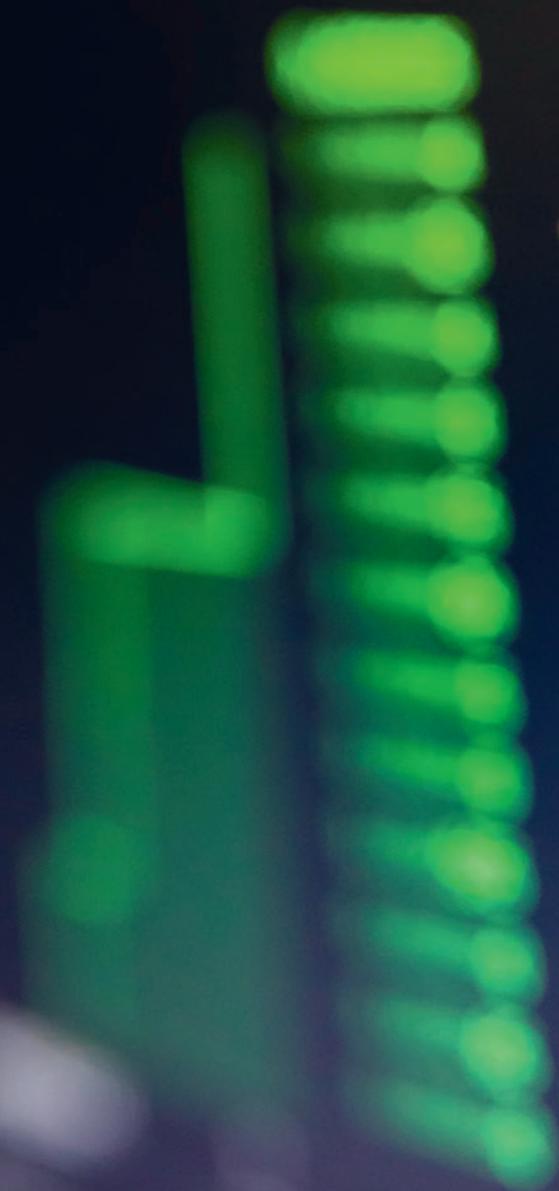
The sale of the three wind-down units' assets is being carried out by the bodies of the companies themselves, within the legal framework. The resolution authority is not directly involved in the realisation of assets. It does not negotiate sales and cannot influence the specific arrangements of a transaction. The resolution authority's role is to monitor compliance with the resolution principles and other provisions in its area of competence. To ensure independence and equidistance from all those involved, this approach is both necessary and welcome.

The environment offered by the FMA in its capacity as resolution authority is an essential factor in a resolution's success. A resolution can be deemed a success where the financial result ultimately achieved is above the insolvency dividend, the schedule has at least been adhered to, no unpredictable events have hindered the resolution process, and the resolution has been carried out without posing a threat to financial market stability. The role of the resolution authority in the resolution process is to provide stability, predictability, legal protection and certainty that any actions taken are in full compliance with the law.

1105.577
1208.020
308.960
2706.502
1007.765
308.394
308.314

6731
55756.000
42848.000
42329.000
21172.000
11144.700
5320.300

0.0000637 BTC



872.728
78.183
7852.000
4.006
208.314
1008.006
20.000
1008.000
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1008.000

872.728
950.890
78573.700
78577.700
81522.700
98944.700
98975.900
207481.000
229450.000
232821.000
243081.000
252743.000

MANIPULATION OF BENCHMARKS

Tougher regulatory and supervisory rules

In the past few years it has come to light that some global banks and other major players in the financial markets had been systematically tampering with important benchmarks such as LIBOR (London Interbank Offered Rate) and EURIBOR (Euro Interbank Offered Rate), but also other benchmarks and indices used for pricing derivatives, foreign currencies and commodities. Millions of credit agreements, and particularly those relating to residential immovable property, as well as financial instruments worth several trillion euro are priced on the basis of these benchmarks. As a consequence of the manipulations, consumers suffered huge financial losses, confidence in the financial markets was shattered, and even the performance of the real economy was tangibly affected.

The reaction to these scandals was tough and uncompromising: while supervisory authorities and courts imposed penalties of several billion euro on the culprits, the European Union (EU) adopted its own regulatory and supervisory regime for major benchmarks on the financial markets.

BENCHMARKS AND GOVERNMENT REGULATION

Benchmarks are a core element of any modern financial system. Their integrity is therefore of paramount significance for the stability of financial markets, not least because they strongly influence a broad range of financial instruments, financial contracts and investment funds.

Market participants use benchmarks to eliminate any information asymmetries and to cut information costs. Without benchmarks such as LIBOR and EURIBOR it would be very difficult for borrowers to compare loan terms and follow interest rate devel-

opments on the market. Large investors, in turn, include benchmarks in their economic models as a kind of risk-free interest rate, and also base their expectations and assessments of supply and demand for assets on them. Furthermore, they use benchmarks to reach economic decisions and to compare the performance of their own investments.

Before the fixing scandal was uncovered, benchmarks were largely unregulated, at both international and national levels. Only on 5 October 2012 did the International Organization of Securities Commissions, (IOSCO) publish its Principles for Oil Price Reporting Agencies, followed on 17 July 2013 by its Principles for Financial Benchmarks.

Any rules that did exist at the time in Europe only covered specific aspects of individual benchmarks as part of an unsystematic approach. They covered neither all weaknesses in data provision nor all kinds of use of financial benchmarks in the financial economy.

Individual EU Member States, such as the United Kingdom for example, initially reacted to the manipulation scandals by adopting national laws on benchmarks, but these diverged greatly from country to country.

In order to establish a harmonised framework for financial benchmarks the European Commission finally proposed a regulation on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds on 18 September 2013. The Commission's aim is to ensure the accuracy and integrity of benchmarks, to reduce the risk of manipulation and to guarantee a high level of protection for investors and consumers. The European Benchmarks Regulation¹ (BMR) was published in the Official Journal of the European Union on 29 June 2016. Selected BMR provisions already became effective on 30 June 2016 or 3 July 2016, and the full Regulation has been applicable since 1 January 2018.

¹ *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.*

EXAMPLES FOR BENCHMARKS

- **LIBOR** (London Interbank Offered Rate) is a benchmark expressing the interest rate leading banks would charge each other for unsecured loans. Before the LIBOR fixing scandal, 18 banks submitted daily input data for the calculation of LIBOR to BBA Libor Ltd., a company under private law then responsible for the benchmark's supervision. LIBOR was therefore not based on actual transaction-based data but simply on the estimates of the contributing panel banks. This facilitated the submission of inaccurate interest rates and rate-rigging. Following the scandal, an independent committee created by the UK government installed the ICE Benchmark Administration (IBA) in July 2013 as the new administrator for LIBOR.
- **EURIBOR** (Euro Interbank Offered Rate) is a reference rate for euro interbank term deposits and is published for maturities of one week, two weeks, one month and two, three, six, nine and 12 months. The administrator of EURIBOR is the European Money Markets Institute (EMMI).

The preventive mechanisms laid out in the BMR are supplemented by provisions contained in the Market Abuse Regulation (MAR) and the Market Abuse Directive² (MAD).

The MAR expressly defines the manipulation of benchmarks as a form of market manipulation, and the MAD obliges Member States to impose criminal sanctions in response to any manipulation of benchmarks.

THE BENCHMARKS REGULATION

The aim of the European Benchmarks Regulation is to guarantee the integrity and transparency of financial benchmarks. To achieve this aim, the Regulation creates a preventive regulatory framework, enabling the transparent calculation of benchmarks, contributing to the avoidance of conflicts of interest and eliminating opportunities for manipulation.

It concerns indices used either as benchmarks in financial instruments and financial contracts or to measure the performance of an investment fund.

Index³ within the meaning of the BMR means any figure that is published or made available to the public; that is regularly determined, entirely or partially by the application of a formula or any other method of calculation, or by an assessment; and on the basis of the value of one or more underlying assets or prices, including estimated prices, actual or estimated interest rates, quotes and committed quotes, or other values or surveys.

Benchmark⁴ within the meaning of the BMR means any index:

- by reference to which the amount payable under a financial instrument or a financial contract, or the value of a financial instrument, is determined; or
- that is used to measure the performance of an investment fund with the purpose of tracking the return of such index or of defining the asset allocation of a portfolio or of computing the performance fees.

The Regulation differentiates between critical, significant and non-significant benchmarks (> Table 2 on page 86).

The Benchmarks Regulation applies to the provision of benchmarks (administrators), the contribution of input data to a benchmark (contributors) and the use of a benchmark within the EU (users).

ADMINISTRATORS OF BENCHMARKS

An administrator is a natural or legal person that has control over the provision of a benchmark. Provision of a benchmark means administering the arrangements for determining a benchmark; collecting, analysing or processing input data for the purpose of determining a benchmark; and determining a benchmark through the application of a formula or other method of calculation or by an assessment of input data provided for that purpose. Administrators may outsource one or more of those functions, including the calculation or publication of the benchmark, or other relevant services and activities in the provision of the benchmark to a specifically authorised

² Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC.

³ Article 3(1)(1) of the BMR.

⁴ Article 3(1)(3) of the BMR.

<i>Critical benchmark Article 20 BMR</i>	<i>Significant benchmark Article 24 BMR</i>	<i>Non-significant benchmark Article 26 BMR</i>
<p><i>Benchmark used as a reference for a total value of at least € 500 billion.</i></p> <p><i>or</i></p> <p><i>Benchmark is used as a reference for a total value of at least € 400 billion, has no or very few appropriate substitutes and its non-provision would have significant and adverse impacts</i></p> <p><i>or</i></p> <p><i>Benchmark is based on submissions by contributors the majority of which are located in one Member State where it is recognised as being critical. (Implementing decision by the European Commission, supervision by a college established under Article 46 BMR.)</i></p>	<p><i>Benchmark used as a reference for a total value of at least € 50 billion.</i></p> <p><i>or</i></p> <p><i>Benchmark has no or very few appropriate substitutes and its non-provision would have significant and adverse impacts.</i></p>	<p><i>Benchmark that does not fulfil the conditions laid down in Articles 20 and 24.</i></p>

Table 2: **Benchmarks**

and suitable third party. However, they remain fully responsible for discharging all of their obligations under the Regulation.

Administrators have been required since 1 January 2018 (where the transitional provisions under Article 51 of BMR apply, by no later than 1 January 2020) to be authorised or registered. As soon as they have been authorised or registered, they are subject to supervision by the competent authority.

- Administrators located within the Union are required to apply to the national competent authority for authorisation or registration.
- Administrators located outside the Union (third country administrators) are required to apply to the competent authority of the Member State of reference for recognition.

CONTRIBUTORS OF BENCHMARKS

A contributor is a natural or legal person contributing input data for the benchmark. Input data is data in respect of the value of one or more underlying assets, or prices, including estimated prices, quotes, committed quotes or other values, which the administrator uses to determine a benchmark.

USERS OF BENCHMARKS

Use of a benchmark pursuant to the BMR means one of the following activities:

- issuance of a financial instrument which references an index or a combination of indices;
- determination of the amount payable under a financial instrument or a financial contract by referencing an index or a combination of indices;
- being a party to a financial contract which references an index or a combination of indices;
- providing a borrowing rate as defined in point (j) of Article 3 of Directive 2008/48/EC calculated as a spread or mark-up over an index or a combination of indices and that is solely used as a reference in a financial contract to which the creditor is a party;
- measuring the performance of an investment fund through an index or a combination of indices for the purpose of tracking the return of such index or combination

of indices, of defining the asset allocation of a portfolio, or of computing the performance fees.

The Benchmarks Regulation specifies the conditions under which a supervised entity may use a benchmark or a combination of benchmarks within the EU in great detail, also when a benchmark or a combination of benchmarks may be used by a third country administrator within the Union.

EXEMPTIONS FROM THE SCOPE OF THE BMR

The Benchmarks Regulation does not apply to certain institutions, circumstances or benchmarks. This particularly concerns central banks (for instance with regard to the index provided by the OeNB, the average government bond yields weighted by outstanding amounts) or public authorities that use benchmarks for public policy purposes, including measures of employment, economic activity, and inflation. Central counterparties as defined in Article 2(1) of Regulation (EU) No 648/2012 are also exempt where they provide prices used for CCP risk-management purposes and settlement. The consumer price index provided by Statistics Austria is another exception. The Regulation is also not applicable to the press, other media and journalists where they merely publish or refer to a benchmark as part of their journalistic activities with no control over the provision of that benchmark. These are just a few examples, a complete list can be found in Hahold-Bilzer/Lehecka/Petritz⁵.

ESMA REGISTER

Since 1 January 2018 a supervised company has only been allowed to use benchmarks within the European Union if the benchmark or administrator of the respective benchmark had been included in the register of the European Securities and Markets Authority (ESMA) (later dates may apply where certain transitional rules are in place).

Inclusion in the ESMA Register presupposes:

With regard to EU administrators:

- that they are authorised as administrators of critical or significant benchmarks, and
- that administrators of significant or non-significant benchmarks have been duly registered;

With regard to third country administrators:

- that an equivalence decision had been adopted by the Commission,
- that the administrator has been authorised by the competent authority of the third country in question, and
- that the administrator located in a EU Member State has endorsed a benchmark provided in a third country.

THE AUSTRIAN BENCHMARKS ENFORCEMENT ACT

The Austrian Benchmarks Enforcement Act (RW-VG; *Referenzwerte-Vollzugsgesetz*) was promulgated in the Federal Law Gazette of 17 July 2017 and has essentially been

⁵ Hahold-Bilzer/Lehecka/Petritz: *Die EU-Benchmark-Verordnung – ein Überblick, Europas Antwort auf die Skandale um die Manipulation von LIBOR und EURIBOR [The Benchmarks Regulation – an overview, Europe's reply to the LIBOR and EURIBOR manipulation scandals]*, in: ZFR 11 (2016).

applicable since 1 January 2018. Specifically, the RW-VG stipulates that the Austrian Financial Market Authority (FMA) is the designated competent authority pursuant to Article 40(1) of the BMR and is required to assume any resulting responsibilities and powers, particularly to monitor compliance with the provisions contained in the RW-VG and the BMR. Accordingly, it defines, among other things, the supervisory powers assigned to the FMA, administrative penal measures, penal provisions, provisions related to the disclosure of decisions, provisions related to cooperation with third countries, and cost unit regulations.

AUTHORISATION AND REGISTRATION PROCEDURES

Every natural or legal person located in the European Union intending to act as an administrator of a critical, significant or non-significant benchmark must file an application for authorisation or registration with its competent authority. The competent authority in Austria is the FMA.

The basic difference between authorisation and registration procedures is that authorisation procedures are more extensive in terms of the number of documents that have to be submitted.

Authorisation is obligatory:

- where the administrator provides a critical benchmark;
- where the administrator is a non-supervised entity and provides a benchmark or a commodity benchmark;
- where the administrator is a non-supervised entity and provides a significant benchmark.

Registration is obligatory:

- where the administrator is an entity already subject to supervision pursuant to the BMR but does not provide a critical benchmark or intend to provide one;
- where the administrator is an entity already subject to supervision by the FMA and provides significant and/or non-significant benchmarks or intends to provide them;
- where the administrator is a non-supervised entity and exclusively provides non-significant benchmarks.

The FMA offers a download from its website (currently only available in German) with extensive information for potential administrators, detailing which documents must be submitted with the application for authorisation or registration, the form of the application, as well as any related costs.

Upon their authorisation or registration, administrators of benchmarks become subject to detailed transparency requirements, must meet specific governance requirements, ensure the quality of the input data and clearly define the benchmark determination process, and make sure that the benchmarks generally meet the criteria set out in the Regulation. Administrators and contributors must endeavour to avoid any conflicts of interest as far as possible and, where this is not possible, control and disclose any conflict of interest in an appropriate manner.

It is not only those administrators who were previously unsupervised that are now subject to increased statutory obligations, supervised companies using benchmarks such as banks and insurers are now also subject to regulatory obligations, non-compliance of which will be sanctioned by the FMA.

In its capacity as national competent authority, the FMA must monitor compliance with the provisions of the BMR and the RW-VG in Austria, and take appropriate action to remedy the situation if it encounters any breaches of those provisions. In addition, the Authority also has duties extending across the border, particularly in relation to benchmarks that are used in several jurisdictions. For instance, the FMA is actively involved in the European colleges, working on the critical benchmarks that are used across all of Europe, or at least across borders. The FMA is currently represented in the EURIBOR college, with this benchmark being of particular relevance to the Austrian financial market, and the EONIA (Euro OverNight Index Average) college.

The FMA makes an important contribution to the avoidance of abusive practices in relation to national and international benchmarks. Through the consistent elimination of the risk of manipulation and the far-reaching powers awarded to national competent authorities and international colleges, the new regulatory regime for benchmarks is having a highly positive effect on the stability of the markets and will restore investors' confidence in an orderly functioning financial system. Furthermore, the new rules make a valuable contribution to increasing consumer and investor protection by expanding transparency, guaranteeing the quality of input data and thereby ensuring that benchmarks are reliable and robust.

VIRTUAL CURRENCIES AND ICOs

Oversight challenges

Depending on the structure of the business model, virtual currencies and ICOs may fall within the scope of regulatory regimes – e.g. because virtual currencies and ICOs are very often seen by inexperienced consumers as an investment, although they are highly speculative instruments that can lead to a total loss.

So-called virtual currencies, such as Bitcoin, Ethereum, Ripple and Litecoin, have experienced a multi-year boom worldwide, and unleashed speculative waves around the globe. Recently, another boom has grown out of this hype, which is closely linked to the technology and business models: initial coin offerings. ICOs – based on the term IPOs – represent a kind of crowdfunding, in which a young company is trying to finance itself digitally, in particular by means of a virtual currency.

For regulators and supervisors, these business models pose major challenges: on the one hand, because virtual currencies and ICOs in many cases aim to elude government regulation; although, depending on the structure of the business model, they may nonetheless fall within the scope of regulatory regimes. On the other hand, because virtual currencies and ICOs are very often seen by inexperienced consumers as an investment, although they are highly speculative instruments that can lead to a total loss. Furthermore, experience has shown that such booming markets, which are new and largely unregulated, also have a strong attraction for criminals interested only in swindle and fraud from the outset.

Virtual currencies and ICOs are therefore a major challenge in terms of consumer and investor protection, as well as having the potential to shake confidence and stability in financial markets. In spite of all this, however, the underlying technologies, such as distributed ledgers, blockchains or smart contracts, also hold out great promise for innovative and forward-looking solutions that will benefit established and incoming financial service providers alike.

VIRTUAL CURRENCIES

The European Banking Authority (EBA) defines virtual currencies as the digital representation of a value that is neither issued by a central bank or public authority, nor necessarily attached to a fiat currency. They are accepted by natural or legal persons as a means of payment and can be transferred, stored or traded electronically. They may be referred to as virtual, digital and electronic currencies as well as cryptocurrencies or digital payment instruments. Here, the most commonly used term will be “virtual currency” (VC).

More than 900 different virtual currencies are currently available online, often based on different business models and differing technological solutions. The best known examples are Bitcoin, Ethereum, Ripple and Litecoin. The business models based on virtual currencies range from pure trading, the operation of ATMs and the sale of vouchers for virtual currencies, to the recently booming ICOs.

Despite all the differences in design, virtual currencies generally have the following characteristics:

- They are not issued by a central bank or a public authority.
- Generation, management and transfer are generally carried out using a predetermined mathematical process within a computer network (mining).
- It is a decentralized system: there is no central authority that controls or manages the transactions.
- All transactions are recorded in a publicly maintained ledger, which is claimed to be forgery-proof (usually in a blockchain).
- Once completed, transactions are irrevocable.
- Virtual currencies are digitally stored and managed in electronic wallets.
- It is a peer-to-peer network, communication and transactions are carried out under equal conditions, without differences in hierarchy.
- Acceptance as a means of payment is not obligatory.

RISKS ASSOCIATED WITH THE USE OF VIRTUAL CURRENCIES

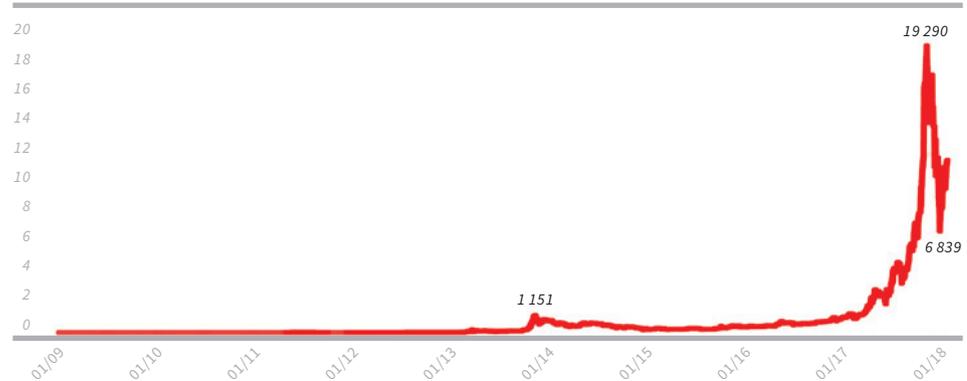
The acquisition of virtual currencies is a highly speculative and risky business. The following risks are typically associated with the use of virtual currencies, which are illustrated using the example of Bitcoin.

VIRTUAL CURRENCIES ARE SUBJECT TO STRONG EXCHANGE RATE FLUCTUATIONS

Conventional currencies are mainly issued by a state central bank, which is generally concerned with ensuring monetary and pricing stability. Central banks therefore intervene in the event of excessively large exchange rate fluctuations, in order to ensure that the most stable possible conditions are maintained for exchanging currencies against goods or other currencies.

This is not the case with virtual currencies. The value of digital money remains unsecured and is determined solely by supply and demand. Virtual currencies are thus prone to strong exchange price fluctuations, making them highly speculative and undermining their usefulness as a means of payment.

Chart 9: **Bitcoin price from January 2009 to January 2018**
(in 1 000 US-\$, source: <https://blockchain.info/de/charts/market-price?timespan=all>)



Bitcoin, for example, has seen extreme price volatility in recent months. Major price gains have been repeatedly countered by massive price falls (> Chart 9). At the same time, strong demand driven by the expectation that the value will rise could also lead to formation of a speculative bubble. As soon as investors are no longer prepared to pay the speculatively high price, the bubble bursts and the price plunges off a cliff. Those who were last to invest sustain the largest losses – in the worst case, a total loss of their invested capital.

TRADING PLATFORMS ARE NOT REGULATED AND ARE NOT SUBJECT TO SUPERVISION

Trading platforms for virtual currencies are not currently subject to any form of supervision by an authority and are, accordingly, free from regulatory oversight. Such platforms are not banks, and the consumer protection regulations under banking law do not apply to them. And there are no other protection mechanisms such as deposit guarantees.

A trading platform may be closed down at any time, and some platforms have in fact already had to cease trading. If a trading platform is shut down, e.g. due to a prohibition against buying, selling and trading of virtual currencies, no form of legal or investor protection exists. This means that 100% of invested capital can potentially evaporate.

IT RISK

There are no statutory minimum IT standards or security regulations for the software used. This implies numerous risks, such as losses arising from hacker attacks, software errors or data loss. Digital wallets are stored on computers, laptops or smartphones, and are therefore also subject to attacks by hackers.

Data is not stored centrally; if the key for a personal wallet is lost, there is no longer any way to access the wallet. There is also no official point of contact for complaints, support or assistance.

NO SPECIAL LEGAL PROTECTION WHEN USING VIRTUAL CURRENCIES

Unauthorised or incorrect transactions cannot be reversed, and there is no responsible contact person for a refund.

The acceptance of virtual currencies like Bitcoin as a means of payment is not guaran-

teed, and remains at the full discretion of the respective transaction partner. There is no legal statute that obliges anyone to accept Bitcoins as a means of payment or that authorises someone to convert Bitcoins into real currencies. There is no guarantee of the permanent existence of individual virtual currencies as a digital means of exchange or payment.

SYSTEMS VULNERABLE TO CRIMINAL ABUSE

Because transactions are very difficult to trace, as recipients and senders remain anonymous, virtual currency transactions can be very easily exploited for the financing of criminal acts, such as money laundering, drug and arms trafficking or child pornography.

And since virtual currencies are neither regulated nor subject to supervision, and it is very difficult to investigate and prosecute fraud on the Internet, such systems are also very vulnerable to being misused for criminal purposes.

POTENTIAL ADVANTAGES OF VIRTUAL CURRENCIES

There are, however, some specific advantages to the use of virtual currencies, which are illustrated here again using the example of Bitcoin.

FAST PAYMENT PROCESSING

Digital transactions are extremely fast. Small transactions can be completed in just a few seconds.

LOW TRANSACTION FEES

Virtual currencies can be transferred for low transaction fees, or no transaction fees at all, as the transaction usually takes place on a peer-to-peer basis without a financial intermediary. This is the case no matter where the virtual currency is transferred to.

ACCESSIBILITY

Access to virtual currencies is via the Internet and is therefore possible at any time worldwide.

DECENTRALISED

The functionality of the Bitcoin system is embedded in its source code. This source code is open source and publicly available. Changes made by an individual are ineffective unless adopted by the majority of participants worldwide.

VIRTUAL CURRENCIES – REGULATION AND SUPERVISION

AUSTRIA

Under the current legal framework, virtual currencies and their systems are not subject to regulation or supervision by the Financial Market Authority (FMA). This is because virtual currencies like Bitcoin are not deemed electronic money within the

The acceptance of virtual currencies like Bitcoin as a means of payment is not guaranteed, and remains at the full discretion of the respective transaction partner. There is no guarantee of the permanent existence of individual virtual currencies as a digital means of exchange or payment.

meaning of the Electronic Money Act (E-GeldG; *E-Geldgesetz*), a means of payment within the meaning of the Austrian Banking Act (BWG; *Bankwesengesetz*) or payment instruments within the meaning of the Payment Services Act (ZaDiG; *Zahlungsdienstegesetz*) due to the lack of an issuing authority.

However, certain business models dealing with virtual currencies may well trigger a licensing requirement or other legal obligation under FMA authority.

Here are some examples of possible virtual currency-related business model characteristics that can trigger a licensing requirement or other obligation:

AUSTRIAN BANKING ACT (BWG)

The acceptance of funds from other parties for the purpose of management or as deposits (deposit business) constitutes a banking transaction pursuant to Article 1 para. 1 no. 1 BWG if carried out for commercial purposes. Management can also consist of investing the money in a virtual currency.

Example: Company A accepts funds from the public in order to invest them at its own discretion in virtual currencies. Investors will be repaid depending on the performance of the investment.

ALTERNATIVE INVESTMENT FUND MANAGERS ACT (AIFMG)

In cases where capital is collected from multiple investors and invested in virtual currencies in accordance with a defined investment strategy, and the benefits (i.e. profits) are passed on to the investors, there are good grounds to suggest the existence of an alternative investment fund within the meaning of the Alternative Investment Fund Managers Act (AIFMG; *Alternatives Investmentfonds Manager-Gesetz*).

Example: Investors receive shares in a company. The investment in virtual currencies is contractually agreed in accordance with a procedure developed by the company founders. The investors share in the returns from these investments.

CAPITAL MARKET ACT (KMG)

A prospectus may also be required under the Capital Market Act (KMG; *Kapitalmarktgesetz*). If, for example, investment products or securities of a company investing in virtual currencies are offered to the public, a prospectus obligation must be assumed; the same applies if funds are invested in a risk sharing group.

Example: The issue documents for participation in a company are published on the Internet. The business activities of the company consist of operating a server farm for the mining of Bitcoins.

PAYMENT SERVICES ACT (ZADIG)

Online platforms for purchasing virtual currencies, which also process payments in euros or any other legal tender, may in turn be subject to a licensing requirement in accordance with the ZaDiG.

Example: Company B operates a platform on which customers can exchange their virtual currencies, and which also settles payment of the purchase prices in euros using their own accounts.

Whether a licensing requirement actually applies very often depends on the details of

the business model. Business models based on virtual currencies must therefore always be evaluated by the FMA on a case-by-case basis. For this reason, the FMA recommends making contact via its specialised FinTech point of contact on the FMA website to clarify all regulatory questions before commencing business.

EUROPE

At European level, as well, virtual currencies are generally free from regulation and supervision.

The European Banking Authority (EBA), however, published its first warning about virtual currencies as far back as December 2013. At the time, it called consumers' attention to the potential risks associated with buying, holding and trading virtual currencies such as Bitcoin.¹

In July 2014, the EBA published its "Opinion on virtual currencies". In this report, it draws attention to more than 70 risks associated with virtual currencies. These risks concern consumers, market participants and regulators and range from the risk of the consumer suffering a total loss, to the risk of an ineffective regulatory response. In this opinion, the EBA also recommends that competent supervisors advise their supervised credit, payment and e-money institutions not to buy, hold or trade virtual currencies.²

On 2 February 2016, in response to the terrorist attacks in France in 2015, the European Commission issued its "Action Plan to strengthen the fight against terrorist financing". Part of this action plan provides for tackling terrorist financing risks linked to virtual currencies; for instance, bringing virtual currency exchange platforms under the scope of the new Anti-Money Laundering Directive.

As a result, the European Commission, the European Parliament and the European Council have decided in a trilogue to amend the Fourth Anti-Money Laundering Directive so as to include exchanges for virtual currencies and so-called custodian wallet providers under the provisions of the Directive:

- Exchanges for virtual currencies fall within the scope of the Directive if they offer the exchange of virtual currencies against payment in legal tender. However, this does not include the exchange of different virtual currencies with each other.
- In any case, custodian wallet providers that manage the cryptographic keys of the holders of virtual currencies (private keys) are subject to the provisions of the Anti-Money Laundering Directive.
- In addition, such providers will be obliged to register in the future.

Furthermore, the amendment to the Fourth Anti-Money Laundering Directive will also, for the first time, include a legal definition of a virtual currency in EU legislation – setting out clear criteria for legal classification.

The FMA welcomes the European decision to address virtual currencies in the anti-money laundering regime, mainly because this move by the European institutions

¹ European Banking Authority (EBA), "Warning to consumers on virtual currencies", <http://www.eba.europa.eu/-/eba-warns-consumers-on-virtual-currencies>

² EBA, "Opinion on virtual currencies" <http://www.eba.europa.eu/documents/10180/657547/EBA-Op-2014-08+Opinion+on+Virtual+Currencies.pdf>

represents an important first step in regulating and supervising the booming virtual financial instruments and services market. It also ensures that, in the future, online service providers will have to identify and verify their customers in the same way as financial institutions in accordance with the relevant due diligence obligations, and continuously monitor transactions.

Following completion of the European parliamentary process, a deadline for implementation of the amendment has been set at 18 months from its entry into force.

INITIAL COIN OFFERINGS (ICOS)

The Austrian market has also been home to increasing numbers of ICOs. The term is based on the English technical term initial public offering (IPO) and represents a kind of digital crowdfunding, in which a young company is trying to finance itself via the Internet using virtual currencies.

As a rule, these ICOs are designed in such a way that they are not subject to regulation and supervision. Under certain conditions, however, they may well constitute a financial service subject to licensing requirements, or fall within the scope of another investor protection framework.

As a regulator and supervisor, the FMA is fundamentally open to new developments and maintains a neutral stance towards technologies. We are therefore duty-bound to advise providers of ICOs as to where there are potential linkages to laws, the supervisory responsibility for which has been conferred upon the FMA.

An ICO, as a rule, is a form of corporate or project financing based on the blockchain technology. During an ICO, capital is mainly collected in the form of virtual currencies. In return the capital providers receive a coin or token from the organiser of the ICO that is connected to the company or project. The coin or token may also take the form of a shareholding in a company, frequently that of a start-up, or a claim to profits to be realised in the future (> *Figure 5*).

Due to the different designs of ICOs in technical, functional and economic terms, it is not possible to provide a one-size-fits-all supervisory law classification of them. An

INITIAL COIN OFFERINGS (ICOS)

ICOs are currently implemented in two main ways:

- either on the basis of smart contracts (program code) or distributed applications (distributed apps/dApps). In simple terms, these are programmed agreements whose computer code is stored on an existing blockchain such as Ethereum.
- or a new blockchain or virtual currency is created for the ICO. Blockchains are forgery-proof, distributed data structures in which transactions are logged, traceable, unchangeable and decentralised.

In both forms, new digital units are generated (token generating event). The generated tokens are usually sold to interested investors in an unregulated public bidding process (token sale). As a rule, investors pay the purchase price in virtual currency, but in some cases also in official (fiat) currency – often in advance.

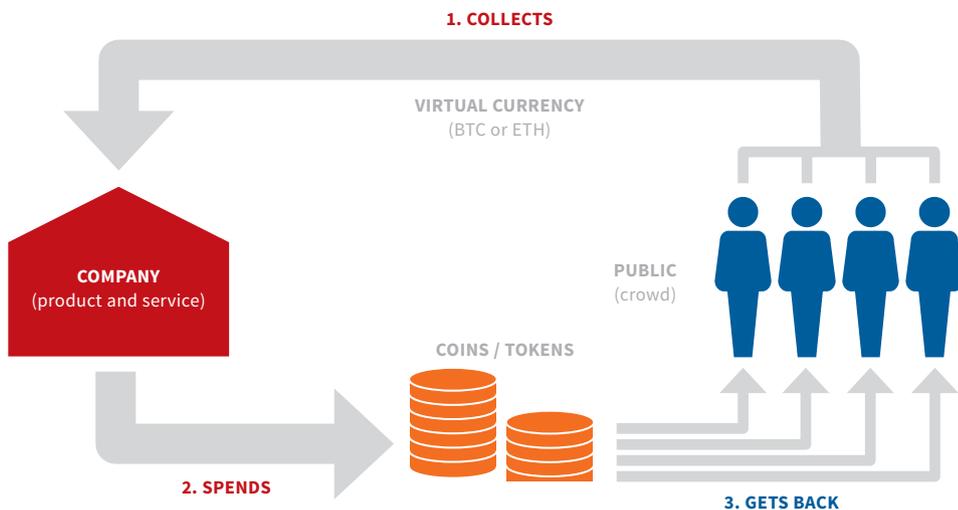


Figure 5: ICO model

assessment under supervisory law must always be based on the specific design of the ICO on a case-by-case basis.

There are currently no specific rules under supervisory law governing ICOs at either Austrian, European or international level. Depending on the specific design of the ICO, there may be some linkages to existing supervisory law. In addition to the specific details regarding the raising and use of the ICO capital, the legal position of the holder of the coin or token is of particular relevance.

A possible licensing requirement – similar to that for virtual currencies and their systems – depends above all on the concrete design of the business model. Below are some examples of possible triggers of a licensing requirement.

AUSTRIAN BANKING ACT (BWG)

If capital is not raised using virtual currencies, but instead by using a legal currency, and the ICO stipulates that the funds raised are to be invested at the discretion of the ICO organiser, and there is a corresponding claim by the investor for repayment, the activity requires a licence for deposit business within the meaning of Article 1 para. 1 no. 1 BWG.

Regardless of the form in which capital is raised (virtual or legal currencies), if the ICO stipulates that the generated coin is intended to be deployed as a payment instrument, the activity may require a licence for issuance and administration of payment instruments in accordance with Article 1 para. 1 no. 6 BWG, depending on the specific design of the ICO.

Article 1 para. 1 no. 11 BWG contains a separate activity requiring a licence, for the participation in underwriting third-party issues in certain instruments (e.g. transferable securities). The process of issuing a tokenised bond for a company, i.e. preparing the issue, taking over ownership of the securities/instruments as well as placing them and any related services would trigger a licensing requirement.

Safekeeping and administration of securities for other parties requires a licence in accordance with Article 1 para. 1 no. 5 BWG (custody business), regardless of the technical manner, e.g. using blockchain and smart contracts.

Further information about the conditions for being granted a licence in accordance with the BWG is available on the FMA website.

2018 SECURITIES SUPERVISION ACT (WAG 2018)

Coins or tokens constitute financial instruments within the meaning of the 2018 Securities Supervision Act (WAG 2018; *Wertpapieraufsichtsgesetz*) There is a strong indication for such a classification if the rights associated with the coin or token are comparable to well-known categories of securities. Voting rights, shares in profits, tradability, the promise of interest payments or the repayment of the capital received at the end of a specific term in particular suggest the existence of a security.

Depending on the design of the coin or token, it may also not be possible to exclude a classification as a financial instrument within the meaning of WAG 2018, for instance where derivatives in other cryptocurrencies are associated with the coin or token.

In such instances, depending on the further characteristics of the ICO, an investment service requiring a licence under WAG 2018 may exist.

Further information about the conditions for being granted a licence in accordance with the WAG 2018 is available on the FMA website.

CAPITAL MARKET ACT (KMG)

In cases where coins or tokens grant the respective holders certain proprietary rights, such as rights to a claim, membership rights or rights in rem (e.g. ownership rights, claims to dividends or repayment, etc.) against the ICO organiser, these may be classified as investments and fall within the scope of the KMG. This applies in particular if the investors form a risk sharing group amongst themselves or together with the issuer. In this case, if the coins or tokens are publicly offered, a prospectus pursuant to the KMG must be published. If, as described above, a transferable security exists, then a securities prospectus as defined in the KMG would be required.

ALTERNATIVE INVESTMENT FUND MANAGERS ACT (AIFMG)

Furthermore, there might also be an obligation to hold a licence in accordance with the AIFMG. In cases where capital is collected from multiple investors and invested in accordance with a defined investment strategy, and the benefits (i.e. profits) are passed on to the coin or token holders, there are good grounds to suggest that an alternative investment fund exists.

Further information about AIFs can be found on the FMA website.

In addition, depending on the design of the coin or token, related activities might require a licence in accordance with the ZaDiG or the E-GeldG.

ANTI-MONEY LAUNDERING PROVISIONS

Where business models are subject to supervision by the FMA, the due diligence obligations for preventing money laundering and terrorist financing – especially in accordance with the Financial Markets Anti-Money Laundering Act (FM-GwG; *Finanzmarkt-Geldwäschegesetz*) – must also be complied with in all cases.

Even if none of the activities fall under the supervision of the FMA in accordance with the FM-GwG, due diligence obligations aimed at the prevention of money laundering

and terrorist financing may in certain circumstances still apply under the Trade Act (GewO; *Gewerbeordnung*). Information on whether a given business is obliged to comply with these obligations can be obtained from the competent trade authority.

At present, neither the virtual currency market nor ICOs are specifically regulated, either nationally or internationally. In other words, they are largely outside the supervision of the authorities responsible for financial markets. Accordingly, investors must always be aware that such financial products, which are as a rule classified as “goods”, carry particularly high risks, which can include a total loss of money invested.

Although virtual currencies in themselves are not at present subject to regulation and supervision, business models based on them – particularly ICOs, depending on their design – may very well fall within the scope of laws the supervisory responsibility for which has been conferred upon the FMA. However, the FMA must assess the concrete contractual details of the business models on a case-by-case basis. For this reason, the FMA recommends that any companies intending to implement such business plans or pursue such financing channels establish contact with its specialised FinTech point of contact, which acts as an exclusive source of information on all licensing and regulatory matters within the integrated supervisory approach.

IT AND CYBER RISKS

The major challenge facing regulators, supervisors and supervised entities

IT and cyber risks now represent one of the most serious threats to businesses, and to financial service providers in particular. This was the finding of the Allianz Risk Barometer, a survey of some 2 000 senior managers and experts from 80 different countries that was conducted for the seventh time in 2018. Cyber crime, IT failure and data breaches were judged to constitute the second largest threat worldwide. Just five years ago they were only ranked as the 15th most serious threat. Yet even the threat posed by business interruption, assessed by experts as the major risk facing companies, is closely linked to IT and cyber risks, as cyber incidents are the most commonly feared trigger of business interruption. This is hardly surprising, with IT and cyber risks estimated to cost the global corporate sector between 400 and 500 billion US dollars every year. Austria's crime statistics now show that the number of instances of cyber crime has risen to more than 10 000.

Meanwhile, companies are growing ever more vulnerable. A Reuters study in 2014 found that more than 25 billion devices were connected worldwide. According to the latest estimates, a further 50 billion devices are expected to have been added by 2020. Moreover, the very efforts undertaken to limit risks by regulatory means can actually entail new risks. The EU's General Data Protection Regulation (GDPR), which enters into force in May 2018, aims to harmonise and strengthen data protection rules across Europe, while also introducing very harsh fines to tackle breaches of the data protection requirements.

THE DIGITAL CHALLENGE

The digital revolution as disruptive technology is, however, already replacing existing

technologies and current products and services, driving these out of the market and fundamentally rewriting the rules of the game. Consequently, supervised companies frequently find themselves confronted with comparatively outdated IT infrastructure, poor data quality and availability, and a lack of any means to aggregate data. Fragmented and weak IT landscapes make companies increasingly vulnerable to attack. The severity of IT risks, however, is often only truly appreciated when they actually materialise, all too often threatening the company's continued existence.

The impact when businesses are hit by IT or cyber risks can take many forms. Financial service providers may suffer huge damage to their public image if they lose customer data. Business operations and links to customers may be brought to a halt for hours or even days if the IT infrastructure fails, and hackers could steal intellectual property as well as data, or even steal or extort money electronically. Then there are also the legal risks associated with all of these situations.

Well-functioning IT systems, a reliable Internet connection and a proactive approach to the opportunities and risks of digitalisation are therefore crucial to the economic survival of today's financial service providers. There is a corresponding increase in the levels of reliability and availability being demanded from the IT infrastructure, with an ever greater need for secure web access and the ongoing challenge of keeping pace with technological progress. Secure and efficient IT based on a flexible, reliable and group-wide architecture will ensure that businesses are able to adapt to new products and services, and is also key if businesses are to incorporate innovation into their business models. IT is also key to efficient cost management. Furthermore, it provides managers with access to the timely, detailed, relevant and up-to-date information that is so necessary for risk management.

IT AND CYBER RISKS AS A SUPERVISORY FOCUS

Given the huge risk potential within IT and global networks in cyberspace, not to mention the importance of well-functioning, secure and efficient systems for businesses and, in extreme cases, for the stability of the markets, IT and cyber risks are becoming an increasing focus of regulatory and supervisory activities.

The design of IT systems and use of external IT services by supervised companies has already had a considerable impact on such areas as cost structure, risk control, gov-

Supervised companies frequently find themselves confronted with comparatively outdated IT infrastructure, poor data quality and availability, and a lack of any means to aggregate data. Fragmented and weak IT landscapes make companies increasingly vulnerable to attack.

CYBER RISKS ARE HERE TO STAY

72% of Austrian companies were the victim of a cyber attack during the past 12 months.

50% of those companies had their business operations interrupted as a consequence.

36% of the companies concerned are unaware of the actual effects the attack had on them.

31% of all cyber attacks were reported to the police/supervisory authorities.

ernance and data quality, and thereby on the company's risk profile. These factors are also considered indirectly in the supervisory process. Large-scale IT projects are often implemented by supervised companies at the suggestion of the supervisor, following an on-site inspection for example, with the supervisor then also contributing to the project design.

Today, however, the regulatory and supervisory challenge lies in ensuring that IT and cyber risks are incorporated into supervised companies' risk management concepts, with appropriate strategies to limit the risks being developed and implemented. These risks need to be identified, evaluated and mitigated using technical and organisational measures in line with international standards. It is also the job of the supervisor to define the relevant requirements and basic parameters.

In its capacity as the competent authority, the Financial Market Authority (FMA) is responsible for checking whether a supervised company's governance system in general and internal control systems in particular provide adequate cover against the risks associated with IT systems and whether the company's management also takes appropriate account of these risks. This also means that the management boards of supervised companies should pursue and communicate an appropriate IT strategy.

DEFINITION OF IT RISKS

The terms IT risk and cyber risk tend to be bandied about in a very vague way and often with different meanings. However, an efficient regulatory and supervisory approach to risk needs clearly defined and categorised risks. With this in mind, the European Banking Authority (EBA) has categorised and defined IT and cyber risks as follows in its final report entitled "Guidelines on ICT Risk Assessment under the Supervisory Review and Evaluation Process (SREP)" (EBA/GL/2017/05, 11 May 2017):

1. ICT availability and continuity risk:

- business continuity management, failure of ICT hardware or software components, data backups;

2. ICT security risk:

- risk of unauthorised access to ICT systems and data from within or outside the institution,
- physical security (e.g. at data centres);

3. ICT change risk:

- risks caused by faulty/unstable systems,
- project risks, particularly in relation to large and complex projects;

4. ICT data integrity risk:

- completeness, accuracy and consistency,
- primary data quality (data in the systems used to run the business), merger of data;

5. ICT outsourcing risk:

- risks in relation to the outsourcing of IT services and reliance on service providers.

All of these risk types must form part of the supervisor's risk assessment. The FMA must check how the business identifies, monitors, assesses and reduces material IT risks. When assessing risk types, the IT risk profile of the company in question should also be considered.

IT STRATEGY

The supervised company's management body is responsible for developing, setting up and monitoring the IT strategy, which must be clearly defined and appropriate for the business strategy. The IT strategy must be regularly updated and at least cover the following areas:

- strategic further development of the organisational and operational IT structure in place at the credit institution and use of external IT services;
- internationally accepted standards and best practices;
- responsibilities for and integration of information security within the credit institution;
- strategic development of the IT systems;
- incident management;
- planned role of IT in the future;
- use of end-user computing (EUC).

Based on the IT strategy, the companies should develop and implement guidelines for their organisational and operational IT structure. These must be regularly updated to ensure that any relevant changes to the credit institution's activities and processes are incorporated on a timely basis. Action must also be taken to ensure that the guidelines are implemented effectively in practice.

IT GOVERNANCE AND INTERNAL MANAGEMENT

The supervisor is required to review whether the business has established clear remits and responsibilities in relation to the identification, assessment, monitoring, reduction and reporting of the related material IT risk. In this regard it is particularly important:

- that the areas of responsibility and remits are clearly communicated, allocated and embedded in the company;
- that the IT risk management activities are performed to a sufficiently high level and that technical resources are in place to assess the credibility of the applicable risk. The responsible authorities should also evaluate whether the institution has sufficient financial means at its disposal and/or other resources needed for implementation;
- that the executive body is able to monitor and react appropriately to key findings from the independent control function;
- that exceptions to applicable IT rules and guidelines are recorded, and that these are documented and reviewed by the independent control function with the focus on the related risks, with reporting where necessary.

INTERNAL AUDIT

The internal audit unit has an important role to play in monitoring IT risks. It is responsible for regularly reviewing IT risks, and including all critical functions in this review process. The scale of the review should be tailored to the institution's size, activities and IT risk profile. All major findings, including the measures agreed, should be reported to management and/or the audit committee. All critical outcomes, remedial measures and implementation of the agreed measures should be monitored

on an ongoing basis and recorded in a progress report, which is to be checked by the management and/or audit committee.

A cybersecurity incident, regardless of whether triggered externally or from within, can therefore have a serious impact on all of a credit institution's activities. Consequently, risk management must take due account of cyber threats and implement the processes needed to reinforce cybersecurity.

CYBERSECURITY MANAGEMENT

Credit institutions are using ever more complex and connected IT systems. The range and volume of Internet and mobile banking solutions on offer is also growing all the time. A cybersecurity incident, regardless of whether triggered externally or from within, can therefore have a serious impact on all of a credit institution's activities. Consequently, risk management must take due account of cyber threats and implement the processes needed to reinforce cybersecurity.

The risk management concept for handling cyber risks must at least cover the following aspects and guarantee effective implementation via appropriate processes and clearly defined roles, remits and responsibilities:

- identification of company-specific threats from cyber attacks, particularly in terms of critical and/or sensitive data and IT systems;
- protection of business processes and technological infrastructure from cyber attacks, especially as regards the confidentiality, integrity and availability of critical and/or sensitive data and IT systems;
- timely detection and recording of cyber attacks using a process for the systematic monitoring of the technological infrastructure (cybersecurity incident detection);
- response to cyber attacks in the form of rapid, targeted measures and in conjunction with business continuity management (BCM) in the event of material cyber attacks that pose a risk to the normal continuation of business activities;
- guarantee of the quick reintroduction of normal operations following a cyber attack by means of appropriate measures (cybersecurity recovery plan).

It is also up to the institutions, in the event of a general or global cybersecurity incident, to create the conditions needed for efficient and effective cooperation with

THE MAIN RULES AND REGULATIONS GOVERNING IT AND CYBERSECURITY

- BCBS 239 – Principles for effective risk data aggregation and risk reporting
- EBA Guidelines on ICT Risk Assessment under the Supervisory Review and Evaluation Process (SREP), (EBA/GL/2017/05)
- SSM Cyber Incident Reporting & Cyber Incident Emergency Process (CIEP)
- EBA Draft Recommendations on Outsourcing to Cloud service providers under Article 16 of Regulation (EU) No 1093/2010
- Directive (EU) 2015/2366 on payment services in the internal market (PSD2)
- Directive (EU) 2016/1148 concerning measures for a high common level of security of network and information systems across the Union (NIS Directive; implementation by May 2018)
- EBA Draft Guidelines on fraud reporting requirements (EBA/CP/2017/13)
- EBA Guidelines on the security measures for operational and security risks of payment services under PSD2 (EBA/GL/2017/17)
- EBA Guidelines on major incident reporting under PSD2 (EBA/GL/2017/10)

external bodies too, such as computer emergency response teams (CERTs), government authorities, telecom providers or ISPs, and similar third parties.

The following test methods and practices should also be applied in the context of a cybersecurity management concept:

- **Vulnerability analysis:** Vulnerability analyses should be conducted regularly in order to pinpoint and evaluate any security holes in systems and processes. Based on the potential vulnerability, any weak points should be removed with subsequent checks to determine whether the gaps in security have been fully remedied.
- **Scenario-based tests:** The response and business recovery plans put in place by a credit institution must be regularly reviewed and tested. A sufficiently broad range of different scenarios should be used during the testing, including the simulation of extreme but plausible cyber attacks. The tests must also question assumptions about reacting to attacks and recovery plans, including governance rules and communication plans. Cyber threat intelligence and cyber threat modelling should be used as much as possible in order to imitate the unique characteristics of a cyber threat. Practical drills are also required in order to test the processes and employees' skills, and also for staff training purposes. Such an approach also improves a business's resilience.
- **Penetration tests:** Penetration tests can be used to identify any weaknesses that could negatively affect systems, networks, employees or processes. In order to carry out a thorough assessment of credit institutions' system security, the aim of these tests is to simulate real attacks on the systems themselves. Penetration tests on Internet-based systems should be carried out at any rate when updated systems have been put in place. The tests should also encompass other stakeholders from the business area such as, for example, those who are involved in business continuity, incident and crisis response teams, as well as third parties such as service providers. Security audits should be carried out by bodies that, if not external to the company concerned, are at least impartial.
- **Red team tests:** Red teams can be deployed to test potential vulnerabilities in an institution's own organisational structure or to look into external dependencies, as well as the effectiveness of a credit institution's control systems. A red team may be composed of a credit institution's own staff and/or external experts. The team members should always be independent of the function being tested.

Given that the regulation and supervision surrounding IT and cyber risks is a dynamically changing field, the FMA, in its capacity as supervisor, will continue in its tried-and-tested approach of engaging in proactive dialogue with the supervised entities and all stakeholders in order to achieve as high a level of understanding as possible for the challenges at stake, doing so in a focused manner but with the necessary sense of proportion.

REGTECH

Digitalisation in regulation and supervision

RegTech, or regulatory technology, is any innovative technology that is used to meet regulatory and compliance requirements. It encompasses a variety of different applications and areas of use, and affects supervisory authorities and companies alike.

Systems to accelerate and simplify internal auditing and processes relating to supervision have been developed on an ongoing basis in recent decades. From this perspective, RegTech is nothing new. Over the past few years, however, the digital revolution, global networks, big data, artificial intelligence, biometrics, cloud computing, distributed ledger technology and much more besides have provided such a boost to innovation that the term RegTech has been coined in allusion to FinTech. This technological revolution in regulation has been encouraged by favourable global trends that have accompanied the digital transformation and its resulting technological implementations.

- As a lesson of the global financial crisis of 2007/2008, the mantra of self-regulation of the markets that had previously resulted in deregulation both horizontally and vertically was once again consigned to the scrapheap. The ensuing root-and-branch reforms and swift succession of many new rules and regulations were all consistent with the new objective that no market, no product, no provider should be able to operate further without regulation and supervision.
- The digital revolution brought new products, new technical solutions and new providers (FinTech) to compete with the establishment, many members of which adapted their business models and fundamentally changed their form. Businesses old and new today operate far more within networks, integrating external service providers much more frequently.

- Consumer IT affinity and literacy is improving rapidly; the new generation of digital natives who have grown up with the Internet, electronic banking, smartphones and social media is taking over the markets and businesses. And regulators, supervisors and authorities have also long since been swept up in and changed by this development.
- The complexity, cost and effort involved in compliance processes for financial service providers have increased considerably, and this trajectory is continuing.
- Communication with national and European authorities is intensifying massively; the associated data volumes are rocketing.
- Correspondingly, the authorities are also open to the use of new technologies.

RegTech ranges from an individual application providing system support to an entire armoury of systems and tools to interact with clients or employees, or solve problems autonomously. A substantial array of impressive applications are already in use in a number of regulatory environments. These include regulatory reporting, customer due diligence and KYC processes to help prevent money laundering, for example, risk management, cybersecurity, customer communications monitoring and documentation – especially with regard to advisory, and deep-learning systems that monitor data to fight fraud, insider trading and market manipulation, not to mention digital simulations used in stress testing. There are other fields of use too, beyond these key areas. The spectrum of potential fields for RegTech is as broad as the range of pioneering innovations and technological developments of recent years: sophisticated tools for data analysis and preparation, big-data developments, cloud computing, application programming interfaces (APIs) and new, machine-readable data formats, distributed networks, blockchain technology and automated legal transactions (smart contracts), tokenisation and cryptographic processes, as well as smart algorithms and AI. All of these technologies can also be used in regulatory processes.

RegTech ranges from an individual application providing system support to an entire armoury of systems and tools to interact with clients or employees, or solve problems autonomously. A substantial array of impressive applications are already in use in a number of regulatory environments.

REGTECH AT THE FMA

Digitalisation is not simply an empty buzzword at the Austrian Financial Market Au-

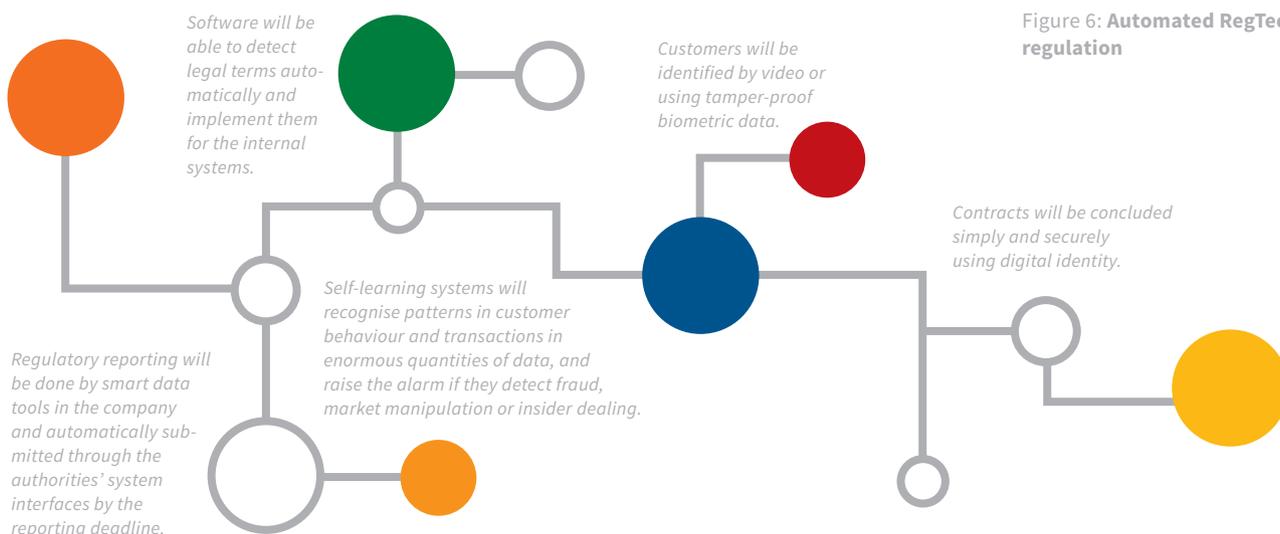


Figure 6: Automated RegTech regulation

thority (FMA). We firmly believe that as an authority we must exploit and can direct technological progress. Constantly refining our IT architecture and internal databases, such as for our own interpretation of the law, and developing Sharepoint solutions to foster collaborative working only reflects part of our desire for greater efficiency in our regulatory work. While other authorities still carry out their administration roles with long paper trails, the Elektronische Akt (ELAK) electronic filing system has been part of the furniture at the FMA for over a decade. All of the staff involved in a given case, whether they work for the FMA, or even at the Oesterreichische Nationalbank (OeNB), can access the files they need in a matter of seconds to work on them simultaneously and ultimately seal the case with their official digital signature.

A range of other specialist RegTech applications has also already been implemented. These include the following:

REGULATORY REPORTING

Supervised companies have a statutory obligation to report various pieces of data, facts and figures at regular intervals and to submit information and documents to the supervisory authority. The volume of data to be submitted increases year on year. Back in 2010 the FMA introduced its electronic “Incoming Platform” to simplify the process for both parties, the supervised entities and the supervisory authority. The platform can be accessed easily via the FMA and OeNB’s websites and uses a standardised format. The data is transmitted securely. The Incoming Platform has even been enshrined in law: credit institutions and payment institutions, investment service providers, insurance undertakings and *Pensionskassen* (pension companies) must now comply with their statutory reporting and information obligations electronically using the Incoming Platform.

The Banking and Insurance Supervision Departments now prepare the reported data in the form of data cubes. This unified data model means that the large volumes of data that insurance undertakings and banks are required to report under Solvency II on the basis of the Austrian Banking Act (BWG; *Bankwesengesetz*) can be queried and classified quickly, efficiently and effectively. A multi-dimensional data matrix is formed, producing a data cube in which the individual transactions are enriched with attributes and additional information in the form of KPIs. Flexible documents and evaluations can be extracted from these smart cubes. It is no longer necessary for the institution to send in new data for each new query. It is also possible to zoom in on the data to various levels of granularity, as well as to cut and aggregate information in many different ways across multiple dimensions.

Our banking supervision partner the OeNB has worked on the development of the uniform data model in collaboration with the major Austrian banking groups. The banking groups then implemented this model in a dedicated company, Austrian Reporting Services GmbH (AuRep). A shared software platform called ABACUS/GMP is used as an interim data repository. The participating banks can submit their statutory regulatory reports automatically and efficiently through ABACUS/GMP. AuRep is one of Europe’s largest “reporting factories”, and is capable of adding in further future technologies. This impressive Austrian development for vertical integration of reporting has long attracted international interest. The vision and aim is to automate as

much as possible of the entire reporting cycle and handle it with the least amount of human intervention.

MARKET SUPERVISION

The FMA has developed the Alert Surveillance Tool (AST), its own analysis instrument to support the observation of the market and detection of market manipulation. AST analysis inputs from trade and order data, ad hoc reports, financial analysis and other data. All transactions in financial instruments that are admitted to trading on the Vienna Stock Exchange or included in trading are stored in the FMA database, irrespective of where the transaction takes place within the European Union. Unusual trading in these financial instruments on the Austrian market is detected on the basis of statistical analysis of prices and volumes, and a combination of price movements and the disclosure of insider information and directors' dealings reports. Between one and two million orders or transactions are processed every day. The alarms triggered by AST form the basis for further investigations.

Another utility called the Order Book Reconstruction Tool allows the actual order book comprising all of the orders and executions of the traded securities to be reproduced. The FMA can use this information to analyse, reconstruct and visualise abnormal trading patterns by market participants. Algorithms built in to the tool, such as those used to detect high frequency traders, represent a significant support for the discovery of market manipulation. Consequently, it assists the human supervisor, adding a weapon to the arsenal.

These tools are under constant development, with new alarm triggers being designed in particular. And they must also be regularly adjusted to take account of changes in regulation.

ANTI-MONEY LAUNDERING

The FMA has introduced a Risk Scoring Tool to support its activities in the field of preventing money laundering and terrorist financing. It implements the risk-based approach according to which the intensity and level of supervision is commensurate with the risk inherent in a specific business model operated by a supervised entity. The supervised companies must submit electronic information, in particular in relation to their products (e.g. private banking, cash transactions) and client structure (e.g. off-shore destinations, number of politically exposed persons). The data is processed by an algorithm that takes account of the quality of the institutions' respective risk systems and prevention measures, calculating an individual risk classification for each company. The FMA then uses this risk classification to prepare its own inspection plans. Concerted efforts have been made by the FMA to ensure that the supervised companies can also use video technology to identify clients as part of their KYC processes. In 2016 legislation caught up with the FMA's initiative in this regard with the Financial Markets Anti-Money Laundering Act (FM-GwG; *Finanzmarkt-Geldwäschegesetz*)¹. Consequently, since 2017 it has been possible to establish and verify a customer's identity using an electronic video-based process. Naturally, whenever the person wishing to enter into

The FMA has developed the Alert Surveillance Tool (AST), its own analysis instrument to support the observation of the market and detection of market manipulation. AST analysis inputs from trade and order data, ad hoc reports, financial analysis and other data.

¹ Federal Law Gazette I No. 118/2016 as amended, accessible from <https://www.ris.bka.gv.at/defaultEn.aspx>.

a customer relationship is not physically present the risk increases. The FMA has issued its own regulation that establishes corresponding organisational and procedural security measures governing how such identification processes should be operated.² For example, the regulation stipulates the way in which a suitably trained employee should verify the authenticity of a personal identity card during a video identification procedure.

REGTECH IN BUSINESSES

Customer due diligence processes are increasingly being enhanced by the use of algorithms that offer more efficient and effective customer risk classification thanks to their ability to evaluate large volumes of data from a range of sources. However, major discussions are ongoing into whether open source solutions should be used or even whether companies may be permitted to use bought-in data.

How to balance broad data access to improve security for the stability of the financial market and investors against the resulting intrusion on customers' data privacy remains a contentious political issue. "Data cultures" have developed in different directions over recent years across Europe, with some countries displaying a significantly greater acceptance of comprehensive data processing and data transparency than others. The EU's General Data Protection Regulation (GDPR) will impose a strict framework around data retention and usage by businesses, and it is not yet entirely clear how these restrictions will limit RegTech applications. What personal information from the Internet can be used by an AI algorithm to calculate a credit rating, for example? Is the person concerned able to influence this?

Less concerning from the perspective of specific customers is the use of artificial intelligence for scenario analysis in stress testing. Algorithms allow many different scenarios to be calculated at great speed, and these can be adjusted in real time to reflect each business's current situation.

Companies can also use such algorithms to improve search and classification systems, as well as communication systems, and introduce real-time monitoring. Some companies have already deployed tools that process language patterns to establish where bad advice is provided and why. These can identify patterns and anomalies, and reveal risks for the companies or suggest improvements. Taking a simple example, when the frequency of critical customer telephone calls increases in a large, opaque organisation, it is possible to focus on the department from which the majority originate and analyse the situation in detail.

In fields like blockchain technology and smart contracts, a number of fundamental legal issues must be clarified before these can be used broadly in the regulated and supervised domain. A blockchain can be used to record payments in virtual currencies or any other assets that can be converted into a data format and transferred between people in a network. Smart contracts are programs that "sit" on the blockchain and automatically execute trading instructions and trigger transfers without the need for any human intervention. In their current form they are generally used for the settle-

² *Online Identification Regulation (Online-IDV; Online-Identifikationsverordnung)*, Federal Law Gazette II No. 5/2017, accessible from <https://www.ris.bka.gv.at/defaultEn.aspx>.

ment of already agreed contracts rather than for contracts in the legal sense. For the participants of a blockchain network, the legal effect of transfers is still not clear in many areas. At what point does the transfer of property occur? How do you deal with an absence of intention if transactions cannot be reversed? While an entirely distributed network might provide a high degree of transparency, there is nobody to turn to if something goes wrong.

Nevertheless, the first blockchain projects are already being used for transfers that are purely for the purpose of information, such as the exchange between authorities and businesses of notifications through distributed protocols to allow self-updating and querying of register entries (known as “compliance on demand”). Regulatory reporting is a particularly worthwhile area for innovation in this respect. However, the visionary spirit of optimism must first pass the test of technical and regulatory practice in many areas.

And a golden thread must be stitched into all of the vision, innovation and euphoria – ultimate responsibility for the use of RegTech within a company is with the supervised entity itself, which must assess and manage the associated (operational) risks appropriately and take suitable precautions. The FMA itself is deeply engaged with RegTech, investigating its potential for improving the efficiency and effectiveness of its activities and processes. As a regulator and supervisor it remains open to innovation and is always technology-agnostic.



LEGAL DEVELOPMENTS

Major changes in national and European financial market legislation

Austrian and European financial market legislation has changed markedly over the past ten years. The lessons learned from the global financial crisis had to be transposed into workable laws, while the legislation also needs to keep pace with the technological changes in the financial sector. Additionally, investor and consumer protection featured highly on the legal agenda, and strict transparency requirements contributed to the development of modern and efficient markets. As the Austrian economy is predominantly based on small and medium-sized companies, the Austrian Financial Market Authority (FMA) stands for the principle of proportionality in regulation and supervision in order to ensure that the proven diversity on the Austrian market can be maintained. The following section provides a summary of recent major changes to the legislation that falls within the FMA's scope of enforcement.

NATIONAL LEGISLATION

CHANGES TO EXISTING LAWS

Benchmarks Enforcement Act (RW-VG; *Referenzwerte-Vollzugsgesetz*), Federal Law Gazette I No. 93/2017

The RW-VG is the accompanying act to Regulation (EU) 2016/1011, the Benchmarks Regulation. The Act designates the FMA as competent authority and lays down its powers in this area.

2017 SME Finance Company Act (MiFiGG 2017; *Mittelstandsfinanzierungsgesellschaftengesetz*), Federal Law Gazette I No. 106/2017

The MiFiGG 2017 created the "SME finance company", a new type of alternative invest-

ment fund (AIF), to facilitate access to equity for small and medium-sized companies, particularly during the set-up and growth phases. This new type of AIF can also be distributed to retail customers. In addition, the MiFiGG 2017 generally eases the requirements for registered and authorised alternative investment fund managers (AIFMs) selling AIFs to (qualified) retail customers.

MiFID II Implementation Act, Federal Law Gazette I No. 107/2017

This Act serves to transpose Directive 2014/65/EU, the Markets in Financial Instruments Directive II (MiFID II), and Regulation (EU) No 600/2014, the Markets in Financial Instruments Regulation (MiFIR). The Stock Exchange Act (BörseG 2018; *Börsegesetz*) and the Securities Supervision Act (WAG 2018; *Wertpapieraufsichtsgesetz*) have been re-enacted and numerous other supervision laws amended. MiFID II strengthens trade transparency by expanding transparency requirements and introducing new requirements for trading on multilateral trading venues. The existing multilateral trading venues, namely regulated markets and multilateral trading facilities (MTFs), are extended to include a new trading venue category of organised trading facility (OTF) as a further trading venue. Product governance requirements, more comprehensive information requirements and an extended ban on accepting commissions ensure a higher level of investor protection. Investment firms from third countries are subject to a specific authorisation regime. In addition, supervisory authorities now have the power to limit or prohibit the distribution of products. Finally, the Act harmonises the existing penal provisions with those contained in European legislation. The BörseG 2018 also marks the end of the second regulated market, with the official market now the only regulated market.

The Financial Market Authority Act (FMABG; *Finanzmarktaufsichtsbehördengesetz*) now provides the FMA with far-reaching powers to refrain from imposing fines, and the principle of cumulation has been replaced by an absorption principle in administrative penal law. The latter means that where several or continuous breaches have been committed, each offence will not be punished individually – or cumulatively – but all offences are to be punished in their entirety in an appropriate manner.

The Act's key provisions entered into force on 3 January 2018.

2018 Data Protection Adaptation Act (*Datenschutz-Anpassungsgesetz 2018*), Federal Law Gazette I No. 120/2017

This Act brings the 2000 Data Protection Act (DSG 2000; *Datenschutzgesetz*) into line with Regulation (EU) 2016/679, the General Data Protection Regulation (GDPR), and implements Directive (EU) 2016/680 on the protection of natural persons with regard to the processing of personal data by competent authorities for the purposes of the prevention, investigation, detection or prosecution of criminal offences or the execution of criminal penalties. Since the GDPR is a directly applicable EU Regulation, all major elements of data protection law are now exclusively regulated at European level. The DSG 2000 specifies supplementary provisions.

Beneficial Owners Register Act (WiEReG; *Wirtschaftliche Eigentümer Registergesetz*), Federal Law Gazette I No. 136/2017

The WiEReG implements Directive (EU) 2015/849, the Fourth Anti-Money Laundering

Directive, creating a nationwide register to record the beneficial owners of legal entities to be kept at the Federal Ministry of Finance. Credit institutions, insurance undertakings, investment firms and investment service providers, AIFMs, electronic money institutions and payment institutions may inspect the register to meet their obligations pursuant to the Financial Markets Anti-Money Laundering Act (FM-GwG; *Finanzmarkt-Geldwäschegesetz*).

Amendment to the 1994 Trade Act (GewO; *Gewerbeordnung* – Anti-Money Laundering Amendment), Federal Law Gazette I No. 95/2017, and of the 2014 Senior Accountant Act (BiBuG 2014; *Bilanzbuchhaltungsgesetz*), Federal Law Gazette I No. 135/2017, and issuance of the 2017 Auditing, Tax Advising and Related Professions Act (WTBG 2017; *Wirtschaftstreuhandberufsgesetz*), Federal Law Gazette I No. 137/2017

These amendments transpose Directive (EU) 2015/849, the Fourth Anti-Money Laundering Directive, and the relevant aspects pertaining to trade law, senior accountants, tax advisers and auditors into Austrian law. Traders are now required to identify their customers when they make or receive cash payments of € 10 000 or more, a threshold that has been lowered from the previous € 15 000. The risk-based approach has been strengthened for senior accountants, tax advisers and auditors, while enhanced customer due diligence is now obligatory for politically exposed persons (PEPs).

Amendment to the Austrian Banking Act (BWG; *Bankwesengesetz*), the FMABG and others (supervisory reform), Federal Law Gazette I No. 149/2017

The 2017 reform of Austria's supervisory system covered a number of measures affecting Austrian financial market supervision, intended in particular to bolster risk-orientation and efficiency in supervision. This includes both changes to the organisation of supervision and simplified requirements for credit institutions, taking greater account of the principle of proportionality. Please refer to page 14 for a more detailed report on the supervisory reform.

Amendment to the BWG, the 2011 Investment Fund Act (InvFG 2011; *Investmentfondsgesetz*), the 1984 Nationalbank Act (NBG 1984; *Nationalbankgesetz*) and to the WiEReG, Federal Law Gazette I No. 150/2017

This amendment adapts Austrian regulatory reporting to Regulation (EU) 2016/867 of the European Central Bank on the collection of granular credit and credit risk data (AnaCredit Regulation). Additionally, investment fund management companies, real estate investment fund management companies and corporate provision funds are relieved from the reporting obligations pursuant to Article 75 BWG.

Amendment to the Consumer Payment Account Act (VKZG; *Verbraucherzahlungskontogesetz*), Federal Law Gazette I No. 158/2017

The amendment restricts the charging of fees to consumers for cash withdrawals from payment accounts. First, the account-servicing payment service provider may only charge their customers a separate fee for cash withdrawals if this was negotiated with the consumer on an individual basis. Institutions are required to at least offer consumers

the option of choosing a payment account that charges a flat rate for cash withdrawals. Second, fees charged by independent operators of ATMs for cash withdrawals must not be passed on to consumers by the account-servicing payment service provider.

FMA REGULATIONS

Life Insurance Due Diligence Regulation (LV-SoV; *Lebensversicherung-Sorgfaltspflichtenverordnung*), Federal Law Gazette II No. 1/2017; School Savings Schemes Due Diligence Regulation (Schulspaar-SoV; *Schulsparen-Sorgfaltspflichtenverordnung*), Federal Law Gazette II No. 2/2017; Amendment to the Regulation on Savings Associations (SpVV; *Sparvereinverordnung*), Federal Law Gazette II No. 3/2017; Corporate Provision Funds Risk Analysis and Due Diligence Regulation (BVK-RiSoV; *BVK-Risikoanalyse- und Sorgfaltspflichtenverordnung*), Federal Law Gazette II No. 4/2017; Regulation on Due Diligence for Fiduciary Accounts (AndKo-SoV; *Anderkonten-Sorgfaltspflichtenverordnung*), Federal Law Gazette II No. 7/2017

Based on the FM-GwG, these regulations determine a low risk of money laundering and terrorist financing for certain life insurance policies (LV-SoV), school savings schemes (Schulspaar-SoV), certain fiduciary accounts held by attorneys, notaries or real estate managers (AndKo-SoV) and in relation to the operations of corporate provision funds (BVK-RiSoV). Insurance undertakings, credit institutions and corporate provision funds are therefore entitled to apply simplified due diligence. Furthermore, corporate provision funds are exempt from the obligation to perform an internal ML/TF risk assessment. Lastly, the SpVV has also been aligned with the FM-GwG.

Online Identification Regulation (Online-IDV; *Online-Identifikationsverordnung*), Federal Law Gazette II No. 5/2017

The Online-IDV enables obliged entities to determine and check the identity of their customers by means of a video-based electronic procedure, in accordance with the FM-GwG.

Amendments to the FMA Regulation on the Incoming Platform (FMA-IPV; *FMA-Incoming-Plattformverordnung*), Federal Law Gazette II No. 52/2017 and No. 391/2017

Following numerous amendments of federal acts, the FMA-IPV was adapted accordingly. The legal options for branches in Member States to make submissions were expanded, reflecting current practice. Moreover, the notification of those responsible pursuant to the Administrative Penal Act (VStG; *Verwaltungsstrafgesetz*) was also added to the list of obligatory electronic submissions.

Amendment to the 2013 Regulation on the Provision for Administrative Expenses (VKRStV 2013; *Verwaltungskostenrückstellungsverordnung*), Federal Law Gazette II No. 92/2017

This amendment lowers the maximum assumed interest rate for the provision according to the business plan for administrative expenses incurred after the beginning

of retirement from previously 3% to 2%. The current capital market situation is the reason for this reduction. *Pensionskassen* have up to ten years to gradually offset any underfunding arising from the amendment.

Amendment to the Regulation on the Annex to the Audit Report for Payment Institutions (ZAPV; *Verordnung über die Anlage zum Prüfungsbericht für Zahlungsinstitute*), Federal Law Gazette II No. 93/2017; Amendment to the Regulation on the Annex to the Audit Report for Electronic Money Institutions (EGAPV; *Verordnung über die Anlage zum Prüfungsbericht für E-Geld-Institute*), Federal Law Gazette II No. 94/2017; Amendment to the Regulation on the Annex to the Audit Report (AP-VO; *Verordnung über die Anlage zum Prüfungsbericht*), Federal Law Gazette II No. 95/2017

These regulations were amended to reflect the provisions of the FM-GwG. The AP-VO additionally introduces a new audit module to record observations by the bank auditor in connection with Regulation (EU) 2015/2365, the Securities Financing Transactions Regulation, and the Austrian SFT Enforcement Act (*SFT-Vollzugsgesetz*).

Amendments to the Regulation on Asset, Income and Risk Statements (VERA-V; *Vermögens-, Erfolgs- und Risikoausweis-Verordnung*), Federal Law Gazette II No. 100/2017 and No. 277/2017

Two new annexes were added to the VERA-V. According to Annex A3g credit institutions are required to report the number of complaints received. According to Annex G1 large credit institutions and groups of credit institutions with total assets of more than € 5 billion must submit their finance plans. Both amendments were made in order to implement European guidelines (JC 2014 43, EBA/GL/2014/04). The period to submit the asset statement (Annex A1a) and the income statement (Annex A2) was extended from the sixteenth to the twentieth banking day from the end of the quarter.

Liquidity Risk Management Regulation in relation to Investment Funds (InvF-LRMV; *Investmentfonds-Liquiditätsrisikomanagementverordnung*), Federal Law Gazette II No. 117/2017

In this case, the FMA specifies the statutory requirements pertaining to the liquidity risk management of undertakings for collective investment in transferable securities (UCITS). Specifically, UCITS management companies are required to conduct stress tests to assess liquidity risk at least monthly. The requirements are guided by existing European legislation relating to the liquidity management of AIFs (Articles 46 to 49 of Commission Delegated Regulation (EU) No 231/2013).

Amendments to the Trading Transparency Exceptions Regulation (HTAusV; *Handelstransparenzausnahmen-Verordnung*), Federal Law Gazette II No. 172/2017 and No. 203/2017; HTAusV 2018, Federal Law Gazette II No. 387/2017

These amendments adapt the provisions pertaining to iceberg orders on regulated markets and MTFs. Iceberg orders are limit orders where those portions of an order that are invisible only become visible once the previously visible portion has been fully completed. The HTAusV was replaced by the HTAusV 2018 as of 3 January 2018. The

HTAusV 2018 has adopted the existing exemptions for pre-trade and post-trade transparency in relation to equity instruments and now also covers waivers for equity-like financial instruments and non-equity instruments in accordance with the wider transparency obligations under MiFIR. At the same time, a waiver of the obligation for systematic internalisers to make public their quotes in relation to illiquid non-equity instruments has been included, along with a waiver of the obligation to publish customer limit orders that were not executed, an exception carried over from the previous law.

2018 Disclosure and Reporting Regulation (VMV 2018; *Verbreitungs- und Meldeverordnung*), Federal Law Gazette II No. 205/2017

The VMV 2018 replaces the previous VMV and includes modifications in accordance with Regulation (EU) No 596/2014, the Market Abuse Regulation, and Directive 2014/65/EU (MiFID II).

Amendments to the FMA Fee Regulation (FMA-GebV; *FMA-Gebührenverordnung*), Federal Law Gazette II No. 206/2017 and No. 388/2017

The FMA-GebV was adapted to reflect the changes in statutory provisions. The amendment introduces, for instance, new cases for fees to be charged by the FMA in accordance with the Deposit Guarantee Schemes and Investor Compensation Act (ESAEG; *Einlagensicherungs- und Anlegerentschädigungsgesetz*) as well as pursuant to Regulation (EU) 2016/1011, the Benchmarks Regulation; fees for issuing the new administrative decisions in response to a request for information, which were introduced as part of the supervisory reform package; fees for approving the new exemptions, subject to approval, in the BWG concerning the risk management and internal audit function, as well as for granting AIFs marketing licences in relation to the MiFiGG 2017. With regard to the InvFG and the Alternative Investment Fund Managers Act (AIFMG; *Alternatives Investmentfonds Manager-Gesetz*), the fee amounts have been adapted. Other modifications concern the BörseG 2018 and the WAG 2018.

Amendment to the 2016 FMA Cost Regulation (FMA-KVO 2016; *FMA-Kostenverordnung*), Federal Law Gazette II No. 223/2017

The FMA-KVO 2016 was adapted to the ESAEG, a lump sum was specified for EEA insurance undertakings, and exchange operating companies, issuers on MTFs and OTFs, EEA investment firms and administrators of benchmarks have been classed as new entities liable to pay costs.

Amendment to the 2016 Regulation on Qualifying Holdings (EKV 2016; *Eigentümerkontrollverordnung*), Federal Law Gazette II No. 255/2017; Amendment to the Regulation on Qualifying Holdings of Central Counterparties (ZG EKV; *Zentrale Gegenparteien-Eigentümerkontrollverordnung*), Federal Law Gazette II No. 256/2017

The EKV 2016 and the ZG-EKV were amended to comply with the Joint Guidelines on the prudential assessment of acquisitions and increases of qualifying holdings in the financial sector (JC/GL/2016/01), issued by the European supervisory authorities EBA

(European Banking Authority), EIOPA (European Insurance and Occupational Pensions Authority) and ESMA (European Securities and Markets Authority). The requirements relating to information to be submitted in owner control procedures have now been specified in much greater detail. Information that has already been provided during the past seven years, and which is still complete, accurate and up to date, need not be re-submitted. The notification obligations applicable to holdings being acquired in the course of intragroup restructuring have been reduced.

Third amendment to the CRR Supplementary Regulation (CRR-BV; CRR-Begleitverordnung), Federal Law Gazette II No. 352/2017

The CRR-BV was amended to comply with the ECB requirements relating to the inclusion of interim or year-end profits in Common Equity Tier 1 capital (CET1) and in relation to the discretions of national competent authorities in the case of less significant institutions (LSIs). Furthermore, the amendment ensures that the previous administrative practice of the FMA to grant prior permission pursuant to Articles 77 and 78 CRR can be upheld.

Amendment to the Minimum Content, Publishing and Language Regulation (MVSV; Mindestinhalts-, Veröffentlichungs- und Sprachenverordnung), Federal Law Gazette II No. 354/2017

Since physically signing a prospectus is no longer necessary following the introduction of electronic prospectus approval as part of the supervisory reform package, the obligation to sign documents being used in place of a prospectus was also deleted from the MVSV to further simplify the administrative procedures. This concerns documents for the allotment of shares, dividends in the form of shares or employee share schemes, which can be published in lieu of a prospectus.

Amendment to the Capital Buffer Regulation (KP-V; Kapitalpuffer-Verordnung), Federal Law Gazette II No. 357/2017

The amendment implements the recommendations of the Financial Market Stability Board (FMSB) of 15 September 2017. Certain institutions are now required to set a capital buffer for systemic risk not just on a consolidated basis but also on an unconsolidated basis. For the first time DenizBank and the Volksbank cooperatives are now required to set a systemic risk buffer.

Amendment to the Small Mutual Associations Investment Regulation (kV-KAV; kleine Versicherungsvereine Kapitalanlageverordnung), Federal Law Gazette II No. 355/2017; Amendment to the Small Insurance Undertakings Investment Regulation (kVU-KAV; kleine Versicherungsvereine Kapitalanlageverordnung), Federal Law Gazette II No. 356/2017

These amendments ensure that small mutual associations and small insurance undertakings are now permitted, in accordance with the OECD Code of Liberalisation of Capital Movements, to use assets from all OECD countries for investments. In addition, the investment thresholds for various categories of assets were increased, some of

them on a flat-rate basis, and some on condition that the association exceed the own funds requirements by at least 30%.

Repeal of the Outsourcing Regulation (AusV; *Auslagerungsverordnung*), the Regulation on Conflicts of Interest and Information for Customers (IIKV; *Interessenkonflikte- und Informationen für Kunden-Verordnung*) and the 2007 Regulation on the Reporting of Securities Transactions (WPMV 2007; *Wertpapier-Meldeverordnung*), Federal Law Gazette II No. 358/2017

The AusV, IIKV and WPMV 2007 were repealed in response to Directive 2014/65/EU (MiFID II) and resulting need for the legislation to be tidied up. Related requirements can now be drawn directly from Regulation (EU) No 600/2014 (MiFIR) as well as from the level 2 measures in connection with MiFID II/MiFIR.

Amendment to the Insurance Undertakings Reporting Regulation (VU-MV; *Versicherungsunternehmen Meldeverordnung*), Federal Law Gazette II No. 389/2017

The amendment adapted the categories of assets to be reported to the underlying technical standard, and modified the references to the WAG 2018.

Commodity Derivatives Regulation (WDV; *Warenderivateverordnung*), Federal Law Gazette II No. 390/2017

The Regulation sets a fixed position limit of 2.5 million units for exchange-traded commodity certificates with an issue volume of less than 10 million units. If the issue volume does not exceed 2.5 million units, comprising all commodity derivatives traded on the Vienna Stock Exchange, position reporting obligations are suspended.

2018 Transparency Regulation (TransV 2018; *Transparenz-Verordnung*), Federal Law Gazette II No. 392/2017

The TransV 2018 replaces the previous TransV and includes modifications in accordance with the BörseG 2018. For the first time, a form is provided which must be used to submit reports on holdings.

Repeal of the 2007 Issuer Compliance Regulation (ECV 2007; *Emittenten-Compliance-Verordnung*), Federal Law Gazette II No. 393/2017

The ECV contributed significantly to establishing effective internal requirements to prevent market abuse. However, its purpose is nowadays increasingly being fulfilled by European instruments, including ESMA guidelines and Q&As. To simplify administrative procedures, the ECV 2007 was therefore repealed.

Cross-selling Regulation (QVV; *Querverkaufsverordnung*), Federal Law Gazette II No. 394/2017

The QVV specifies the information to be provided to customers when several products or services with at least one investment service are sold as a package. It also lays down principles for remuneration practices and principles for designing packages in a manner that ensures that post-sale cancellation rights continue to apply. The QVV implements the ESMA Guidelines on cross-selling practices (ESMA/2016/574).

Amendment to the Regulation on the Reporting of Own Funds by Special-Purpose Credit Institutions (SK-EMV; *Sonderkreditinstitute-Eigenmittelmeldeverordnung*), Federal Law Gazette II No. 397/2017

References in the Annex to the SK-EMV were modified in accordance with the WAG 2018.

EUROPEAN LEGISLATION

REGULATIONS AND DIRECTIVES ADOPTED IN 2017

Regulation (EU) 2017/1129 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market

This Regulation replaces Directive 2003/71/EC, the Prospectus Directive. The general threshold for the obligation to draw up a prospectus to apply is raised to € 1 million. In addition, it provides, for example, for simplified disclosure regimes for secondary issuances by listed companies and for small and medium-sized enterprises (SMEs) in the form of an EU Growth prospectus. Prospectuses will in future be published primarily in electronic form. The information to be provided in the prospectus is specified in greater detail, ensuring that such prospectuses will in future be shorter and easier to understand. Furthermore, the prospectus summary is now limited to a maximum length of seven pages, and a faster and simpler approval process is created for frequent issuers. Effective entry into force: 21 July 2019; the new thresholds apply from 21 July 2018.

REGULATION (EU) 2017/1131 ON MONEY MARKET FUNDS

The Regulation provides for uniform rules on money market funds across the Union in order to increase the liquidity of MMFs as well as to ensure the stability of their structure. The Regulation applies to all undertakings for collective investment in transferable securities (UCITS) and alternative investment funds (AIFs) that invest in assets with a maturity not exceeding two years and that seek to offer returns in line with money market rates or to preserve the value of the investment. 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.

Effective entry into force: 21 July 2018.

Regulation (EU) 2017/1991 amending Regulation (EU) No 345/2013 on European venture capital funds (EuVECA) and Regulation (EU) No 346/2013 on European social entrepreneurship funds (EuSEF)

The goal of these regulations is to broaden the opportunities of investing capital in innovative SMEs and social undertakings. The amendment aims to promote the dissemination of EuVECA and EuSEF funds:

- The group of fund managers allowed to manage and market EuVECA and EuSEF

funds is being extended to include all fund managers registered pursuant to Directive 2011/61/EU (AIFM Directive), meaning that fund managers with portfolios exceeding € 500 million may also manage EuVECA and EuSEF funds.

- Fund managers must hold own funds amounting to at least one eighth of the fixed annual overheads, but no less than € 50 000. Where the value of the EuVECA and EuSEF assets exceeds € 250 million, an additional amount of own funds is required.
- Host Member States may not charge fees on cross-border EuVECA and EuSEF funds.
- With respect to EuVECA, investments in undertakings with up to 499 employees (small mid-caps) and in small and medium-sized enterprises that are listed on an SME growth market as defined in Directive 2014/65/EU are permitted in order to allow growth-stage entities that already have access to other sources of financing to also gain access to EuVECA funds. With respect to EuSEF, an expansion of the definition of positive social impacts widens the range of permissible investments.

Effective entry into force: 1 March 2018.

Regulation (EU) 2017/2401 amending Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms

Alongside the STS Regulation (for simple, transparent and standardised securitisation), a regulation to amend the Capital Requirements Regulation (CRR) with regard to capital requirements for securitisation positions was also adopted. The amendment should tackle three issues:

- the mechanistic reliance on external ratings in determining capital requirements should be avoided;
- insufficient risk sensitivity due to the lack of sufficient risk drivers across approaches in determining risk weights should be addressed;
- procyclical cliff effects in capital requirements should be prevented.

If there are sufficient underlying assets in the securitisation whose risk weight may be assessed using the internal ratings based approach, the Securitisation IRB Approach (SEC-IRBA) should be applied. Where this is not possible, the hierarchy of methods has been changed, compared with the original Commission proposal: the SEC-SA (Securitisation Standardised Approach) now comes first, and the SEC-ERBA (Securitisation External Ratings Based Approach) second, i.e. the SEC-SA is always first choice. Since, however, the rating results of the SEC-SA and the SEC-ERBA differ strongly for some securitisations, the SEC-ERBA may be applied directly in cases where there is a major difference. For securitisation transactions backed by pools of auto loans, auto leases and equipment leases, the SEC-ERBA may be used before the SEC-SA.

Publication in the Official Journal of the European Union: 28 December 2017, applicable as of 1 January 2019.

Regulation (EU) 2017/2402 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation (STS Regulation)

This Regulation contains rules for simple, transparent and standardised (STS) securitisations, with two types of STS requirements being defined: one for long-term securitisations 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. Special due diligence requirements have been laid down for institutional investors. Publication in the Official Journal of the European Union: 28 December 2017, applicable as of 1 January 2019.

Regulation (EU) 2017/2395 amending Regulation (EU) No 575/2013 as regards transitional arrangements for mitigating the impact of the introduction of IFRS 9 on own funds and for the large exposures treatment of certain public sector exposures denominated in the domestic currency of any Member State;
Directive (EU) 2017/2399 amending Directive 2014/59/EU as regards the ranking of unsecured debt instruments in insolvency hierarchy

These two legislative acts are part of the Commission’s Basel reform package (see also “European legislative projects” below) but were removed from the overall package to ensure that the necessary deadlines are met (fast-track procedure).

- The Directive regarding the ranking of unsecured debt instruments in insolvency procedures (bank creditors’ hierarchy) was supplemented: Even though covered deposits had ranked higher to date than unsecured deposits (in excess of € 100 000), unsecured senior debt had not been deemed subordinate to other forms of unsecured exposures. Member States are now required to create a new class of non-preferred senior debt. This should facilitate the effective application of the bail-in tool for cross-border institutions and avoid distortions on the internal market.
- The Regulation as regards transitional arrangements for mitigating the impact of the introduction of the international financial reporting standard (IFRS) 9 on regulatory own funds allows banks to include in their Common Equity Tier 1 capital a portion of the increased expected credit loss provisions for a transitional period of five years. This additional portion should be reduced over the transitional period down to zero. The exemption from the large exposure limit available for exposures to certain public sector debt denominated in the domestic currency of another Member State should also be gradually abolished within three years.

Both legislative acts were published in the Official Journal in December 2017 and entered into force on 1 January 2018.

EUROPEAN LEGISLATIVE PROJECTS

The following legislative projects of particular relevance to the FMA’s activities were discussed at European level in 2017 but have not yet been adopted.

Regulation amending Regulation (EU) 806/2014 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 is to be built upon the existing system composed of national deposit guarantee schemes (DGSs);

- EDIS is to ensure that each investor continues 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);
- EDIS membership is to be mandatory for euro area countries whose banks are currently under the Single Supervisory Mechanism (SSM) but it is 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 so that the financial system can be protected even more effectively and efficiently from being used for money laundering purposes or 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 in 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 national 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.
- Virtual currency exchange platforms and wallet providers are also to be brought under the scope of the Directive.

Following delays in the legislative process, a reliable schedule can no longer be provided on the basis of publicly available information. This also applies to other Commission proposals where no schedule has been added.

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

This Regulation on the recovery and resolution of central counterparties (CCPs) is designed to supplement the requirements for CCPs 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 proposal are:

- Preparation and prevention: CCPs will be required to prepare detailed recovery plans.
- Early intervention: The aim of early intervention measures is to ensure that financial difficulties are countered as soon as they occur. The supervisory authority 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. To this end, Member States are required to set up national resolution authorities.
- Cooperation among national authorities: Resolution colleges are to be set up for each CCP. Apart from the national resolution authority concerned, national supervisory authorities as well as ESMA and the EBA should also be represented in these colleges.

Regulation amending Regulation (EU) No 806/2014 (SRM) as regards loss-absorbing and recapitalisation capacity for credit institutions and investment firms – Commission proposal COM(2016) 851; Directive amending Directive 2014/59/EU (BRRD) on loss-absorbing and recapitalisation capacity of credit institutions and investment firms – Commission proposal COM(2016) 852; Directive amending 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; Regulation amending 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

On 23 November 2016 the European 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) as part of its Basel reform package.

The most important proposals are:

- The introduction of a binding leverage ratio of 3% of Tier 1 capital which should prevent institutions from excessively granting loans despite insufficient own funds.
- The determination of a binding and detailed net stable funding ratio (NSFR), which should make institutions secure their long-term activities with stable sources of funding. This applies alongside the liquidity coverage ratio (LCR), which ensures that credit institutions are able to withstand severe stress on a short-term basis.
- Enhancing the proportionality of the prudential framework for smaller and less complex institutions.

- A fundamental review of the trading book (FRTB). The aim is to prevent regulatory arbitrage and to capture the full range of risks to which institutions are exposed.
- Continuous regulatory adjustments to make it easier for institutions to grant loans to SMEs and for funding infrastructure projects.
- In future (mixed) financial holding companies will also fall under the scope of the prudential framework and be subject to an authorisation requirement.

The amendments are to enter into force with staggered transitional periods of up to two years.

Regulation amending Regulation (EU) No 648/2012 as regards the clearing obligation, the suspension of the clearing obligation, the reporting requirements, the risk-mitigation techniques for OTC derivatives contracts not cleared by a central counterparty, the registration and supervision of trade repositories and the requirements for trade repositories – Commission proposal COM(2017) 208

In the course of the regular review of Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories, several provisions were found to require an amendment and were improved as follows:

- Clearing threshold for small financial counterparties: For smaller banks or funds, representing the majority of counterparties, a new clearing threshold is introduced below which no clearing obligation applies.
- Extended clearing exemption for pension funds: The temporary exemption from the clearing obligation of pension funds and other pension scheme arrangements (PSAs) is extended by another three years, in order to enable specific clearing solutions to be developed.
- Simplified application for NFCs: The clearing threshold for non-financial counterparties now applies to each asset class separately so that NFCs are subject to the clearing obligation only with regard to the asset class that exceeds the clearing threshold. Calculation of the aggregate month-end average position for the months March, April and May must henceforth only be conducted once a year.
- Simplified reporting requirements: For transactions between a financial counterparty and a non-financial counterparty not subject to the clearing obligation, the financial counterparty will in future be responsible for reporting on behalf of both counterparties. This should help ease the reporting burden on small NFCs. Intra-group transactions where at least one of the counterparties is a non-financial counterparty are now exempt from the reporting obligation. Historic transactions, i.e. transactions that were entered into before the starting date of the reporting obligation and remain outstanding on that date (backloading), no longer need to be reported.
- Improvements for trade repositories: The registration and supervision of trade repositories, the accessibility of the data in trade repositories and the quality of the transaction data reported to trade repositories should be improved.

The amendments are to enter into force with staggered transitional periods of up to two years.

Regulation amending Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority) and amending Regulation (EU) No 648/2012 as regards the procedures and authorities involved for the authorisation of CCPs and requirements for the recognition of third-country CCPs – Commission proposal COM(2017) 331

In view of the withdrawal of the United Kingdom from the EU, the amendments of Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC, and of Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories should improve the supervision of third-country CCPs, promote CCP supervisory convergence and intensify the involvement of the central banks in the supervision of the clearing of financial instruments denominated in Union currencies. The key points of the Commission proposal are:

- Systemically important third-country CCPs that provide services and perform activities in the Union will be subject to direct supervision by the European Securities and Markets Authority, with ESMA setting up a new CCP Executive Session involving the European Commission and the central banks in the EU for that purpose. As far as the clearing of financial instruments denominated in Union currencies is concerned, central banks of issue of those currencies should be involved in CCP supervision. This reflects the fact that a significant and systemically important volume of transactions will be cleared in CCPs outside the EU's jurisdiction when the United Kingdom leaves the EU.
- ESMA will in future be more involved in the coordination of supervisory activities relating to European CCPs among competent national authorities and in resolving any disagreements. This should help prevent regulatory arbitrage, which might also be exploited by groups from third countries.

Regulation on a pan-European Personal Pension Product (PEPP) – Commission proposal COM(2017) 343

This Regulation should enable providers to create personal pension products on a pan-European scale, which should supplement state, occupational and national personal pensions products but not replace them. With this proposal the Commission is pursuing the following two objectives:

- bolstering European capital markets; and
- making personal pensions more attractive.

According to the draft proposal, scope is left to Member States as regards age limits for starting the accumulation phase, the minimum duration of the accumulation phase, upper and lower limits for contributions and the conditions for redemption before retirement age, as well as age limits for drawing the pension. Product authorisation is granted by the European Insurance and Occupational Pensions Authority (EIOPA). The Commission also recommends equal tax treatment of PEPPs and national third-pillar pension products. This is of particular relevance as the portability of personal pension products should be ensured for people moving to another EU country. PEPPs should be offered by insurance undertakings, banks, occupational pension funds, investment firms and asset managers and divided into five investment strategies entailing varying

degrees of risk. PEPP savers must be allowed to change provider free of charge once every five years.

Regulation of the European Parliament and of the Council amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority); Regulation (EU) No 1094/2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority); Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority); Regulation (EU) No 345/2013 on European venture capital funds; Regulation (EU) No 346/2013 on European social entrepreneurship funds; Regulation (EU) No 600/2014 on markets in financial instruments; Regulation (EU) 2015/760 on European long-term investment funds; Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds; and Regulation (EU) 2017/1129 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market – Commission proposal COM(2017) 536

This reform of the European System of Financial Supervision comprises numerous modifications both in relation to the organisation and funding of the European Supervisory Authorities (ESAs) and in relation to the centralisation of direct supervision with ESMA, for example:

- As regards the funding of the ESAs (EBA, EIOPA and ESMA), at least 60% of the contributions should be paid by the financial institutions directly (remaining share: EU General Budget) instead of as previously by national competent authorities (NCAs) and out of the EU budget.
- The proposal envisages the introduction of an independent Executive Board to prepare decisions to be taken by the Board of Supervisors. This Executive Board will be attributed decision making powers in relation to certain matters of a non-regulatory nature such as regarding breaches of Union law and dispute settlement, and it will be in charge of decisions in relation to requests for information (also from financial market participants directly), stress tests and independent reviews.
- It also introduces the new “Strategic Supervisory Plans”, which will be prepared by the Executive Board, will be binding for the NCAs and serve as a benchmark for reviews.
- The proposal clarifies that Stakeholder Groups are not obliged to reach consensus; where they cannot reach a common opinion or advice they can submit a separate opinion or advice.
- New provisions specify that the ESAs should contribute to the fostering of consumer protection, and they are tasked with new missions related to Financial Technologies (FinTech) to ensure stable and functioning financial markets.
- The amendments entrust the ESAs with responsibility for regular third-country equivalence monitoring. Furthermore, ESMA should be directly responsible for supervising third-country CCPs, prospectuses by third country issuers and critical benchmarks, as well as benchmarks relating to third countries.
- ESMA will also be established as a single supervisory body with direct responsibility

for EuVECA, EuSEF and ELTIF funds, as well as for the approval of prospectuses relating to asset backed securities and prospectuses drawn up by specialist issuers.

- Transactions should be reported directly to ESMA, and a centralised reporting system should be created.

Directive of the European Parliament and of the Council amending Directive 2014/65/EU on markets in financial instruments and Directive 2009/138/EC on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II) – Commission proposal COM(2017) 537 (considered together with the above proposal)

The proposal sets out amendments to transfer direct supervision of data reporting service providers to ESMA. It also enhances EIOPA's role with regard to the approval of insurance undertakings' internal models.

Directive of the European Parliament and of the Council amending Regulation (EU) No 1092/2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board – Commission proposal COM(2017) 538

The changes regarding the European Systemic Risk Board (ESRB) primarily concern how it is organised:

- Those areas in which the ESRB Chair and the Steering Committee may give directions to the head of the Secretariat of the ESRB have been specified.
- The ESRB Chair should be held by the ECB on a permanent basis (served by the ECB President).
- The task of representing the Chair externally may be delegated by the ECB President to the Secretariat Head (for example at the Economic and Financial Committee).
- The Chair of the Supervisory Board of the ECB (SSM) and the Chair of the Single Resolution Board should become additional members with voting rights of the General Board of the ESRB, as well as of the Steering Committee and the Advisory Technical Committee.
- With respect to the non-voting members of the General Board, recommendations and warnings, related opinions of the addressees and the ESRB's assessment regarding implementation should not only be transmitted to the Council, the Commission and the ESAs but also to the European Parliament.

Amendment of pending proposal for a Regulation amending Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority) and amending Regulation (EU) No 648/2012 as regards the procedures and authorities involved for the authorisation of CCPs and requirements for the recognition of third-country CCPs (EMIR II Commission's proposal) – Commission proposal COM(2017) 539

General ESMA powers (breaches of Union law, mediation, peer reviews) in relation to CCPs will be assumed by the CCP Executive Session, the new body already proposed by the Commission.

Regulation on the prudential requirements of investment firms and amending Regulations (EU) No 575/2013, (EU) No 600/2014 and (EU) No 1093/2010 – Commission proposal COM(2017) 790; Directive on the prudential supervision of investment firms and amending Directives 2013/36/EU and 2014/65/EU – Commission proposal COM(2017) 791

The Commission's proposals aim to review the prudential requirements made of investment firms, emphasising the principle of proportionality. Investment firms are to be divided into three size categories. Large investment firms of systemic importance (with total assets of € 30 billion or more) must apply for authorisation as a credit institution, meaning CRR/CRD IV are fully applicable and they become subject to supervision by the banking authority. All other investment firms will no longer have to apply CRR and CRD IV. A new prudential framework will be set up instead for those investment firms, simplifying the regulatory requirements applicable to them. Small investment firms (with total assets not exceeding € 100 million) should hold own funds in the amount of one quarter of their previous year's fixed overheads, but at least between € 75 000 and € 750 000, depending on the investment services provided by them. Medium-sized investment firms should calculate their requirement based on the sum of the K-factor requirement. K-factors capture risks to customer (RtC), and for firms that deal on own account and execute client orders in their own name, risks to market (RtM) and risks to firm (RtF). These K-factors are multiplied by the corresponding coefficients set out in the Regulation in order to determine the capital requirement.

Directive amending Directive (EU) 2016/97 as regards the date of application of Member States' transposition measures – Commission proposal COM(2017) 792

The proposal postpones the date from which Member States are to apply Directive (EU) 2016/97 (IDD) by seven months to 1 October 2018. The plan is for it to be adopted by means of an accelerated legislative procedure.