

FACTS AND FIGURES  
TRENDS AND STRATEGIES  
2015



# FACTS AND FIGURES, TRENDS AND STRATEGIES 2015

PUBLISHER INFORMATION

Published by: Austrian Financial Market Authority (FMA)

A-1090 Vienna, Otto-Wagner-Platz 5

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

E-mail: [fma@fma.gv.at](mailto:fma@fma.gv.at)

Internet: [www.fma.gv.at](http://www.fma.gv.at)

Sources (unless otherwise stipulated): FMA

Preface by the Executive Board of the FMA.....	4
<b>Legislation</b>	
Major changes in national and international financial market legislation .....	6
<b>The Financial Market Stability board</b>	
How the Austrian institutions cooperate with regard to macroprudential supervision .....	16
<b>The FMA as resolution authority</b>	
Statutory mandate and official strategy .....	22
<b>Europe's new banking supervision system (SSM)</b>	
The role of the FMA as national competent authority (NCA).....	28
<b>The new Insurance Supervision Act (VAG 2016)</b>	
Solvency II, the new supervisory regime for insurance in Austria.....	37
<b>The notion of inside information</b>	
The field of tension between European legal rulings and Austrian court decisions .....	43
<b>The Alternative Investment Fund Managers Act (AIFMG)</b>	
The role of the FMA as supervisor of alternative investment fund managers .....	49
<b>The European Market Infrastructure Regulation (EMIR)</b>	
The new regulatory and supervisory regime for derivative trading .....	54



## P R E F A C E B Y T H E E X E C U T I V E B O A R D O F T H E F M A



Financial market regulation and supervision are very dynamic fields. In the first instance, they are driven by sweeping political changes such as Austria's forging of closer links with the European Union, the creation of a single European market and participation in European economic and monetary union, all of which have resulted in a fundamental overhaul of the regulatory framework governing the financial markets. Mention only needs to be made of the "acquis communautaire", the accumulated body of European Union law, the Financial Services Action Plan with its 42 pan-European regulation projects or European banking union, which the euro area countries are currently building together. Secondly, it is a huge challenge for the regulators and supervisors to just keep pace with the developments on individual markets, be it technological developments such as the rapid development of information and communication technology, be it product innovations where providers' creativity appears to know no bounds, be it in the field of regulatory and supervisory arbitrage, with weaknesses and gaps in the global system being exploited efficiently and effectively, not to mention ruthlessly.

Exceptional crises, such as the global financial crisis that erupted in 2008, also call our whole regulatory and supervisory approach into question. While regulation and supervision were previously seen as obstacles to growth, amid calls for deregulation, the pendulum has now swung back in the other direction. Regulation and supervision should be omnipotent, protecting one and all from the perils of life, or more precisely the perils of the markets.

Striking the right balance is a social and political decision made not by the supervisor but by the lawmakers. In line with our proactive communication concept, it is particularly important to us as regulators and supervisors, however, that we keep market participants and our stakeholders briefed on the latest developments. We have therefore developed a new annual publication series „Facts and figures, trends and strategies“, the 2015 version of which is included in this Report.

It is intended as a useful and practical guide to current developments in regulation and supervision on the Austrian financial market, and we hope you enjoy reading the information provided.

HELMUT E TTL, KLAUS KUMPFMÜLLER

## Legislation

### Major changes in national and international financial market legislation

**F**inancial market legislation is one of the most dynamic fields of law worldwide. Regulators and supervisors must keep pace with the developments on the markets, while coping with constantly changing requirements and new challenges. What is more, the global financial crisis called into question the efficiency and effectiveness of the existing system of regulation in many areas, demanding new legislative responses to the lessons learned from the crisis. Lessons that had to be learned both at international and national levels, and continue to be learned.

#### NATIONAL LEGISLATION

##### CHANGES TO EXISTING LAWS

AUSTRIAN BANKING ACT (BWG; *BANKWESENGESETZ*), STOCK EXCHANGE ACT (BörseG; *BÖRSEGESETZ*), INSURANCE SUPERVISION ACT (VAG; *VERSICHERUNGSAUFSICHTSGESETZ*) AND OTHER STATUTES, Federal Law Gazette I No. 13/2014

Until now, suspicious transaction reports submitted by the Financial Intelligence Unit to the Ministry of Finance could not be used in proceedings for financial offences to the detriment of the accused, except in the case of financial offences falling under the jurisdiction of the courts (e.g. smuggling or tax fraud). The BWG, BörseG and VAG now no longer prohibit use in this way.

AKTIENGESETZ (AktG; STOCK CORPORATION ACT) AND OTHER STATUTES, Federal Law Gazette I No. 40/2014

Following the OECD's criticism expressed in the course of its evaluation, the AktG now provides for sanctions in connection with the conversion of bearer shares into registered shares pursuant to the 2011 Company Law Amendment Act (GesRÄG 2011; *Gesellschaftsrechts-Änderungsgesetz*). Under the new rules, the courts may impose coercive penalties of up to € 3 600 on executive boards that, by not converting, fail to comply with the legal requirement to maintain a proper share register pursuant to Article 61 para. 1 AktG, while bearer share certificates of shareholders who fail to convert on time may be declared invalid. Moreover, past dividend claims may be lost if shareholders have not had their registered shares entered in the share register in due time.



INSURANCE SUPERVISION ACT (VAG; *VERSICHERUNGSAUFSICHTSGESETZ*) AND COMPANY EMPLOYEE AND SELF-EMPLOYMENT PROVISIONS ACT (BMSVG; *BETRIEBLICHES MITARBEITER- UND SELBSTÄNDIGENVORSORGE-GESETZ*), Federal Law Gazette I No. 42/2014

The VAG stipulates a general obligation for all domestic insurance and reinsurance undertakings to make preparations for Directive 2009/138/EC (Solvency II) in order to be able to comply with its requirements by 1 January 2016 at the latest. The obligation to make preparations is specified in detail regarding the governance system, the forward-looking assessment of own risks and the reporting requirements as laid down in the relevant EIOPA guidelines (European Insurance and Occupational Pensions Authority). The BMSVG now includes the provision that a collective investment undertaking shall continue to be managed as a separate collective investment undertaking when the assets assigned to it are transferred to another staff provision fund. However, new employers may no longer be included in that undertaking.

FEDERAL ACT ON THE CREATION OF A WIND-DOWN ENTITY (GSA; *BUNDESGESETZ ZUR SCHAFFUNG EINER ABBAUEINHEIT*), FEDERAL ACT ON RESTRUCTURING MEASURES FOR HYPO ALPE ADRIA BANK INTERNATIONAL AG (HaaSanG; *BUNDESGESETZ ÜBER SANIERUNGSMASSNAHMEN FÜR DIE HYPO*) AND OTHER STATUTES, Federal Law Gazette I No. 51/2014

The GSA enables the creation of a wind-down entity that is tasked with managing the bank's assets and realising them duly and actively, and in the best possible manner. As far as the wind-down entity is concerned, the FMA is the authority responsible for monitoring compliance with the applicable provisions of supervisory law (money laundering, fit and proper tests of the bodies). Solvency and liquidity provisions pertaining to banking supervision do not apply in this case. Only the FMA may file an application for initiating insolvency proceedings in the event that the wind-down entity becomes insolvent. In carrying out its supervisory remit, the FMA may obtain expert opinions pursuant to Article 79 BWG from the Oesterreichische Nationalbank (OeNB).

The HaaSanG implements reorganisation measures in accordance with Directive 2001/24/EG. The FMA is the authority vested with the power to make decisions on measures regarding the reorganisation institution HBIInt. As such it is required to issue a regulation ex officio within two weeks of the Act entering into force detailing those liabilities which are to expire pursuant to Article 3 HaaSanG upon publication of the regulation and furthermore indicating those disputed liabilities that are to be deferred pursuant to Article 4 para. 1 HaaSanG upon the regulation's publication until at least 30 June 2019 or even to a later date until completion of proceedings as defined in Article 2 no. 9 HaaSanG.

AUSTRIAN BANKING ACT (BWG; *BANKWESENGESETZ*), STOCK EXCHANGE ACT (BörseG; *BÖRSEGESETZ*) AND OTHER STATUTES, Federal Law Gazette I No. 59/2014

Federal Law Gazette I No. 59/2014 amends the BWG to include statutory accompanying measures in connection with Regulation (EU) No 1024/2013 (SSM Regulation). It is made clear that the FMA and the OeNB are only to perform tasks and exercise powers and duties that do not form part of the ECB's remit in accordance with the SSM Regulation. Moreover, the amendment stipulates a general obligation for the FMA and the OeNB to coordinate efforts and to exchange information within the SSM as well as information and coordination requirements for the FMA and the Financial Market Stability Board in relation to macroprudential measures. The BWG is also amended to adapt the extent of the annual audits at credit institutions in line with the new regulatory requirements having arisen with Basel III, the new capital regime. The various subject-related audit areas (audit modules) are restructured. The audit activities performed are to be described in the respective audit modules.

The FMA is entitled to take measures in line with [Regulation \(EU\) No 263/2012 \(Leerverkaufsverbotsverordnung\)](#) on short selling and certain aspects of credit default swaps. The amendment to the BörseG grants the FMA the opportunity to publish regulations on its website, which then enter directly into force upon publication. This allows prompt intervention in emergency situations and/or in the event of significant price losses so that uncertainty surrounding individual shares does not spread to the entire financial market.

*PENSIONSKASSEN ACT (PKG; PENSIONSKASSENGESETZ), 2011 INVESTMENT FUND ACT (InvFG 2011; INVESTMENTFONDSGESETZ), ALTERNATIVE INVESTMENT FUND MANAGERS ACT (AIFMG; ALTERNATIVES INVESTMENTFONDS MANAGER-GESETZ), Federal Law Gazette I No. 70/2014*

The amendments to the PKG, InvFG 2011 and AIFMG are intended to prevent over-reliance on credit ratings in these supervisory laws by integrating risk-management processes in transposition of Directive 2013/14/EU. In addition, technical modifications based on initial experience with the AIFMG are incorporated into the InvFG 2011 and AIFMG. And the AIFMG is also amended to allow private equity funds of funds as alternative investment funds and AIFs in corporate holdings to be sold to retail customers under certain conditions (the invested sum amounts to at least € 100 000 for each retail customer, no leverage is used, etc.).

*FEDERAL ACT ON THE RECOVERY AND RESOLUTION OF BANKS (BaSAG; BUNDESGESETZ ÜBER DIE SANIERUNG UND ABWICKLUNG VON BANKEN), Federal Law Gazette I No. 98/2014*

The BaSAG implements Directive 2014/59/EU (Bank Recovery and Resolution Directive – BRRD). The FMA is instated as the resolution authority for Austria. The Act stipulates that the FMA, in the capacity of resolution authority, and the OeNB shall cooperate closely for the purposes of the BaSAG. Credit institutions will in future be required to draw up recovery plans to prepare for a potential crisis. The FMA as resolution authority will in future prepare the recovery plans, with institutions obliged to contribute to the preparatory process. The FMA's early intervention powers already laid down in the BWG are adapted to meet European requirements as set forth in the BRRD and integrated into the BaSAG.

The FMA is granted specific powers in its capacity as resolution authority (bailing in creditors, selling the institution, setting up a bridge bank, spinning off assets, among others) in order to be able to carry out the orderly resolution of an institution should it fail or threaten to fail and to safeguard financial market stability. To ensure that these resolution tools can be effectively applied, the resolution authority must set up a resolution financing arrangement funded with appropriate financial resources. The BRRD provides for a target level of 1% of all covered deposits by 31 December 2024. The resolution financing arrangement is funded by regular ex-ante contributions from the institutions. In addition, the resolution authority may also raise ex-post contributions from the institutions if necessary.

## FMA REGULATIONS

*REGULATION ON THE BANKING INTERVENTION AND RESTRUCTURING ACT (BIRG-V; BANKENINTERVENTIONS- UND -RESTRUKTURIERUNGSGESETZ-VERORDNUNG), Federal Law Gazette II No. 2/2014*

This Regulation implements the powers to issue regulations as referred to in Article 7 para. 5 and Article 14 para. 6 BIRG, according to which the FMA must determine criteria of significance for subordinate, attributed or participating institutions. The BIRG expired at the end of 31 December 2014.

*REGULATION ON ASSET, INCOME AND RISK STATEMENTS (VERA-V; VERMÖGENS-, ERFOLGS- UND RISIKOAUSWEIS- VERORDNUNG), Federal Law Gazette II No. 28/2014, Federal Law Gazette II No. 144/2014, Federal Law Gazette II No. 343/2014*

Based on Regulation (EU) No 575/2013 (CRR) and Directive 2013/36/EU (CRD IV), the BWG was extensively amended with Federal Law Gazette I No. 184/2013. VERA-V had to be adapted accordingly. In addition, VERA-V was amended in line with the EBA's Implementing Technical Standards Amending Commission Implementing Regulation (EU) No 680/2014 (FINREP ITS) and adjusted by removing the reporting requirement of IFRS groups (including reports for foreign subsidiaries). In connection with the collection of general remuneration data as well as data regarding high earners, VERA-V was amended to reflect the current EBA guidelines (EBA/GL/2014/07 and EBA/GL/2014/08).

DEPOSITING FEE REGULATION (HGV; *HINTERLEGUNGS- GEBÜHREN- VERORDNUNG*), Federal Law Gazette II No. 74/2014

This amendment introduced staggered reductions in the fees for depositing the final terms of a base prospectus (Article 7 para. 4 of the Capital Market Act – KMG; *Kapitalmarktgesetz*).

REGULATION ON LOSS DATA REPORTING (VTDM-V; *VERLUSTDATENMELDUNGS- VERORDNUNG*), Federal Law Gazette II No. 79/2014

The reports according to the VTDM-V now fall within the scope of application of the EBA's FINREP ITS (Implementing Regulation (EU) No 680/2014). The VTDM-V was thus repealed with effect from the end of 31 May 2014.

REGULATION ON MONEY LAUNDERING AND TERRORIST FINANCING RISK (GTV; *GELDWÄSCHEREI- UND TERRORISMUSFINANZIERUNGS- RISIKO- VERORDNUNG*), Federal Law Gazette II No. 94/2014, Federal Law Gazette II No. 223/2014

Against the background of the FATF public statements of 14 February 2014 and 27 June 2014, Ethiopia, Kenya, Pakistan, Tanzania, Turkey and Yemen were deleted from the list of high-risk countries in the GTV.

REGULATION ON REPORTS TO THE CENTRAL CREDIT REGISTER (ZKRM-V; *ZENTRALE KREDITREGISTER- MELDUNGS- VERORDNUNG*), Federal Law Gazette II No. 108/2014

The ZKRM-V was amended in technical respects and certain kinds of reports were removed in order to streamline the Central Credit Register.

MAXIMUM INTEREST RATE REGULATION (*HÖCHSTZINSSATZ- VERORDNUNG*), Federal Law Gazette II No. 179/2014; REGULATION ON ADDITIONAL PROVISIONS (*ZUSATZRÜCKSTELLUNGS- VERORDNUNG*), Federal Law Gazette II No. 180/2014

The amendment reduces the maximum interest rate for calculating the technical provisions and the guaranteed rate of interest for premiums in life assurance from 1.75% to 1.50%. The maximum interest rate used for calculating the technical provisions is lowered analogously for state-sponsored retirement provision. The interest rate for provisions for investment risks in state-sponsored retirement provision that exceed the investment risks in life assurance was reduced from 3.25% to 2.75%.

FMA REGULATION ON THE PERFORMANCE OF RECOVERY MEASURES PURSUANT TO ARTICLE 7 PARA. 2 IN CONJUNCTION WITH ARTICLES 3 AND 4 PARA. 1 HAASANG (*VERORDNUNG DER FMA ÜBER DIE DURCHFÜHRUNG VON SANIERUNGSMASSNAHMEN*), Federal Law Gazette II No. 195/2014

By issuing this Regulation, the FMA fulfils the obligation imposed on it by Article 7 para. 2 HaaSanG, Federal Law Gazette I No. 51/2014, to issue a regulation relating to two recovery measures within two weeks of the HaaSanG entering into force. Firstly, the Regulation details those liabilities which are to expire pursuant to Article 3 HaaSanG upon publication of the Regulation; and secondly, the Regulation indicates those disputed liabilities that are to be deferred pursuant to Article 4 para. 1 HaaSanG upon the Regulation's publication until at least 30 June 2019 or even to a later date until completion of proceedings as defined in Article 2 no. 9 HaaSanG.

REGULATION ON CREDIT INSTITUTION RISK MANAGEMENT (KI-RMV, *KREDITINSTITUTE- RISIKOMANAGEMENT- VERORDNUNG*), Federal Law Gazette II No. 235/2014

This amendment brings the KI-RMV into line with the BWG amendment in Federal Law Gazette I No. 59/2014, i.e. explicitly excludes credit institutions authorised to pursue real estate investment fund activities and management companies pursuant to the InvFG 2011 from the scope of the Regulation's application. Moreover, some technical modifications are also being made.

REGULATION ON PREPARATORY GUIDELINES (*VORBEREITUNGSLEITLINIEN-VERORDNUNG*), Federal Law Gazette. II No. 238/2014

This Regulation specifies the information requirements pertaining to the annual report for 2014 and the Q3 2015 report contained in the EIOPA guidelines as well as the deadline for submission of the ORSA report pursuant to the EIOPA guidelines for insurance and reinsurance undertakings.

REGULATION ON THE ANNEX TO THE AUDIT REPORT (AP-VO; *VERORDNUNG ÜBER DIE ANLAGE ZUM PRÜFUNGSBERICHT*), Federal Law Gazette II No. 239/2014

The amendment to the AP-VO replaces the extensive list of questions that has been used so far with so-called audit modules. These are intended to improve bank auditors' contribution to supervision, helping them to recognise undesirable economic developments in good time.

LIQUIDITY REGULATION (*LIQUIDITÄTSVERORDNUNG*), Federal Law Gazette II No. 339/2014; FIFTH LIQUIDITY REGULATION, Federal Law Gazette II No. 340/2014; REGULATION ON PROOF OF COMPLIANCE WITH LIQUIDITY PROVISIONS (LIA-V; *LIQUIDITÄTSAUSWEIS-VERORDNUNG*), Federal Law Gazette II No. 341/2014

The previous quantitative liquidity rules will be replaced in 2015 by harmonised liquidity rules across the EU. Article 25 BWG expired at the end of 31 December 2014, which meant that the Liquidity Regulation, the Fifth Liquidity Regulation and the LiA-V all had to be repealed at the same time.

REGULATION ON FINANCIAL STATEMENTS AND CONSOLIDATED FINANCIAL STATEMENTS (JKAB-V; *JAHRES- UND KONZERNABSCHLUSS-VERORDNUNG*), Federal Law Gazette II No. 342/2014

In the JKAB-V, the forms for the financial statements of corporate provision funds have been adapted, the law in view of Commission Implementing Regulation (EU) No 680/2014 has been tidied up, and modifications have been made in relation to Federal Law Gazette I No. 184/2013 (implementation of Basel III).

## INTERNATIONAL LEGISLATION

### LEGISLATION ADOPTED IN 2014

REGULATION (EU) No 468/2014 ESTABLISHING THE FRAMEWORK FOR COOPERATION WITHIN THE SINGLE SUPERVISORY MECHANISM BETWEEN THE EUROPEAN CENTRAL BANK AND NATIONAL COMPETENT AUTHORITIES AND WITH NATIONAL DESIGNATED AUTHORITIES (SSM FRAMEWORK REGULATION)

Based on Regulation (EU) No 1024/2013 (SSM Regulation) the present SSM Framework Regulation establishes a framework to organise the practical arrangements for cooperation within the SSM. This includes the specific methodology for the assessment and review of whether a supervised entity is classified as significant and thus falls within the ECB's direct supervision, the internal structures and workflows within the Single Supervisory Mechanism (for example, the activities of the joint supervisory teams (JST), composed of staff members from the ECB and from the NCAs), as well as the common procedures (i.e. procedures that are carried out under common responsibility of the ECB and NCAs) and finally, among other things, cooperation regarding macroprudential tasks and tools, obtaining information (e.g. on-site inspections) and administrative penalties. Effective entry into force: 15 May 2014.

REGULATION (EU) No 596/2014 ON MARKET ABUSE (MARKET ABUSE REGULATION) AND DIRECTIVE 2014/57/EU ON CRIMINAL SANCTIONS FOR MARKET ABUSE (MARKET ABUSE DIRECTIVE)

The Market Abuse Regulation (MAR) introduces a minimum harmonisation of administrative measures and sanctions and also closes loopholes by extending the market abuse regime to include financial instruments, new trading venues and OTC markets. The Market Abuse Directive (MAD) lays down further minimum requirements

for criminal sanctions in relation to market manipulation and insider dealing. Effective entry into force/implementation deadline: 3 July 2016.

REGULATION (EU) No 600/2014 ON MARKETS IN FINANCIAL INSTRUMENTS (MIFIR) AND DIRECTIVE 2014/65/EU ON MARKETS IN FINANCIAL INSTRUMENTS (MIFID II)

MiFIR, which effectively enters into force on 3 January 2017, and MiFID II, which needs to be implemented by 3 July 2016, replace the Markets in Financial Instruments Directive (MiFID) including its implementing acts and include extensive new rules for securities trading. The main points are as follows:

- regulation of high-frequency trading;
- restriction of OTC trading;
- introduction of organised trading facilities (OTF) as new trading venue;
- transparency for equity-like and non-equity financial instruments;
- strengthening investor protection;
- harmonisation of supervisory powers and sanctions;
- introduction of a new third-country regime.

REGULATION (EU) No 806/2014 ESTABLISHING UNIFORM RULES AND A UNIFORM PROCEDURE FOR THE RESOLUTION OF CREDIT INSTITUTIONS AND CERTAIN INVESTMENT FIRMS IN THE FRAMEWORK OF A SINGLE RESOLUTION MECHANISM AND A SINGLE RESOLUTION FUND (SRM REGULATION)

This Regulation on the Single Resolution Mechanism (SRM) establishes the Single Resolution Board (SRB), an independent authority located in Brussels. The Board will henceforth decide together with the European Commission on the resolution of banks in SSM states. The Board's decisions are implemented by the national competent authorities, which in Austria is the FMA in the capacity of national resolution authority, under SRB supervision. In addition, the Regulation also provides for the setting up of a Single Resolution Fund. Effective entry into force: 1 January 2016.

REGULATION (EU) No 909/2014 ON IMPROVING SECURITIES SETTLEMENT IN THE EUROPEAN UNION AND ON CENTRAL SECURITIES DEPOSITORIES

The Regulation launches rules regarding the authorisation and ongoing supervision of CSDs as well as for the preservation of its services in the event of a default, a common settlement period, i.e. the settlement date of transactions should be no later than on the second business day after the trading takes place, and consequences in the case of delayed settlement including sanctions. Furthermore, strict limitations for admissible banking transactions and rules for cooperation with other CSDs, and finally a definition of the freedom of establishment for CSDs, including rules for the issuer's choice of CSD. Effective entry into force (of core provisions): 1 January 2015.

REGULATION (EU) No 1286/2014 ON KEY INFORMATION DOCUMENTS FOR PACKAGED RETAIL AND INSURANCE-BASED INVESTMENT PRODUCTS (PRIIPS)

The aim of the Regulation is to improve the transparency of PRIIPs offered to retail investors, particularly with regard to investment products such as investment funds, structured products for retail investors and certain types of life insurance policies with an investment element. European retail investors should always receive short, comparable and standardised disclosures in the form of a Europe-wide and uniform key information document (KID), whatever the investment product they are considering. The proposal in essence contains provisions on the content and preparation of the KID, as well as the obligation to provide such. Effective entry into force: 31 December 2016.

DIRECTIVE 2014/17/EU ON CREDIT AGREEMENTS FOR CONSUMERS RELATING TO RESIDENTIAL IMMOVABLE PROPERTY

The Directive aims at establishing a Europe-wide mortgage credit market with a high level of consumer protec-

tion. It includes conditions for the provision of credit through creditors and credit intermediaries as well as rules pertaining to the admission of credit intermediaries. Implementation deadline: 21 March 2016.

#### DIRECTIVE 2014/49/EU ON DEPOSIT GUARANTEE SCHEMES

The recast of the Directive on deposit guarantee schemes (DGS) is to protect bank customers against the consequences of the insolvency of a credit institution by maintaining a general European coverage level of € 100 000 (applicable since Directive 2009/14/EC), faster repayment (within seven working days) and improved information on the deposit guarantee scheme. A new provision stipulates the requirement for an ex-ante financial target level of 0.8% of the amount of the covered deposits, which the DGS must have reached within 10 years of the Directive entering into force. Implementation deadline: 3 July 2015.

#### DIRECTIVE 2014/51/EU AMENDING THE POWERS OF THE EUROPEAN SUPERVISORY AUTHORITY (EUROPEAN INSURANCE AND OCCUPATIONAL PENSIONS AUTHORITY) AND THE EUROPEAN SUPERVISORY AUTHORITY (EUROPEAN SECURITIES AND MARKETS AUTHORITY) (OMNIBUS II)

This Directive regulates the powers of EIOPA and ESMA, and amends Directive 2009/138/EC (Solvency II) and Directive 2003/17/EC (Prospectus Directive). It extends the areas already referred to in Directive 2010/78/EU (Omnibus Directive) within the scope of which the Commission may adopt technical standards and rules by means of delegated or implementing acts. Implementation deadline: 31 March 2015.

#### DIRECTIVE 2014/59/EU ESTABLISHING A FRAMEWORK FOR THE RECOVERY AND RESOLUTION OF CREDIT INSTITUTIONS AND INVESTMENT FIRMS

The Bank Recovery and Resolution Directive (BRRD) harmonises the tools used to deal with banking crises. If banks fail in future, shareholders and creditors should also have to face some of the consequences by way of the bail-in tool. Banks must prepare recovery plans to be implemented in the event of financial difficulties. Various new powers allow authorities to intervene in banks in order to prevent their failure or if they failed to restructure the institutions concerned, with losses having to be borne by shareholders and creditors according to clearly defined rules for liability. The resolution plans should be implemented in such a way that failing institutions are not rescued at taxpayers' cost. National resolution funds in the euro area Member States will be replaced by the Single Resolution Fund in 2016. Implementation deadline: 1 January 2015.

#### DIRECTIVE 2014/91/EU ON THE COORDINATION OF LAWS, REGULATIONS AND ADMINISTRATIVE PROVISIONS RELATING TO UNDERTAKINGS FOR COLLECTIVE INVESTMENT IN TRANSFERABLE SECURITIES (UCITS) AS REGARDS DEPOSITARY FUNCTIONS, REMUNERATION POLICIES AND SANCTIONS (UCITS V)

UCITS V defines clear and comprehensive rules for UCITS depositaries, precautionary measures to avoid a risk-inducing remuneration policy, as well as a uniform sanctioning and publishing regime. Implementation deadline: 18 March 2016.

#### DIRECTIVE 2014/92/EU ON THE COMPARABILITY OF FEES RELATED TO PAYMENT ACCOUNTS, PAYMENT ACCOUNT SWITCHING AND ACCESS TO PAYMENT ACCOUNTS WITH BASIC FEATURES

Each EU citizen is given the right to a basic payment account, switching of accounts is simplified, particularly also across borders, and transparency and comparability of account fees improved. In detail, the Directive stipulates:

- that banks must provide their current account customers, prior to conclusion of a contract and subsequently at any time they request it, with a separate fee information document that briefly, clearly and comprehensibly states all fees, including the overdraft interest rate, with this information also having to be provided in an easily accessible manner on their websites and at their premises;
- that banks are obliged to inform account holders once a year of all the fees charged on their payment account, stating each fee separately;

- that consumers must have free access to at least one website in each Member State, enabling fees to be compared easily and reliably.
- that each bank must offer every new customer a switching service free of charge, encompassing all steps necessary to switch accounts.

Implementation deadline: 18 September 2016.

## EUROPEAN LEGISLATIVE PROJECTS

The following legislative projects of special relevance to the FMA's activities were tackled at European level in 2014 but have not yet been concluded or published.

### DIRECTIVE AMENDING DIRECTIVE 97/9/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL ON INVESTOR-COMPENSATION SCHEMES – COMMISSION PROPOSAL COM(2010) 371

The aim of this proposal is to bring the scope of investor compensation into line with MiFID and, additionally, to increase the level of compensation to € 50 000. Claims in the event of market abuse are excluded.

### DIRECTIVE ON INSURANCE MEDIATION (IMD2/IDD2) – COMMISSION PROPOSAL COM(2012) 360

This proposal aims to amend Directive 2002/92/EC (Insurance Mediation Directive – IMD1) in order to ensure a level playing field between all participants involved in the selling of insurance products and to strengthen policyholder protection. The revised Directive (IMD2) should achieve the following improvements: expand the scope of application of IMD1 to all distribution channels (e.g. direct writers, car rentals, etc.); identify, manage and mitigate conflicts of interest; raise the level of harmonisation of administrative sanctions and measures for breach of key provisions of the current Directive; enhance the suitability and objectiveness of advice; ensure sellers' professional qualifications match the complexity of products sold; simplify and approximate the procedure for cross-border entry to insurance markets across the EU. As of the last compromise proposal the Directive is now referred to as Insurance Distribution Directive 2 (IDD2).

### REGULATION ON INFORMATION ACCOMPANYING TRANSFERS OF FUNDS – COMMISSION PROPOSAL COM(2013) 44

The Regulation is intended to ensure the complete traceability of transfers of funds as a means of facilitating the prevention, detection and investigation of money laundering and terrorist financing. The Commission has proposed the Regulation to implement the recommendations made by the Financial Action Task Force (FATF) in 2012.

### DIRECTIVE ON THE PREVENTION OF THE USE OF THE FINANCIAL SYSTEM FOR THE PURPOSE OF MONEY LAUNDERING AND TERRORIST FINANCING – COMMISSION PROPOSAL COM(2013) 45

This proposal on the now Fourth Anti-Money Laundering Directive (AMLD) extends the scope of the risk-based approach with regard to the prevention of money laundering and terrorist financing (risk-based and not rule-based). The aim is to use resources to combat money laundering and terrorist financing in a more target-oriented and efficient manner. The proposal contains the following new provisions:

- Obligatory implementation of group-wide policies and procedures for anti-money laundering and combating terrorist financing purposes. These include in particular group-wide safeguards and procedures for sharing information within the group, which shall be implemented at all branches and subsidiaries in EEA Member States and third countries.
- Broadening scope to cover the gambling sector, from transactions of € 2 000 or more (apart from casinos, online gambling is now also covered).
- Reducing the thresholds for traders in goods from € 15 000 to € 7 500 for the Directive to apply.
- Requirement to use enhanced due diligence in relation to domestic politically exposed persons.
- Setting up national registers to hold information on beneficial owners of companies. Companies are also



required to always hold up-to-date information on those persons who ultimately own or control the company.

#### REGULATION ON EUROPEAN LONG TERM INVESTMENT FUNDS – COMMISSION PROPOSAL COM(2013) 462

Through the creation of a new form of fund vehicle, the EU Long Term Investment Fund (ELTIF), the European Commission intends to attract “patient capital” from both professional investors and retail investors, for infrastructure projects, real estate and unlisted companies.

#### DIRECTIVE ON PAYMENT SERVICES IN THE INTERNAL MARKET (PSD2) – COMMISSION PROPOSAL COM(2013) 547

This proposal is to repeal Directive 2007/64/EC, the so-called Payment Services Directive (PSD). The Commission intends to extend the scope of the PSD, to lay down rules for retailers to surcharge their customers for the use of a certain means of payment (see also COM(2013) 550), to revise the existing rules for a refund in the case of direct debits and the liability rules in case of unauthorised transactions, as well as to introduce stricter security measures for payment service providers. The proposals also provides for licensing and registration requirements, own funds requirements and transparency rules (relating to fee conditions, for example) for payment service providers.

#### REGULATION ON INTERCHANGE FEES FOR CARD-BASED PAYMENT TRANSACTIONS – COMMISSION PROPOSAL COM(2013) 550

The European Commission’s aim pursued with this proposal is to cap the fees for credit and debit card payments (so-called Multilateral Interchange Fees, or MIFs, which form part of the fees that accrue to merchants when accepting card payments and which are ultimately passed on to consumers), and to strengthen competition in this area. In future all credit card transactions should not exceed a maximum interchange fee of 0.30% of sales, and the fee for all debit card transactions will be lowered to a maximum of 0.20% within the EU. Both limits are to apply to both domestic and cross-border transactions.

#### REGULATION ON MONEY MARKET FUNDS – COMMISSION PROPOSAL COM(2013) 615

The proposal introduces common standards to increase the liquidity of money market funds (MMFs) as well as to ensure the stability of their structure. Uniform rules will be introduced to ensure a minimum level of daily and weekly liquid assets. A standardised policy will be established to permit the fund manager to gain a better understanding of its investor base. Common rules are also introduced to guarantee that MMFs invest in high quality and well diversified assets of good credit quality. In this way it will be ensured that the liquidity of the fund is adequate to face 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. These valuation rules will restore the evident truth that MMFs are normal mutual funds whose investment assets are subject to price fluctuations.

#### REGULATION ON REPORTING AND TRANSPARENCY OF SECURITIES FINANCING TRANSACTIONS – COMMISSION PROPOSAL COM(2014) 40

The Commission proposes to introduce a reporting obligation for securities financing transactions (SFTs) across Europe as well as stricter rules on transparency of rehypothecation and to extend the information requirements for investment funds (additional information requirements for UCITS and AIFs). The obligation to report SFTs is to make the credit interlinkages more transparent, thus enabling easier recognition of the micro and macroprudential risk potential.

#### REGULATION ON STRUCTURAL MEASURES IMPROVING THE RESILIENCE OF EU CREDIT INSTITUTIONS – COMMISSION PROPOSAL COM(2014) 43

With this proposal the European Commission intends to prohibit large Union credit institutions and banking



groups with a particularly complex structure from carrying out risky proprietary trading. In addition, the competent authorities are to be granted the power to require the separation of potentially risky trading activities from deposit-taking if these activities threaten financial stability. In order to avoid activities being driven towards less strictly regulated “shadow banking”, transparency of certain transactions outside the regulated banking sector is to be increased.

DIRECTIVE ON THE ACTIVITIES AND SUPERVISION OF INSTITUTIONS FOR OCCUPATIONAL RETIREMENT PROVISION (IORP II DIRECTIVE) – COMMISSION PROPOSAL COM(2014) 167

The European Commission is working on proposals to strengthen the internal market for occupational retirement provision. It plans to facilitate cross-border activities of institutions for occupational retirement provision (IORPs), to ensure effective supervision of IORPs and to strengthen governance. Moreover, the proposals extend the requirements relating to the disclosure of information to members and beneficiaries and adapt the rules on investment.

## The Financial Market Stability Board (FMSB)

### How the Austrian institutions cooperate with regard to macroprudential supervision

**T**he newly created Austrian Financial Market Stability Board (FMSB) began its work on 8 September 2014. The Board is composed of representatives from the Federal Ministry of Finance (BMF), the Fiscal Advisory Council, the Oesterreichische Nationalbank and the FMA. Its members meet to analyse and discuss issues relating to macroprudential supervision and to prepare and make decisions. The FMSB's counterpart at European level is the European Systemic Risk Board (ESRB) based at the European Central Bank.

What specifically does macroprudential supervision involve?

- Microprudential supervision – the FMA's core task – involves securing creditor protection and strengthening financial market stability through ongoing supervision of individual financial institutions.
- Macroprudential supervision, in contrast, identifies and analyses risks on a forward-looking basis, in the interests of the overall stability of the financial system. As well as cyclical and structural issues, this also involves fundamental issues in conjunction with incentive problems in the financial system, the latter's inherent procyclicality and the risks arising from direct and indirect links between institutions and other undertakings, and between different sectors. It also involves attempting to develop appropriate measures for avoiding or at least curbing these risks.

The aims of macroprudential supervision are to safeguard the stability of the financial system, to lower the social costs of any financial crisis and to make a sustainable contribution to medium-term and long-term economic growth. After all, a real economy can only function smoothly with no friction if households, companies and governments have access to credit and if financial services are made available, and this also applies during and after any form of shock that hits the financial system or affects significant financial market participants.

As a form of systemic risk supervision, macroprudential supervision therefore differs greatly from microprudential supervision at institution level in terms of its ultimate objective

#### ESRB RECOMMENDATIONS

Macroprudential supervision must take a forward-looking approach, identifying those risks that could destabilise the financial system (systemic risk), analysing them and, if necessary, introducing timely countermeasures. To this

end, and in accordance with the Recommendation of the ESRB of 4 April 2013 on intermediate objectives and instruments of macroprudential policy (ESRB/2013/1)<sup>1</sup>, the macroprudential supervisory institutions are required to define specific intermediate objectives for the purposes of meeting their overriding aims and as a means of implementing their supervisory policy in everyday practice. These should at least address the following types of market failure:

- excessive credit growth and leverage;
- excessive maturity mismatch and market illiquidity;
- direct and indirect exposure concentrations;
- systemic impact of misaligned incentives with a view to reducing moral hazard;
- threat to the resilience of financial infrastructures.

The intermediate objectives set by the macroprudential authorities must be evaluated on an ongoing basis and, where necessary, adapted and extended in line with the specific features of the national financial system.

## MACROPRUDENTIAL SUPERVISION INSTRUMENTS<sup>2</sup>

If macroprudential supervision identifies a systemic risk for the financial system, timely and effective action must be taken using the corresponding instruments. As a general rule, macroprudential supervision in Europe encompasses the entire financial market. To date, however, it has mainly had access to banking sector instruments for tackling systemic risks. In terms of the young supervisory discipline that is still being developed both theoretically and empirically, the European lawmakers have been pursuing a gradual development approach, involving as a first step mainly but by no means exclusively<sup>3</sup> the most strongly integrated sector of the financial

### WHY IS MACROPRUDENTIAL SUPERVISION NECESSARY<sup>4</sup>?

The insolvency of US investment bank Lehman Brothers in September 2008 rocked the international financial markets and triggered huge distortions. This destabilised the global financial system and had a catastrophic impact on many countries' real economies. The weaknesses inherent in the legal and paradigmatic structures of financial supervision and the resulting need for reform were revealed for all to see.

Yet there was a flawed approach to supervision, focusing almost exclusively on the development of individual institutions' risk-bearing capacity, on paradigmatic trust in the disciplinary effect of market forces as they coped with financial market participants engaging in disproportionately risky business operations and, primarily in Europe, on the geographically restricted authority of national supervisory authorities. This proved to be an inadequate response to an ever more international financial system, the development of which had been driven by excessive euphoria.

With the international financial system having teetered on the brink, one of the important lessons learned from the crisis was that as well as taking microprudential supervision aimed at ensuring the stability of individual financial market participants to the next level, a macroprudential form of supervision also needed to be created quickly in the interests of the stability of the system as a whole.

<sup>1</sup> [https://www.esrb.europa.eu/pub/pdf/recommendations/2014/140630\\_ESRB\\_Recommendation.en.pdf](https://www.esrb.europa.eu/pub/pdf/recommendations/2014/140630_ESRB_Recommendation.en.pdf)

<sup>2</sup> An overview of the macroprudential measures already in use can be found on the ESRB website at <https://www.esrb.europa.eu/mppa/html/index.en.html>

<sup>3</sup> See for example the Annual Reports and relevant Commentaries and Occasional Papers prepared by the ESRB (<https://www.esrb.europa.eu/pub/html/index.en.html>).

<sup>4</sup> For a detailed description of the aims, functioning, costs and benefits of macroprudential supervision, see for example Ittner, Andreas; Schmitz, Stefan W., "Die Kosten der Bankenregulierung" [The costs of banking regulation], *Wirtschaftspolitische Blätter* 4/2014, 673-89 and Oesterreichische Nationalbank, "Macroprudential Supervision: A Key Lesson from the Financial Crisis", *Financial Stability Report* No. 27, 2014, 83-94.

## MACROPRUDENTIAL INSTRUMENTS FOR BANKING SUPERVISION IN AUSTRIA

SINCE 1 JANUARY 2014

Specific macroprudential instruments

- *systemic risk buffer (SRB)* to limit long-term, non-cyclical systemic risks [Article 23d of the Austrian Banking Act (BWG; *Bankwesengesetz*) in conjunction with Article 133 CRD IV];
- *national flexibility package* to avoid systemic risks in the national financial system that cannot be cushioned using other instruments [Article 458 CRR].

Instruments at the interface between micro and macroprudential supervision

- *stricter criteria to avoid risks relating to real estate security* [Article 124/126 CRR];
- *Pillar 2 measures* to address systemic risks, particularly for groups of credit institutions with a similar risk profile [particularly Articles 39, 69 and 70 BWG in conjunction with Articles 97, 98 and 102 to 104 CRD IV].

AS OF 1 JANUARY 2016

- *countercyclical capital buffer (CCB)* to strengthen the risk-bearing capacity of the banking sector in times of increasing cyclical systemic risks, particularly with regard to excessive credit growth [Article 23a BWG in conjunction with Article 130 CRD IV];
- *buffer for global and other systemically important institutions (G-SII, O-SII)* to strengthen the risk-bearing capacity of individual institutions that are relevant to the global or national financial system [Articles 23b and 23c in conjunction with Article 131 CRD IV].

market from a regulatory and supervisory perspective, namely the banking sector. The focus below therefore lies on macroprudential instruments in banking supervision, an overview of which is provided in the above box “Macroprudential instruments for banking supervision in Austria”.

The instruments enshrined in the Capital Requirements Directive (CRD IV) and Capital Requirements Regulation (CRR), as well as those instruments defined by national law that extend beyond the European requirements (e.g. loan-to-value ratios), can be categorised as follows:

- according to the intermediate objectives: which instruments can be used to alleviate and/or curb the market frictions defined for individual intermediate objectives?
- according to instrument type and mode: are the individual instruments aimed at balance sheet structure, terms and conditions of business or the incentive structure?
- according to type and mode of the systemic risks: is the systemic risk a structural risk, in other words a risk that is generally not dependent on the economic or credit cycle, or a cyclical risk?

## THE PRINCIPLE OF RECIPROCITY

In addition to the specific legal consequences that apply to non-compliance with macroprudential instruments such as the capital buffer requirements<sup>5</sup>, the principle of reciprocity is a particular feature of macroprudential supervision. Reciprocity in this context means the automatic or voluntary recognition of measures taken by authorities in other (Member) states to reduce systemic risks. By applying supervisory measures reciprocally, the aim is to create a level playing field, avoiding any form of regulatory arbitrage, which could significantly impede the effectiveness of macroprudential measures.

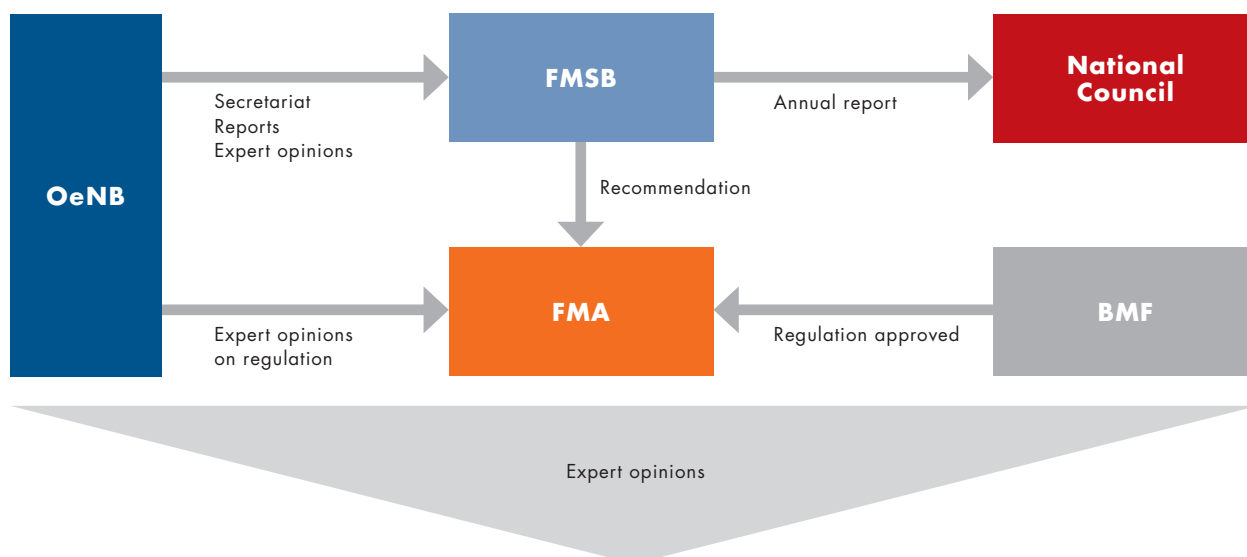
<sup>5</sup> Limits on profit distributions and submission of a capital conservation plan for approval pursuant to Articles 24 and 24a BWG.

In accordance with CRD IV, for example, the principle of automatic reciprocity applies within the EEA for the countercyclical capital buffer up to a level of 2.5%. If a national authority – or the ECB in the context of its macroprudential authority pursuant to Article 5 of the SSM Regulation (see below) – sets a countercyclical capital buffer for the risk positions of its own Member State (or, in the case of the ECB, an SSM Member State), all CRR credit institutions must abide by this additional equity requirement for risk positions with that Member State.

## THE MACROPRUDENTIAL SUPERVISION SYSTEM IN AUSTRIA

The system of macroprudential supervision in Austria – as depicted in Figure 1 – pools the specific expertise found in the institutions relevant to financial market stability and thus meets the broad remit of a systemic approach to supervision<sup>6</sup> without the need for inefficient and costly parallel structures.

Figure 1: Institutional design of macroprudential supervision in Austria<sup>7</sup> (source: OeNB)



The FMA is the macroprudential authority as defined in CRD IV/CRR and is consequently responsible for officially implementing the relevant measures in Austria (see in particular Articles 22a to 23d BWG). Given its expertise in economics and finance with regard to financial market stability, the OeNB supports the FMA by providing analyses and expert opinions. In addition, the OeNB provides the FMSB's secretariat, thereby also making an important organisational contribution to the smooth functioning of macroprudential supervision in Austria. The FMSB assumes the central role within the macroprudential supervisory process. It comprises representatives from the Finance Ministry, Fiscal Advisory Council, OeNB and FMA. Its remit includes the authority to issue risk warnings and to issue specific recommendations for action.

Within the Single Supervisory Mechanism (SSM), the ECB also has authority in the area of systemic risk supervision. In accordance with Article 5 of the SSM Regulation, the ECB may order macroprudential measures if these are stricter than those imposed by the national authorities (top-up power) and provided that the measures have their legal basis in European law. Figure 2 (on the following page) is a schematic diagram of macroprudential supervision at European level.

<sup>6</sup> As in earlier chapters, this section focuses mainly on the institutional design of macroprudential banking supervision.

<sup>7</sup> For reasons of simplicity, the diagram is based on the general process and does not take account of exceptional circumstances or European institutions.

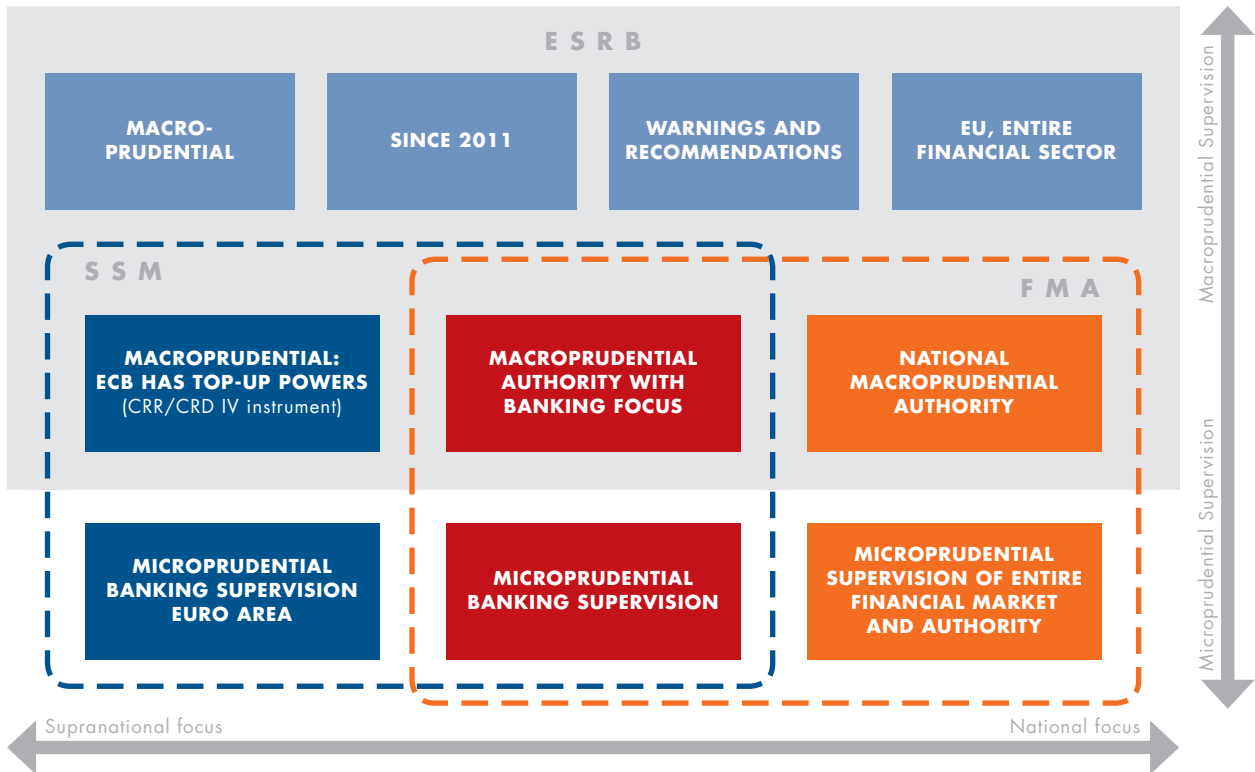


Figure 2: Macroprudential supervision in the EU and SSM

### THE FINANCIAL MARKET STABILITY BOARD (FMSB)

In the ESRB Recommendation on the macroprudential mandate of national authorities (ESRB/2011/3) , the Board recommends that the Member States set up an independent, macroprudential “authority” in the broader sense as defined by the ESRB. This “authority” may be set up as a single institution or as a board composed of the authorities whose actions have a material impact on financial stability. In Austria, this recommendation was implemented in the form of the establishment of the Financial Market Stability Board as defined in Article 13 et seq. of the Financial Market Authority Act (FMABG; *Finanzmarktaufsichtsbehördengesetz*).

Figure 3: Current members of the Financial Market Stability Board

<b>BMF</b>	Alfred Lejsek (Chairperson) Alfred Katterl (Deputy Chair) Peter Part (alternate member) Beate Schaffer (alternate member)
<b>FISCAL ADVISORY COUNCIL</b>	Bernhard Felderer Elisabeth Springler Edith Kitzmantel (alternate member) Ulrich Schuh (alternate member)
<b>OeNB</b>	Andreas Ittner Philip Reading (alternate member)
<b>FMA</b>	Klaus Kumpfmüller Helmut Ettl (alternate member)

In accordance with Article 13 para. 4 FMABG, the FMSB is composed of two representatives of the BMF (Chairperson and Deputy Chair), two representatives of the Fiscal Advisory Council (subject to the condition that the President of the Fiscal Advisory Council must sit on the FMSB), and one representative from both the OeNB and the FMA. An alternate member must be appointed for every FMSB member (see Figure 3). In exercising their function as FMSB members, none of the representatives or their alternates are bound to act on instructions from the institutions that they represent. Decisions of the FMSB are generally made on the basis of a simple majority, with the Chairperson having the casting vote in the event of a tie.

The FMSB’s responsibilities include in particular:

- discussion of key issues with regard to financial market stability;

<sup>8</sup> [https://www.esrb.europa.eu/pub/pdf/recommendations/2011/ESRB\\_2011\\_3.en.pdf](https://www.esrb.europa.eu/pub/pdf/recommendations/2011/ESRB_2011_3.en.pdf)

- promotion of cooperation and the exchange of opinions between the institutions represented on the Board during normal periods and during times of crisis;
- preparation of expert opinions, recommendations and requirements in relation to any threat to an institution's continued existence and a resulting systemic threat;
- issuing and publishing of risk information and recommendations, provided that such publication does not pose a serious threat to the stability of the financial markets;
- provision of advice on handling ESRB warnings and recommendations; and
- annual reporting to the National Council.

Just as the ESRB has similar powers at European level, the FMSB, in its capacity as an interinstitutional decision-making forum, may adopt risk warnings in relation to negative developments of relevance to the stability of Austria's financial market as well as adopting specific recommendations for action, submitting these to the FMA in particular as the macroprudential authority. The FMA must react to such recommendations in the form of a comply or explain mechanism.

At its first meetings the FMSB dealt with such issues as structural systemic risks facing the Austrian banking sector, as well as future options for activating the O-SII buffer for systemically important credit institutions and the countercyclical capital buffer. Also included in the agenda have been any negative repercussions in the Austrian financial system as a result of the Russia/Ukraine crisis and the results of the ECB's comprehensive assessment.

### **THE LIMITS OF MACROPRUDENTIAL SUPERVISION**

Although macroprudential supervision makes an important contribution to securing financial market stability, it should in no way be viewed as a panacea in the prevention of financial crises. Firstly, there is the challenge to consider of being able to predict the sometimes very dynamic developments of the financial market sufficiently reliably. Secondly, the scope of this supervision is by definition limited to the use of prudential supervisory instruments, with the result that it has no influence over other incentive mechanisms that could influence financial market stability, such as favourable tax treatment of borrowed capital or the indirect effects of what is currently a very expansionist monetary policy.

# The FMA as resolution authority

## Statutory mandate and official strategy

**T**he Federal Act on the Recovery and Resolution of Banks (BaSAG; *Bankensanierungs- und Abwicklungsgesetz*) entered into force on 1 January 2015.<sup>1</sup> The Bank Recovery and Resolution Directive (BRRD)<sup>2</sup> was implemented in Austria with the BaSAG, creating for the first time a comprehensive recovery and resolution regime for banks that are insolvent or under threat of insolvency. In this context, the Austrian Financial Market Authority (FMA) was entrusted with the role of national resolution authority.

### THE NEW EUROPEAN BANK RECOVERY AND RESOLUTION REGIME

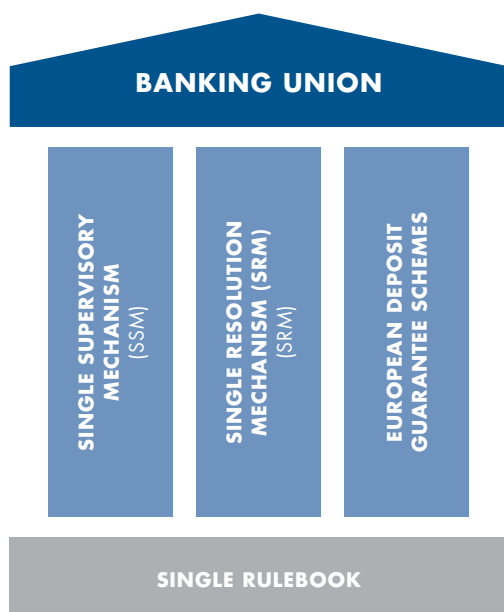


Figure 4: The new European banking union

In response to the serious distortions that the global financial crisis touched off in the European Economic and Monetary Union, and in particular to interrupt the dangerous downward spiral that resulted from the coupling of the banking crisis and the sovereign debt crisis, European legislators developed the concept of a banking union. Based on a harmonised set of rules for the whole of the European Economic Area, the banking union rests on three solid pillars: the Single Supervisory Mechanism (SSM), which is the euro area's common system of banking supervision under the leadership of the European Central Bank (ECB), the Single Resolution Mechanism (SRM) and European deposit guarantee schemes. The SSM entered into force as of 4 November 2014 and the SRM will become effective on 1 January 2016, while deposit guarantee schemes will be put in place in stages beginning in 2015. The banking union comprises all euro area countries but is designed to be open, i.e. every other EU Member State can join voluntarily at any time.

The legal basis for the Single Resolution Mechanism is provided by

<sup>1</sup> Federal Law Gazette I No. 2014/98.

<sup>2</sup> Directive 2014/59/EU of 15 May 2014, OJ L 173, 12.6.2014, p. 190.



Directive 2014/59/EU (BRRD) and Regulation (EU) No 806/2014 (SRM Regulation). The design and architecture of this legislation is modelled on the rules governing the SSM.

The BRRD<sup>3</sup> establishes a harmonised European system of law for dealing with credit institutions and investment firms which have fallen into financial difficulties, while requiring minimum harmonisation of the substantive rules applying to the recovery and resolution of banks in the Member States. The Member States are required to apply those provisions starting with 1 January 2015. The existing articles of the Austrian Banking Act (BWG; *Bankwesengesetz*) that specify “Receivership and insolvency provisions” (Articles 81 to 91) continue to apply but only to a very limited group of licensed institutions.<sup>4</sup>

### THE SINGLE RESOLUTION BOARD (SRB)

In addition to the BRRD, the SRM Regulation<sup>5</sup> was adopted to establish a European resolution authority responsible for planning and carrying out the resolution of banks that are under direct supervision by the ECB and for cross-border banking groups. Located in Brussels, the SRB took up activities as of 1 January 2015. The Board’s current executive representatives (as of 30 April 2015) are listed below.

*Chair:* Elke König (Germany)  
*Vice Chair:* Timo Löytyniemi (Finland)  
*Board Members:* Mauro Grande (Italy/ECB)  
 Antonio Carrascosa (Spain)  
 Joanne Kellermann (Netherlands)  
 Dominique Laboureix (France)

A staff of about 250 will take care of the Board’s operative duties once it is fully established in 2017; employees should number about 120 by the end of 2015.

The plenary session is attended by the Chair, the Board Members and a member appointed by each participating Member State to represent the country’s national resolution authority. Executive Director Klaus Kumpfmüller represents Austria on the Board. Among the Board’s duties are to take decisions concerning the use of the Single Resolution Fund where funding for a specific resolution measure exceeds € 5 billion, and decisions involving organisational issues.

The Board’s executive session is attended by the Chair and the four Board Members. The executive representatives can take independent decisions where the amount of support to be provided by the Fund is less than € 5 billion. When the consultations and resolutions concern a specific company (or its subsidiaries), the member representing the Member State in which the company is established is also invited to attend.

Any decision taken by the Board on the resolution of an institution requires a resolution plan. Such a plan must be submitted to the European Commission. The Commission and the European Council may, within 24 hours, lodge objections to the resolution plan or request changes, which the Board has to consider.

The national resolution authority responsible in the particular case then implements the Board’s decisions.

The SRM Regulation enters into force in stages and will be fully applicable as of 1 January 2016. The Board’s tasks in 2015 include the review of recovery plans and preparing resolution plans. As of 1 January 2016 the Single Resolution Board will also be able to take measures aimed at early intervention and resolution. Similarly, management of the Resolution Fund will also be required from that date forward.

<sup>3</sup> Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council.

<sup>4</sup> This limited group, referred to as ‘non-CCR institutions’, comprises to a small degree the banks referred to as ‘special institutions’.

<sup>5</sup> Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010.

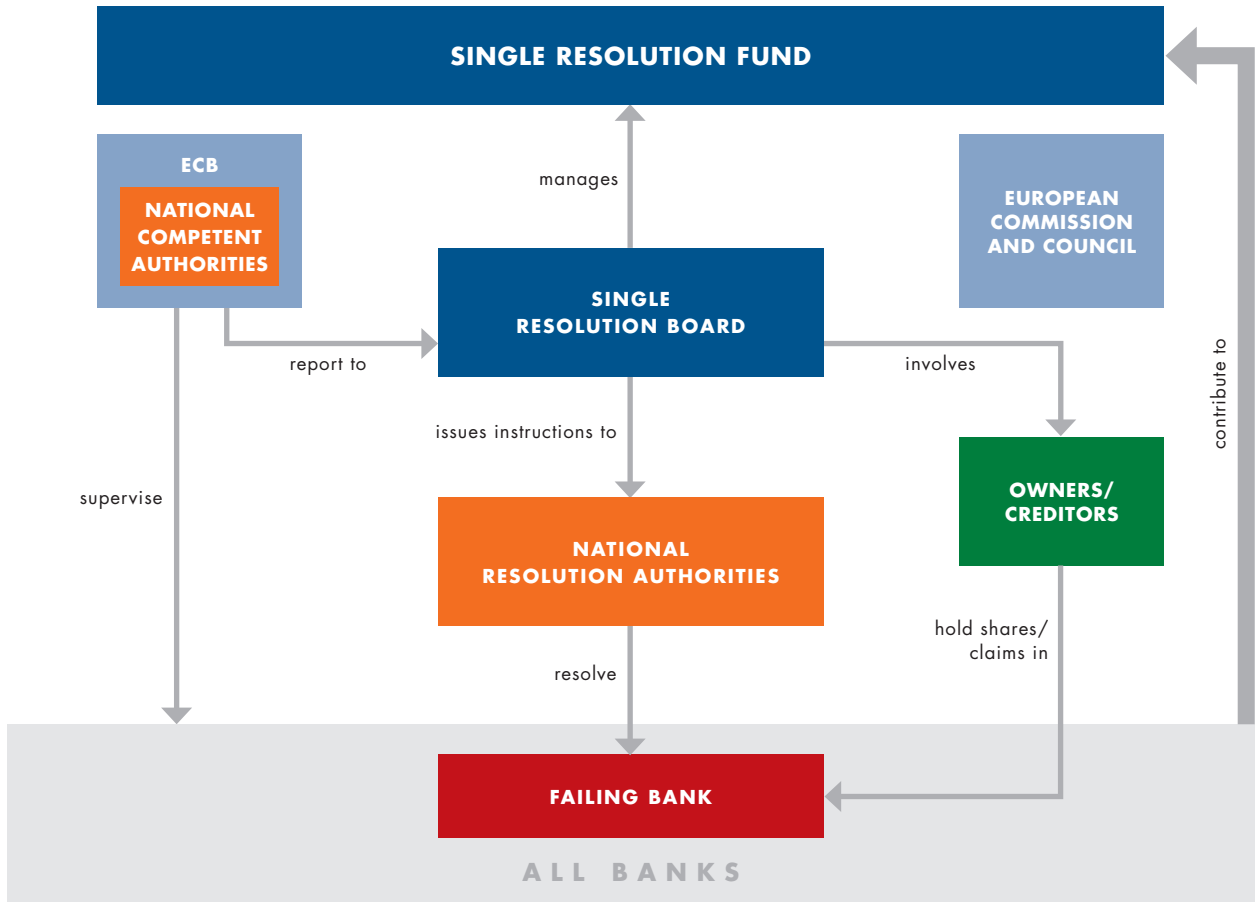


Figure 5: Structure and functioning of Europe's new Single Resolution Mechanism for banks

## THE RECOVERY AND RESOLUTION REGIME IN AUSTRIA

### RECOVERY AND RESOLUTION PLANS

Parts of the BRRD had been anticipated in Austria back in 2014 through the Banking Intervention and Restructuring Act (BIRG; *Bankeninterventions- und -restrukturierungsgesetz*). Pursuant to the BIRG, groups of credit institutions, affiliations of credit institutions and institutional protection schemes (IPS) having total assets of more than € 30 billion were required to prepare recovery plans to be submitted to the FMA. The BIRG was in force until 31 December 2014. Pursuant to the BaSAG, this requirement now also applies to smaller credit institutions and groups of credit institutions as of 2015. In its recovery plan the credit institution or group must indicate which measures it would take to restore its financial stability in the event of a significant deterioration of its financial situation. The recovery plan should therefore include options that would allow a credit institution to independently regain stability in the event of a crisis. The plan, which normally has to be updated once a year, is reviewed by the FMA as supervisory authority or by the ECB. In accordance with the supervisory principle of proportionality, the FMA issued the Bank Recovery Plan Regulation (BaSaPV; *Bankensanierungsplanverordnung*). The regulation specifies detailed requirements for recovery plans and how often such plans must be updated, depending on the size of the institution and the types of risk entailed in the business model. The BaSAG also expands the scope of supervisory powers for the case that early intervention is required to ensure an institution's recovery. Such early intervention is now already possible where an institution runs the risk of not complying with a capital add-on. The catalogue of early intervention powers was also supplemented, for example by additionally providing for the option of appointing a temporary administrator.

## THE FMA AS RESOLUTION AUTHORITY

The BIRG had also required banking groups with total assets of more than € 30 billion to prepare resolution plans, demonstrating how an orderly resolution or restructuring of the group could be carried out. Those resolution plans were to be submitted to the FMA in its role as supervisory authority by 31 December 2014. Pursuant to the new BaSAG and in contrast to the BIRG, the FMA in its new role as resolution authority is tasked with preparing resolution plans for all credit institutions and groups, with the credit institutions being obliged to contribute effort to the extent necessary. While the BIRG did not define any specific resolution tools for banks, such mechanisms have now become part of Austrian law through the BaSAG.

The FMA is the national resolution authority for Austria, as specified in Article 3 para. 1 BaSAG. Consequently, to ensure independent activities and to prevent any conflict of interest, a Bank Resolution Division was established within the Integrated Supervision Department. The division is entirely separate from Banking Supervision, and its head reports directly to the FMA Executive Board. Oliver Schütz was appointed Head of the Bank Resolution Division as of 16 February 2015. At its last meeting in 2014, the Supervisory Board of the FMA approved eight full-time equivalents (FTEs) for the new division, and at the first meeting in 2015 staff resources were expanded by an additional 16 FTEs. The division began operational activities when the BaSAG entered into force on 1 January 2015.

The Oesterreichische Nationalbank (ONB) is required to work closely with the FMA as national resolution authority, with the provisions governing cooperation being similar to those applying to banking supervision.

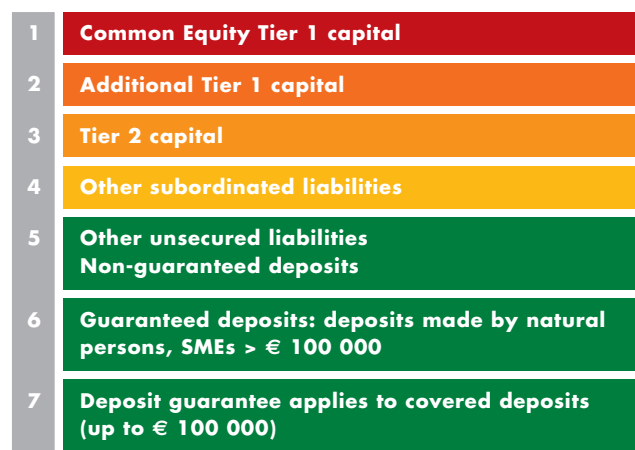
In its role as resolution authority, the FMA has been given extensive powers to ensure its ability to carry out orderly resolution of any institution that fails or threatens to fail, and to safeguard financial market stability. The objectives in any orderly resolution include ensuring that critical functions continue to be fulfilled, avoiding substantial negative impact on financial market stability as well as protecting public funds and customers' guaranteed deposits, where these objectives would not be met to the same extent through bankruptcy proceedings. The FMA may implement the following specific resolution tools:

- selling the institution;
- setting up a bridge bank;
- spinning off assets;
- bailing in creditors.

The latter tool, i.e. bailing in creditors, is the core tool specified by the BRRD as well as the BaSAG. It provides the resolution authority with the option of writing down an institution's eligible liabilities or converting the debt into equity (waterfall). Certain types of liabilities are exempted from the scope of application of the bail-in tool; the most important examples include guaranteed deposits, liabilities to employees, secured liabilities and interbank liabilities with an original term of less than seven days.

In addition, to ensure continued services and to mitigate the negative impact on financial market stability, the FMA may separate the institution's performing assets from the impaired or under-performing assets. To this end, the FMA may transfer shares in an institution or any or all of an institution's assets to a private-sector purchaser or to a bridge bank without the shareholder's consent.

Figure 6: The bail-in waterfall





## THE ROLE OF THE EUROPEAN BANKING AUTHORITY (EBA)

In numerous cases the BRRD specifies that provisions of the Directive are to be detailed by Commission legislation. In these instances the BRRD (European Commission/SRM) tasks the EBA with drafting regulatory or implementing technical standards by mid-2015. The EBA has been focused on preparing these proposals since mid-2014, so that a number of consultation papers could be adopted already in late 2014. Most of the draft proposals are scheduled to be adopted in the first quarter of 2015. Accompanying guidelines are also being prepared, which will similarly be subject to public consultation.<sup>6</sup>

The BRRD also requires the EBA to create a permanent internal committee to serve as an EBA Resolution Committee, while the competent (supervisory) authorities and resolution authorities are required to cooperate with the EBA for the purposes of the BRRD. The EBA met this requirement with the establishment of the Resolution Committee as of 1 January 2015. The heads of each of the resolution authorities take part in this committee. Austria is represented by FMA Executive Director Klaus Kumpfmüller.

The Resolution Committee takes independent decisions in matters relating exclusively to resolution, for instance when deciding on proposals for standards and guidelines but also on breaches of contract. In such cases the EBA Board of Supervisors is entitled only to object but not to amend any decisions. Committee decisions on matters concerning both resolution and supervision are referred to the Board of Supervisors for final approval.

## RESOLUTION COLLEGES

Effective resolution of institutions and groups active on a cross-border basis requires cooperation between the European Union, the Member States and third-country resolution authorities. To meet this need, it is planned to establish resolution colleges under the leadership of the resolution authority responsible for the parent institution. Such colleges will be responsible for resolution. As resolution authority, the FMA will be committed to sharing the positive experience gained through participating in supervisory colleges with the resolution colleges.

---

<sup>6</sup> For example: Guidelines on the specification of measures to reduce or remove impediments to resolvability and the circumstances in which each measure may be applied under Directive 2014/59/EU (EBA/GL/2014/11 of 19 December 2014).

## Europe's new banking supervision system (SSM)

### The role of the FMA as national competent authority (NCA)

**T**he economic and financial crisis of recent years has shown that supervising credit and payment institutions at national level is no longer enough. As the European single market for financial services has been developed further and the financial industry has become ever more international, national approaches have come up against their natural limits. A banking sector that was increasingly operating at a European level, alongside globally networked banking business, contrasted with national supervisory authorities. Cooperation between these national authorities was at best arduous and time-consuming, and always based on the premise that national interests came first. This created a huge imbalance in the opportunities for nationally oriented supervisors and internationally active financial institutions to work together. At the same time, it made supervision increasingly inefficient and ineffective.

Consequently, during the global financial crisis, many European states faced major financial costs as they sought to shore up their banks or, at the very least, provide them with financial support in a bid to prevent their financial systems collapsing and also impacting on the real economy. This triggered government debt crises, which also shook the financial markets. A vicious circle was created, and it took a great deal of effort and unparalleled European solidarity to halt the downward spiral. However, ultimately, it was taxpayers who footed the bill in the wake of the financial and banking crisis.

In order to avoid a repeat of this vicious circle of banking and government debt crisis in future, and thus also to protect taxpayers, Europe has developed and implemented the concept of banking union. Resting on the foundation of EU-wide, harmonised rules, the banking union is based on three pillars: the Single Supervisory Mechanism (SSM), the Single Resolution Mechanism (SRM) and a common deposit guarantee scheme (CDGS). The SSM entered into force on 4 November 2014, the SRM will apply across Europe as of 1 January 2016 and the CDGS will be implemented and funded over several stages commencing in 2015.

#### THE SSM, EUROPE'S NEW BANKING SUPERVISION SYSTEM

The legal basis for the SSM is provided by Regulation (EU) No 1024/2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (SSM Regulation) and Regulation (EU) No 468/2014 establishing the framework for cooperation within the Single

Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (SSM Framework Regulation). The ECB has also prepared a “Guide to banking supervision”<sup>1</sup> to help explain how the new statutory rules will work in practice. In Austria, the new rules have been translated into national law through the implementation of Article 77d of the Austrian Banking Act (BWG; *Bankwesengesetz*). This appoints the Financial Market Authority (FMA) as the national competent authority (NCA) and clearly defines cooperation with the Oesterreichische Nationalbank (OeNB) in this area.

While the entry into force of the SSM as of 4 November 2014 has seen responsibility for supervising all euro area banks transferred to the ECB, operational responsibility is carried out jointly by the ECB and the NCAs as part of a decentralised system and based on a mechanism that is clearly defined by law. The SSM cannot function without the NCAs as the central component of the joint supervisory mechanism. While it is the ECB that makes decisions and coordinates the processes, it is the employees of the NCAs who input their expertise in and experience of day-to-day operational supervision.

### COOPERATION PRINCIPLES

For the purposes of ensuring consistency in supervision and maintaining the highest possible standards throughout the SSM, the Single Supervisory Mechanism is based on the following principles:

- **Best practices:** The SSM must base its work on the procedures with the best track records among the NCAs, further developing its supervisory model in line with these procedures on a Europe-wide basis.
- **Integrity and decentralisation:** Through intensive cooperation and the ongoing exchange of information between the ECB and the NCAs, the SSM can draw on the national experience gained by the individual Member States. This means that the unity of the supervisory system can be upheld and any redundancy avoided.
- **Homogeneity:** Supervisory principles and procedures are applied appropriately and in a harmonised manner to all of the relevant credit institutions.
- **Consistency with the single market:** The SSM currently encompasses all of the euro area states. It is, however, basically open to all of the other EU (EEA) Member States whose currency is not the euro. The aim is therefore to promote the convergence process within the single market.
- **Independence – Separation of monetary policy and banking supervision:** Given that the ECB is now responsible for two functions, namely monetary policy for the euro area and banking supervision in the SSM, with the potential for conflicts of interest between these two functions, each should be organised independently of the other and kept strictly separate from the other.
- **Risk-based approach:** The risk-based approach ensures that supervisory resources are deployed in those areas where they make the biggest contribution to financial stability.
- **The principle of proportionality:** The optimum allocation of resources, but also supervisory practices, must be proportionate to the risk profile and systemic importance of the respective credit institution.
- **Effective and timely correction measures:** A “proactive” approach to supervision should maintain both European and national financial stability. In this way, the need to make use of tax revenue to rescue banks should be avoided.

<sup>1</sup> This guide can be downloaded from <https://www.bankingsupervision.europa.eu/press/publications/html/index.en.html>

## THE ORGANISATIONAL STRUCTURE

### SEPARATION OF MONETARY POLICY AND BANKING SUPERVISION IN THE ECB

Since the introduction of the euro, the ECB has been engaged in monetary policy tasks within the scope of the European System of Central Banks (ESCB). In this function it serves as the central bank for the currency union. Its remit includes defining and implementing the EU's monetary policy, setting key interest rates, carrying out foreign exchange transactions, holding and managing the Member States' official currency reserves and promoting the smooth functioning of payment systems.

The new powers added since the creation of banking union may not under any circumstances be mixed with those relating to monetary policy. This similarly applies to the ECB's tasks in relation to the European Systemic Risk Board (ESRB).

The ECB is obliged to report to the European Parliament and Council on its observance of this separation.

In order to achieve an effective separation of the functions within the ECB, the staff responsible for performing the tasks derived from the SSM Regulation must be separated in the organisational structure from those employees who are responsible for carrying out other ECB tasks. This also applies to reporting within the two functions. As the senior decision-making body, the ECB Governing Council must also perform its monetary policy function separately from its supervisory function.

## THE DECISION-MAKING PROCESS

As part of the implementation of the SSM, a Supervisory Board was set up at the ECB itself. This comprises a Chair, a Vice-Chair, four ECB representatives and one representative from each of the national competent authorities (NCAs) of the participating Member States. Austria is represented on this Board by FMA Executive Director Helmut Ettl, who is a voting member.

The Supervisory Board's draft decisions are proposed on the basis of thorough, objective and transparent information, bearing in mind the interest of the EU as a whole. The decision-making process itself is based on the concept of implicit consent, and referred to as the "non-objection procedure". The Supervisory Board met on a total of 23 occasions during the year under review, with meetings also being held during the preparatory phase before the SSM entered into force. As a general rule meetings are scheduled every 14 days and can be expected to last for one to two days.

It is the role of the ECB's Supervisory Board to submit a completed draft decision to the ECB Governing Council, the ECB's decision-making body. If the Governing Council does not object to a draft decision within ten working days, the decision is deemed adopted, in which case it must be executed by the Supervisory Board. Generally, the Governing Council may adopt or object to draft decisions but does not have the right to change them.

In order to resolve any differences of opinion between the NCAs and the Supervisory Board, the ECB has set up a Mediation Panel. This Panel has one member per participating Member State. The Mediation Panel makes its decisions on the basis of a simple majority, with each member having one vote.

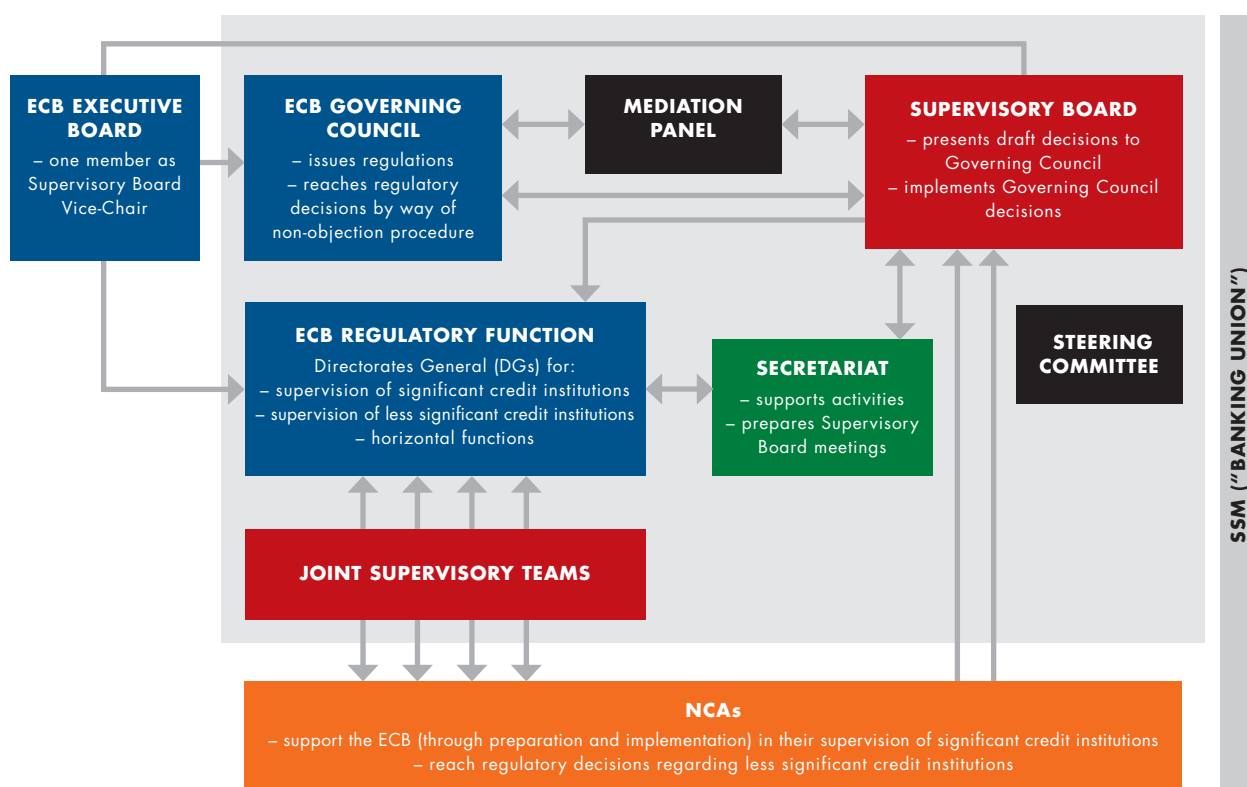
## THE LANGUAGE REGIME WITHIN THE SSM

Within the SSM, the ECB and NCAs have agreed to use English as their working language. However, given that banking supervision is an official activity, every entity subject to the standards, be they a natural or legal person, has a right enshrined in European law to a procedure conducted in that entity's recognised national language.

Correspondingly, supervised credit institutions, as well as other legal or natural persons that are individually subject to the ECB's supervisory procedures, may prepare and/or submit the required documents to the ECB in one of the official languages of the EU. Moreover, they have a statutory entitlement to procedures being carried out in that language and to all of the relevant documentation being submitted in that language.



Figure 8: Structure and functioning of Europe's new Single Supervisory Mechanism (SSM) for banks



The ECB and the credit institution (or any individually affected legal or natural person) may however agree to use English as their working and procedural language.

### ALLOCATION OF TASKS BETWEEN THE ECB AND FMA

The ECB is not an all-encompassing, omnipresent “super authority”. To achieve the objective of uniform banking supervision within the euro area, responsibility for supervision and supervisory tasks is shared between the ECB and NCAs in line with the principles of subsidiarity and proportionality. This is the only way to achieve optimum market proximity and the optimum use of available resources and acquired knowledge.

To this end, a distinction is made in the SSM between “significant institutions” (SIs) and “less significant institutions” (LSIs), with the former being significant at a European level and the latter only of regional significance. The significant institutions are supervised directly by the ECB, while the less significant institutions are only subject to indirect ECB supervision and continue to be the direct responsibility of the national competent authority. The distinction is made using a precisely defined set of criteria (see box “Significant institution or less significant institution”), based on the size of the bank (in European or national terms), its systemic relevance (in European or national terms) and the risk associated with its business model.

The ECB conducts annual reviews of the classification of banks. However, in order to avoid frequent switches of supervisory responsibilities between NCAs and the ECB, and for the purposes of continuity, institutions are changed from less significant to significant if an institution fulfils at least one of the criteria for one year. Institutions are downgraded from significant to less significant if the significance criteria are not met for three years in a row.

The classification of a credit institution or credit institution group is carried out in the form of an ECB decision. As at the launch of the SSM, the ECB had classified 120 banks and credit institution groups, together accounting for 85% of assets in the euro area banking sector, as SIs, thereby placing them under its direct supervi-

**SIGNIFICANT INSTITUTION OR LESS SIGNIFICANT INSTITUTION?**

For the purposes of allocating tasks between the ECB and NCAs within the SSM, banks are classified either as significant credit institutions (SIs) or less significant credit institutions (LSIs).

To be considered significant, an institution must fulfil at least one of the following criteria:

- the total value of its assets exceeds € 30 billion;
- the total value of its assets exceeds 20% of the national gross domestic product and exceeds at least € 5 billion;
- the three most significant banks established in a Member State;
- the credit institution is reported to the ECB by the NCA as being significant to the national economy, and this is confirmed by the ECB;
- a credit institution may be classified as significant by the ECB based on its significant cross-border activities;
- a credit institution has received direct financial support from the European System of Financial Supervision (ESFS) or the European Stability Mechanism (ESM).

All other banks are therefore classified as LSIs.

sion. All other banks and groups continue to be supervised directly at national level in the capacity of LSIs. A list of significant institutions is available on the ECB website.

With regard to Austria, the following credit institutions were classified as significant as at 4 November 2014:

- BAWAG P.S.K. Bank für Arbeit und Wirtschaft und Österreichische Postsparkasse AG
- Erste Group Bank AG
- Österreichische Volksbanken AG
- Raiffeisen Zentralbank Österreich AG
- Raiffeisen-Holding Niederösterreich-Wien reg.Gen.m.b.H.
- Raiffeisenlandesbank Oberösterreich AG
- Sberbank Europe AG
- VTB Bank (Austria) AG

In the case of credit institution groups, if the leading institution in the group is classified as an SI, all of the other credit institutions forming part of that group are also deemed significant. For example, all of the savings banks and Volksbank cooperatives that form part of the Erste Group Bank AG group or Österreichische Volksbanken AG group are automatically also classified as significant. The eight significant institutions from Austria (i.e. with a licence granted by the FMA) therefore encompass around 150 independently licensed credit institutions.

**SUPERVISION OF SIGNIFICANT INSTITUTIONS**

Significant institutions (SIs) are subject to direct supervision by the ECB. Operational supervision of these institutions, however, is carried out by Joint Supervisory Teams (JSTs), composed of ECB employees and staff from the NCAs of the countries in which the credit institution group mainly operates. It is the NCAs that therefore provide between 70% and 90% of the members of a JST. A JST is set up for every SI. The size, composition and organisational structure of the JST are based around the nature, complexity, scale, business model and risk profile of the supervised credit institution.

These Joint Supervisory Teams are headed by a JST coordinator from the ECB but not from the country where the supervised institution is established. The coordinator is responsible for implementing the supervisory tasks

and activities as included in the Supervisory Examination Programme. The coordinator is also a contact person for the credit institutions, coordinates the work of the JST, allocates tasks to the different JST members, and organises meetings and teleconferences.

Each JST also has a sub-coordinator for each NCA that is represented on the JST by more than one member. These sub-coordinators support the JST coordinator in the day-to-day supervision and provide a link to the NCA perspective. For particularly large JSTs, a core JST may also be set up comprising the JST coordinator and sub-coordinators.

The NCAs therefore make a significant contribution towards preparing decision-making, particularly given that the ECB, when supervising significant institutions, is not just required to apply directly applicable EU law but also national statutory provisions that have been enacted to transpose European laws into national legislation. For example, the ECB must directly apply the Austrian Banking Act (BWG; *Bankwesengesetz*), and relies on FMA expertise to assist it in this area.

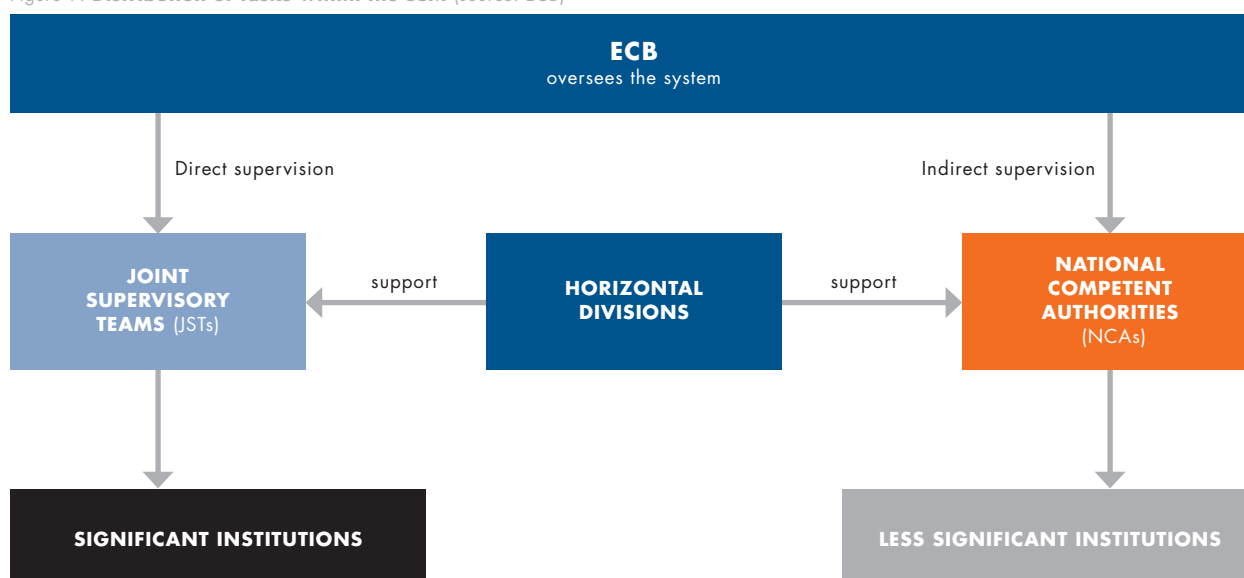
FMA employees who were previously responsible for the respective Austrian significant credit institution as the single point of contact (SPOC) are therefore still involved in supervising these SIs on a significant scale. Now, however, they receive their instructions from the JST coordinator. Additionally, the SPOCs that were previously responsible for supervising branches of significant credit institutions from another Member State now also form part of those JSTs that have been set up to supervise the SI from the other Member State.

The de facto result is that most of the tasks arising during a procedure fall to the JST employees from the NCAs. With regard to joint procedures, such as the fit and proper assessment of managers and supervisory board members, and processes relating to the freedom to provide services and the freedom of establishment, the role of the NCAs has actually been extended. In this case, the submission and inspection are initially carried out at national level before being presented to the ECB for decision-making.

## SUPERVISION OF LESS SIGNIFICANT INSTITUTIONS

Supervision of less significant institutions (LSIs) is based on the principle of proportionality. These institutions continue to be supervised directly by the national competent authorities (NCAs). As far as the FMA and Aus-

Figure 9: Distribution of tasks within the SSM (source: ECB)



Depending on classification (significant/less significant institutions), banks operating in the SSM are either subject to direct supervision by the ECB or continue to be supervised by the NCAs, in which case the ECB exercises an indirect supervisory function. Provisions are also in place for common procedures in relation to certain supervisory tasks. Based on the principle of proportionality, supervision of less significant credit institutions basically remains the task of the FMA. Generally, the ECB is only called upon in the event of specific risks having an impact.

tria are concerned, this means that the former is still responsible for the direct supervision of some 550 regionally significant credit institutions. In this case the ECB is only responsible for indirect supervision, designed in particular to ensure that high-quality supervisory standards are applied across the SSM and that uniform rules are in place. However, the leading role played by the FMA, coupled with its expertise, means that adequate account can still be taken of the particular features of the Austrian banking industry.

The FMA is required to report to the ECB regularly on its supervisory activities involving less significant institutions. In addition, the ECB may also issue general instructions, requests or guidelines. In special cases, the ECB may also engage in direct supervision in order to guarantee the uniform application of high supervisory standards.

Nevertheless, it is the FMA that generally continues to be directly responsible. Despite the need to observe the principle of proportionality, the SSM also requires a minimum of supervisory activity in relation to less significant credit institutions. The ongoing supervisory activities in the context of the SSM with regard to less significant institutions include the following:

- discussions with management;
- conducting regular risk analyses;
- planning and carrying out on-site inspections;
- implementation of common procedures.

#### COMMON PROCEDURES

Alongside the distinction between direct and indirect supervision of credit institutions, common procedures have also been created to deal with three particular supervision cases. In these cases, it makes no difference whether the credit institution is a significant or less significant institution. Rather, one single procedure is applied to all CRR credit institutions, in other words all institutions that take deposits or other repayable monies from retail customers and grant loans.

These common procedures are subject to a specific defined allocation of duties between the NCAs and the ECB:

#### AUTHORISATIONS

Licence applications must be submitted to the NCA of the Member State where the new credit institution is to be established. The NCA, the FMA in Austria's case, must inform the ECB that it has received the application within 15 working days. If the NCA is satisfied that all of the conditions for a licence are met, it proposes to the ECB a draft decision. If the application is to be rejected, however, a hearing procedure is arranged. The final decision on whether or not to grant a licence is always taken by the ECB. The applicant is subsequently informed by the NCA of the ECB's decision.

#### WITHDRAWAL OF AUTHORISATIONS

Both the ECB and the NCA of a Member State where the credit institution is established may propose that a licence be withdrawn. The NCA is required to act on the basis of national laws or if requested by the institution concerned. The cases in which the ECB may start a withdrawal process are defined in the corresponding provisions of European law. Following comprehensive consultations between the ECB and the NCA, the latter prepares a draft decision. The institution concerned may issue a statement prior to any final decision and is also entitled to a hearing. The ECB will subsequently decide on the outcome of the proceedings and will inform the NCA, the national resolution authority and the credit institution of its decision.

#### ACQUISITION OR SALE OF A QUALIFYING HOLDING

Notification of the acquisition of a qualifying holding (every instance of a threshold of 20%, 30% or 50% of the capital share or voting rights being exceeded) must be submitted to the NCA of the Member State where

the institution being acquired is established. As soon as the notification has been submitted in full, the ECB must be notified within five working days. It is the role of the NCA to check the notification and to prepare a draft decision, which is then submitted to the ECB for decision-making purposes. The acquisition of the qualifying holding is deemed to be approved if the ECB does not raise any objection within 60 working days of the date on which the notification was received by the NCA. In contrast, if the ECB voices its objection to an acquisition it must inform the applicant accordingly.

## MACROPRUDENTIAL SUPERVISION IN THE SSM

As a general rule, responsibility for macroprudential supervision remains with the FMA. This includes such areas as stipulating the requirements for capital buffers to be maintained alongside own funds, as well as other measures to avert systemic risks or macroprudential risks. In this context the FMA must work closely with the Financial Market Stability Board (FMSB), the Oesterreichische Nationalbank and also cooperate indirectly with the European Systemic Risk Board (ESRB). The ECB may, however, also intervene in these processes and, where applicable, set stricter rules than those imposed by the NCAs.

## EXCLUSIVE POWERS OF THE FMA

There are also key supervisory issues that remain the exclusive responsibility of the NCAs, also with regard to those institutions that are classified as significant and subject to direct ECB supervision. This particularly relates to preventing money laundering and terrorist financing, combating unauthorised banking business, supervising payment and electronic money institutions, as well as banks not covered by the CRR, and consumer protection. These supervisory issues remain the sole responsibility of the national competent authority.

## SUMMARY

Within the new banking supervision system in Europe, the SSM (Single Supervisory Mechanism), the ECB was given responsibility for supervising all euro area banks with effect from 4 November 2014. However, the ECB must perform the tasks assigned to it within a clearly defined system of cooperation with the national competent authorities. Significant institutions (SIs) from a European perspective are supervised directly by the ECB with all other less significant institutions (LSIs) continuing to be directly supervised by the national competent authorities (NCAs). In both cases, however, operational supervision is carried out on the basis of close cooperation between the ECB and NCAs, with between 80% and 90% of the work being performed by the national supervisors. In Austria, the lawmakers have assigned the FMA the function of NCA.


This means that the FMA has the following remit in particular:

- The FMA has a seat and a vote on the Supervisory Board of the SSM. Its role on this Board is, as far as possible, to represent Austrian interests, exerting significant influence on the type, basic direction and intensity of supervision of the institutions based in the euro area.
- The FMA is still responsible for the direct supervision of the more than 550 Austrian banks classified as regionally significant, which means that it is responsible for supervising a key portion of the Austrian banking sector.
- With regard to the banks and credit institution groups subject to direct ECB supervision, it is responsible for the tasks of the Austrian NCA. FMA employees, in the capacity of local sub-coordinators and members of the Joint Supervisory Teams (JSTs), are actively involved in the supervision of significant institutions and input their knowledge of the Austrian legal framework and the local banking sector into the work of the team.
- The FMA has a particular role to play with regard to the common procedures, in most cases acting as the first port of call, contributing to decision-making and carrying out important preparatory work for the ECB's decision-making.

- The following tasks are the sole responsibility of the FMA:
  - prevention of money laundering and terrorist financing;
  - combating unauthorised banking business;
  - consumer protection issues;
  - supervision of all credit institutions that are not CRR credit institutions;
  - enforcement of specific banking supervision laws (e.g. BSpG, HypBG, PfandbriefG).
- Macroprudential supervision is another area that is basically the responsibility of the national authorities and thus of the FMA. However, the ECB may impose stricter measures than the national supervisors.

# The new Insurance Supervision Act (VAG 2016)

## Solvency II, the new supervisory regime for insurance in Austria

 On 11 December 2014 the Austrian National Council adopted the 2016 Insurance Supervision Act (VAG 2016; *Versicherungsaufsichtsgesetz*), transposing the European Union's Solvency II Directive<sup>1</sup> into national law. This places the supervision of insurance undertakings on a completely new foundation. Solvency II rests on three pillars:

- Pillar 1 – quantitative surveys of insurance and reinsurance undertakings' risk situations and any resulting solvency requirements.
- Pillar 2 – qualitative requirements relating to the governance system of insurance and reinsurance undertakings.
- Pillar 3 – information obligations and market transparency.

The risk-based approach of the new supervisory system as well as the more in-depth cooperation among European authorities will make a significant contribution towards a healthier and more competitive Austrian insurance sector.

### THE OBJECTIVES OF THE NEW SUPERVISORY REGIME

The overriding objective in the new supervisory regime is naturally unchanged: policyholder protection. In addition, the FMA must also observe any potential impact on the stability of the financial system in the Member States and consider any possible procyclical effects during periods of exceptional movements in the financial markets.

A further objective is to expand and strengthen risk management. For this purpose, the current system of calculating the solvency capital requirement, which is rather mechanical, is being replaced by a system that should depict any risks associated with activities as precisely as possible. Such a risk-oriented calculation of the solvency capital requirement also provides an incentive to further improve risk management systems.

The VAG 2016 also aims at improving the supervision of insurance groups, particularly those with cross-bor-

<sup>1</sup> Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II), OJ L 335, 17. 12. 2009, last amended by Directive 2014/51/EU, OJ L 153, 22.5.2014.

der activities, which are becoming ever more important. To this end, cross-border cooperation and the efficient exchange of information is being stepped up, particularly with regard to supervisory colleges established by the competent authorities.

## THE VAG 2016

In order to achieve the objectives of the new supervisory regime, the VAG 2016 includes a number of profound changes to existing insurance supervision law. Provisions contained in the current version of VAG 1978 that have proven their worth in supervisory practice are not affected by the Solvency II changes and have been incorporated into the VAG 2016 more or less unchanged. This concerns in particular provisions relating to mutual associations, special provisions for different types of insurance, accounting and consolidated accounting, *Deckungsstock*, and provisions on execution and insolvency.

For easier understanding and to improve readability, the VAG 2016 has been divided into 14 Chapters including a total of 55 Sections.

Chapter 1 stipulates general provisions and defines the extended scope of application, which will cover the following in future:

- insurance and reinsurance undertakings with head offices in Austria;
- small insurance undertakings;
- small mutual associations;
- third-country (re)insurance undertakings;
- EEA (re)insurance undertakings;
- insurance holding companies;
- insurance associations with activities limited to asset management;
- private foundations; and
- special purpose vehicles.

In addition, this Chapter also includes definitions for the first time. The differentiation between Austrian and foreign insurance undertakings is no longer used in the VAG 2016. The term “insurance undertaking” now covers all insurers authorised pursuant to Article 14 of Directive 2009/138/EC (i.e. all insurance undertakings with their head office in a Member State). Furthermore, in contrast to the VAG 1978, the VAG 2016 no longer contains a list of the provisions applicable to reinsurance undertakings. Instead, reinsurers are now simply expressly referred to in the relevant provisions in accordance with the Directive.

Chapter 2 and Chapter 3 are dedicated to mutual associations. Small mutual associations have a longstanding tradition in Austria, most of them having emerged from farmers’ cooperative associations, and make up more than half of all supervised undertakings. Measured in terms of premium volume, their market share is however lower than one per cent. The new Solvency II regime does not apply to them. The Directive only requires such small insurance undertakings that do not fall under Solvency II to be registered. Chapter 3 therefore introduces a separate supervisory regime for small insurance undertakings, offering a high level of protection for policyholders while at the same time not excessively burdening the undertakings in respect of the economic and organisational requirements. However, since these small insurance undertakings are not authorised pursuant to Article 14 of Directive 2009/138/EC, their business activities are restricted to the territory of Austria.

Chapter 4 comprises provisions that have already proven their worth for specific types of insurance.

Chapter 5 implements the qualitative requirements of Pillar 2 in governance arrangements. Accordingly, insurance undertakings must set up an effective governance system with appropriate and transparent organisational structures, clearly allocating and separating responsibilities as well as an effective system for the transmission of information to ensure sound and prudent management. Guidelines and contingency plans are to be prepared, new requirements relating to outsourcing met, provisions relating to the internal control system fulfilled and governance functions established (a risk management function, a compliance function, an internal audit function and an actuarial function). Individuals exercising key functions must be fit and proper.



The responsible actuary will continue to be used. This function has grown historically in Austrian insurance supervision law and has proven its worth; it is also linked to the *Deckungsstock* system. The auditor's main tasks will continue to be calculation of the technical provisions for national financial statements and the statutory and actuarial bases used for calculating premiums and technical provisions.

The risk management function should facilitate implementation of the risk management system. An own risk and solvency assessment (ORSA) is to be carried out as part of the risk management system. A forward-looking assessment should allow consideration of those risks not covered in the solvency capital requirement (SCR). The aim is to be able to assess and control own risks more effectively. In addition, ORSA also requires the assessment of the continuous compliance with regulatory capital requirements and the requirements on technical provisions, as well as the assessment of the deviation of the risk profile of an undertaking from the assumptions drawn from the standard formula or by using an internal model.

Solvency II requires investments to be managed in line with the prudent person principle. Insurance undertakings should have assets of sufficient quality to cover their overall financial requirements. The quantitative limits for asset groups are omitted. However, the FMA may determine by regulation more detailed qualitative rules in relation to the prudent person principle.

Chapter 6 details provisions for the prevention of money laundering and, like Chapter 7, which covers accounting and consolidated accounting, corresponds to a large extent to the previous VAG.

Chapter 8 deals with solvency and thus the quantitative Pillar 1 rules. The SCR is calculated by means of a standard formula or by using a partial or full internal model to be approved by the FMA. The standard formula covers all significant quantifiable risks to which an insurance undertaking is exposed. It takes both non-life and life and health insurance risks into account, as well as market and credit risks and operational risks. Mathematical calculations are made to see whether an undertaking will be able, based on a level of probability of 99.5%, to meet its obligations towards policyholders and beneficiaries over the next twelve months. The minimum capital requirement, which is calculated using a factor-based approach, is the absolute minimum level of security.

For the purposes of determining the SCR, insurance undertakings must prepare a solvency balance sheet in addition to the annual financial statements based on the Corporate Code (UGB; *Unternehmensgesetzbuch*). Consequently, the value of technical provisions should correspond to the amount which another insurance undertaking would be expected to need in order to take over and fulfil the underlying insurance obligations. When calculating the technical provisions, insurance undertakings can avoid artificial volatility by a volatility or matching adjustment to the risk-free interest rate term structure. Whilst the volatility adjustment is basically available to all, the matching adjustment may only be applied under certain conditions that are currently not met in the Austrian market. It may therefore only be used for future product innovations. The solvency balance sheet gives the eligible own funds, which are to be classified into tiers according to their loss-absorbing capacity.

Chapter 9 specifies rules for group supervision, which is performed in addition to solo supervision. Group supervision will be of increased importance in the new supervisory system. The group supervisor will have a key role to play in supervising insurance groups.

Chapter 10 regulates the information requirements. In line with Pillar 3 of Solvency II the new requirements pertaining to disclosure and transparency stipulate that insurance undertakings must publicly disclose, at least annually, essential information on their solvency and financial condition. The reporting requirements towards the FMA extend well beyond the existing rules. As far as the information requirements towards policyholders are concerned, pre-contractual information in connection with endowment life assurance policies must be supplemented by the costs entailed as well as by clear and comprehensible specimen calculations. The policyholders are thus to be provided with a realistic scenario of the range of future benefits. During the term of the life assurance contract, policyholders must be informed in writing of any changes and developments of significance to them.

Chapter 11 is dedicated to supervisory authorities and procedures. It lays down new rules in relation to the

standardised supervisory review process, within the scope of which the FMA should not only assess compliance with the quantitative requirements of Pillar 1 but also the qualitative requirements with regard to the governance system and the ability of the undertaking to control the risks associated with its activities. In addition, the FMA shall be given the additional possibility, alongside the supervisory measures previously available to the Authority, to require capital add-ons where the SCR does not adequately reflect the individual risk profile or where the governance system shows serious shortcomings.

Chapter 12 regulates the *Deckungsstock* as well as the dissolution of insurance undertakings, and stipulates provisions on execution and insolvency. The related provisions were mostly taken over from the currently valid VAG unchanged.

Chapter 13 contains penal provisions.

Chapter 14 comprises transitional and final provisions. To achieve a gradual introduction of Solvency II, certain applications may be filed with the FMA as early as from 1 April 2015. However, any FMA decisions on applications for the granting of an approval or authorisation will only become effective as of 1 January 2016.

## PREPARING FOR SOLVENCY II

The European lawmakers laid the foundations for Solvency II back in 1999 when they adopted the relevant framework directive (see footnote 1). Since this is not just a new system to calculate insurance undertakings' own funds requirements but rather a new regime that revolutionises supervision within the European Union, the new regulations have been discussed, examined and validated in great detail and the insurance undertakings have been given a sufficient amount of time to prepare for the new regime. From a supervisory perspective, these efforts have proven worthwhile.

### QUANTITATIVE IMPACT STUDIES (QIS)

In preparation for Solvency II a total of eight Quantitative Impact Studies (QIS) have been carried out at both European and national levels over recent years, the last one in 2014. The objective of the studies was to have all Austrian insurance undertakings testing the degree to which they were prepared for the new supervisory regime and assessing their solvency under the requirements of the new regime. The last study also looked into the impact of the prevailing low interest rates on life and health insurers. The FMA placed special emphasis on guaranteeing a high level of data quality, having developed its own software tool to validate the data.

### IMPLEMENTATION OF INTERNAL MODELS

The FMA continuously assists undertakings during the process of implementing (partial) internal models, thus enabling any issues to be tackled at an early stage.

### STRUCTURED DIALOGUE

In order to make the preparatory process for the new supervisory regime as efficient as possible and in order to achieve the objectives outlined in the guidelines issued by the European Insurance and Occupational Pensions Authority (EIOPA), the FMA has engaged in a structured dialogue with the insurance industry to assist them with implementation. This should help identify in good time any issues resulting from differing interpretations or any problems during the practical implementation of the new supervisory rules on the Austrian market. Where necessary, appropriate solutions will then be found in cooperation with the insurance industry in an iterative process, with the possibility of these subsequently being incorporated into the final EIOPA guidelines or into FMA regulations. The structured dialogue is divided into three subject areas, as shown in Figure 10.

In early May 2014 the undertakings were invited to submit any questions in relation to the implementation of the EIOPA guidelines to the FMA, structured according to the relevant work packages. As each work package is closed, the FMA organises an information event to present any significant issues submitted by the undertakings and to set out possible solutions. The results of the first two work packages, namely on governance func-



to determine rules for cooperation, exchange of information and consultation processes among the supervisory authorities. The authorities involved in the supervision of a group have already established coordination arrangements, which determine the scope of these colleges of supervisors.

### SMALL MUTUAL ASSOCIATIONS

Small mutual associations do not fall within the Solvency II rules, except for small reinsurance associations. In order to still offer their policyholders a constant level of protection, these undertakings will also be subjected to a uniform, albeit simpler, solvency regime in future. Capital requirements uniformly applicable to this market as well as general framework conditions concerning investments, which have been laid down in the respective articles of association to date, will now be specified in a regulation. By defining eligible assets and upper limits, the aspects of risk diversification and the interests of the associations' members, as well as the issue of insufficient resources should be equally addressed.

## The notion of inside information

### The field of tension between European legal rulings and Austrian court decisions

**F**air and orderly trading in listed financial instruments is one of the essential prerequisites for a well-functioning capital market, and therefore for economic growth and wealth. Issuers of listed securities are thus subject to strict information and transparency rules. The concept of “inside information” is particularly important in this regard. Inside information is information that is not in the public domain but that could have a significant impact on the price of a listed financial instrument.

Any such information that exists in an undertaking must be published as quickly as possible (on an ad hoc basis), and efforts must be made until such publication to ensure that nobody can misuse this information for financial gain. This is the only way to ensure that trading in the financial instrument concerned is based on information that is potentially available to all market participants. Leaving aside the existence of any inside information, care should generally be taken during all communication to ensure that no inaccurate or misleading signals are sent out to the market as a result of information being published. After all, it is vital that information is handled properly. Otherwise the integrity of the financial market and investor confidence will suffer.

Issuers of listed financial instruments are however confronted with a great deal of information as they go about their day-to-day economic activities. This has to be identified and evaluated, in the context of a very broad field of tension. The following considerations deal exclusively with the issue of whether information should be classed as inside information and the aspect of market manipulation using information.

#### CURRENT LEGAL SITUATION

The European Parliament and the Council, in their Directive 2003/6/EC of 28 January 2003 on insider dealing and market manipulation (market abuse), have already made reference to the concept of an integrated and efficient financial market, which requires market integrity. According to Recital 2 of this Market Abuse Directive (MAD), market abuse harms the integrity of financial markets and public confidence in securities and derivatives.

These declared targets and rules also apply in Austria, where MAD was transposed into national law through Article 48a et seq. of the Stock Exchange Act (*BörseG; Börsegesetz*). Market abuse as defined in MAD com-

prises inside trading and market manipulation. Recital 24 of MAD states that prompt and fair disclosure of information to the public enhances market integrity, whereas selective disclosure by issuers can lead to a loss of investor confidence in the integrity of financial markets.

In summary, investor confidence in the integrity of the markets is based on investors being treated equally and being protected from the unlawful use of inside information. The European Court of Justice (ECJ), in its Judgment of 23 December 2009, clearly expressed these principles in the case C-45/08 – Spector Photo Group and Van Raemdonck.

Against this background, the FMA is required to assess the concept of inside information pursuant to Article 48a para. 1 no. 1 BörseG as a point of reference for numerous statutory provisions (e.g. publication obligations for issuers, ban on insider dealing). The BörseG defines inside information as “any information of a precise nature, which has not been made public and relates directly or indirectly to one or more issuers of financial instruments or to one or more financial instruments, and its disclosure could have a significant effect on the price of said financial instruments or their derivatives, because said information would serve an informed investor as a basis on which to reach investment decisions”.

## COURT RULINGS

In light of the most recent supreme court rulings of the ECJ and the Administrative Court (VwGH), the notion of precise information should first be considered in closer detail.

In its Judgment of 28 June 2012 in the case C-19/11 – Markus Gelll v Daimler AG, the ECJ dealt with the issue of intermediate steps in a protracted process.

The dispute in the main proceedings, prompting the German Federal Court of Justice to refer two questions, was as follows: Following the general meeting on 6 April 2005, the Chairman of Daimler’s Board of Management (Mr Schrempp) was thinking of tendering his resignation before the expiry of his mandate in 2008. In mid-May 2005, he discussed his intentions with the Chairman of the Supervisory Board. Between June and the end of July 2005, other members of the Supervisory Board and the Board of Management were also informed of Mr Schrempp’s plans to resign. On 28 July 2005 Daimler’s Supervisory Board decided that Mr Schrempp would step down at the end of the year and be replaced by Mr Zetsche. This decision was published in the form of an ad hoc report, in response to which the Daimler share rose sharply.

Specifically, the German Federal Court of Justice referred the following two questions to the ECJ for a preliminary ruling:

1. For the purposes of applying point 1 of Article 1 of Directive 2003/6/EC and Article 1(1) of Directive 2003/124/EC, is account to be taken, in the case of a protracted process intended, over the course of a number of intermediate steps, to bring about a particular circumstance or to generate a particular event, only of whether that future circumstance or future event is to be regarded as precise information within the meaning of those provisions of the Directives, meaning that it must be examined whether that future circumstance or future event may reasonably be expected to occur, or, in the case of a protracted process of this kind, can intermediate steps which already exist or have already occurred and which are connected with bringing about the future circumstance or event also constitute precise information within the meaning of the aforementioned provisions of the Directives?
2. Does the expression “may reasonably be expected” within the meaning of Article 1(1) of Directive 2003/124/EC require that the probability be assessed as predominant or high, or does the reference to circumstances which may reasonably be expected to come into existence or events which may reasonably be expected to occur imply that the degree of probability depends on the extent of the effects on the issuer and that, where prices are highly likely to be affected, it is sufficient if the occurrence of the future circumstance or event is uncertain but not improbable?

The ECJ’s answer to the first question was that in the case of a protracted process intended to bring about a particular circumstance or to generate a particular event, not only may that future circumstance or future

event be regarded as precise information within the meaning of those provisions, but also the intermediate steps of that process which are connected with bringing about that future circumstance or event.

With regard to the second question, the ECJ added that the provisions of the Directives refer to future circumstances or events from which it appears, on the basis of an overall assessment of the factors existing at the relevant time, that there is a realistic prospect that they will come into existence or occur. However, that notion should not be interpreted as meaning that the magnitude of the effect of that set of circumstances or that event on the prices of the financial instruments concerned must be taken into consideration.

Deciding whether information is to be deemed to be of a precise nature depends firstly on the probability of occurrence and secondly on the potential for significantly affecting the price. These two minimum requirements must be satisfied cumulatively. With regard to the probability of occurrence, the ECJ adds that only the German version of Commission Directive 2003/124/EC uses terms equating to 'with a sufficient degree of probability' (mit hinreichender Wahrscheinlichkeit), while all the other language versions use an adverb such as 'reasonably'. This means that a criterion based on rules drawn from the common experience has been introduced. Consequently, Article 1(1) of Directive 2003/124/EC, in using the terms 'may reasonably be expected', cannot be interpreted as requiring that proof be made out of a high probability of the circumstances or events in question coming into existence or occurring. Rather, it refers to future circumstances or events from which it appears, on the basis of an overall assessment of the factors existing at the relevant time, that there is a realistic prospect that they will come into existence or occur. The ECJ stresses that the possibility cannot be ruled out that information relating to an event which is unlikely to occur may still have a significant effect on the price of the relevant issuer's securities. That does not necessarily mean that the event will occur, however.

The Austrian BörseG should be interpreted in the context of these European court rulings. Transposing the MAD into Austrian law, Article 48a para. 1 BörseG defines inside information. The above examples of ECJ judgments can therefore be used as a starting point and support for interpreting the legal terms introduced as a result of the implementation of the MAD.

The Austrian Administrative Court (VwGH), in its ruling of 24 March 2014 (reference: 2012/17/0118) relating to the commencement of sales negotiations on share packages, stated that during a protracted process doubts regarding the probability of a transaction being entered into were understandable in light of the seller's communicated price expectations, which did not even amount to half of the market value.

The Court also stated that informed investors, faced with ad hoc reports that did not state a sale price, could only speculate on the outcome of the negotiations once aware that sales negotiations had begun or were in progress. If the stock market price or balance sheet/carrying amounts of the companies concerned were used, the investor could however anticipate positive or also negative effects on the development of the issuer's shares. The lack of a precise figure for the sale price meant therefore that the information was not sufficient to enable a conclusion to be drawn on the potential impact on the price of the financial instruments. In this case, the VwGH therefore ruled that there was no inside information.

A further argument made by the VwGH against the existence of adequate probability of occurrence in the specific case was the lack of direct negotiations between the prospective buyers and sellers, even when investment banks were involved, as the investment bank's role had been to bring together potential contracting parties and not to negotiate on these parties' behalf.

As far as the FMA is concerned, where there are indications of potential breaches of the statutory provisions, it carries out an evaluation and review of all of the aspects needed for information to be classed as inside information. In such cases, the circumstances are retraced and subjected to a classification pursuant to Article 48a para. 1 no. 1 BörseG. It is only when all of the circumstances in place at the time of the information being created have been considered in their entirety that the issue of whether the information being assessed constitutes inside information or not can be resolved.

For example, in the case of the commencement of sales negotiations on share packages, it is the FMA's view, a view shared by the criminal courts, that further elements, unrelated to the price expectation, can be used to

assess whether information is precise information as defined in the BörseG. During sales processes the granting of exclusive rights to one bidder, if there is more than one bidder involved, for example, could indicate that it is reasonable to assume that the negotiations will be successfully concluded. Similarly, the commissioning of parties to prepare draft contracts and/or the requesting of legal expert opinions could be signs that the information constitutes precise information as defined in the BörseG.

It is the FMA's view that the figures and provisional figures in relation to the preparation of financial reports, quarterly reports, half-yearly reports or annual reports could meet all of the criteria for inside information. The Regulation of the FMA on principles for the communication of information within the company as well as for organisational measures to avoid the misuse of inside information (2007 Compliance Decree for Issuers – ECV 2007; *Emittenten-Compliance-Verordnung*) should also be considered against this background. Article 8 ECV stipulates that issuers must stipulate appropriate time frames during which any person from a confidentiality area may not issue orders relating to the issuer's financial instruments (blocking periods and trading suspensions). Reasonable periods in this regard are three weeks before the planned publication of the (provisional) quarterly figures and six weeks before the planned publication of the (provisional) annual figures.

Correspondingly, at least those persons who are involved in the preparation of figures need to be informed of any suspension of trading, and such persons will be held responsible for any infringement due to a breach of the ban on misuse of inside information. The Central Public Prosecutor for Economic Crime and Corruption (WKStA), the Austrian authority responsible for investigating breaches of the ban imposed by Article 48b BörseG, confirmed the existence of inside information and a breach of the ban in the case described in brief below.

The case reported to the WKStA involved transactions in derivatives linked to shares in a listed, Austrian technology company. These transactions, carried out by employees of the company prior to the quarterly results/prior to major ad hoc reports, were partly implemented through the employees' own securities accounts held at a foreign bank and partly through a third party's securities account. It became clear that the employees worked in Group Controlling and had unrestricted access to company data prior to publication. The transactions described generated a profit of more than € 40 000. On the basis of these facts of the case, the WKStA made its decision in line with the provisions of Chapter 11 of the Code of Criminal Procedure (StPO; *Strafprozessordnung* – Withdrawal from prosecution), as the facts were sufficiently clear. In addition, the profit earned from the transactions was declared invalid.

The interplay between determining whether information is inside information and thus subject to strict ad hoc reporting requirements or not, and further public relations work on the part of the issuer demonstrates the field of tension between the rules. The BörseG sets out strict requirements for the existence of inside information in implementation of the European framework legal act. This information, as described above, is viewed as an important element in upholding investor confidence in the financial market. Moreover, the judicial decisions made at European and national level as summarised above show that this relatively young subject area can in no way be assessed within a predefined scheme. This is clearly demonstrated by the differing interpretations on the part of the various authorities and courts with decision-making powers.

## MARKET MANIPULATION THROUGH INFORMATION

Particular attention should be focused in this regard, as referred to above, on press relations work, public relations and investor relations activities on the part of the issuer independently of whether there is inside information or not. Article 48a para. 1 no. 2 lit. c BörseG states that the dissemination of information via the media including the Internet or through other channels that send or could send false or misleading signals with respect to the financial instruments, among other things, by disseminating rumours and false or misleading news if the person who disseminated this information knew or should have known that the information was false or misleading is viewed as market manipulation.



Based on this definition, this provision is not based on any qualified price relevance. The degree of probability, whether and under what circumstances a deal, for example, would actually be reached is also irrelevant in this regard. What needs to be assessed is the capacity in which the interview was given, the position held at that time by the person who gave the interview or issued a statement, and the particular information that was disclosed. It should be noted that any detrimental effect on the public interest in giving investors access to media information on financial instruments that is purely based on the facts is a significant criterion for assessing the extent of the offence.

In a decision of 24 June 2014 (reference: 2011/17/0249), the Administrative Court stated with regard to an interview evaluated by it that it was sufficient for the disseminated information to send out inaccurate or misleading signals regarding financial instruments. One aspect that should not be overlooked is that information that is not deemed to be inside information could nevertheless be the type of information that could have an impact on investor behaviour or result in analysts changing their assessment.

Against this background, the disclosure of information that does not represent inside information may be punishable from the perspective of a breach of the terms of Article 48c BörseG (market manipulation).

## DEVELOPMENTS IN EUROPEAN LAW

The provisions described above and how they are interpreted will continue to be significant in future. On 12 June 2014 the European Union published 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. The European Union also published Directive 2014/57/EU of the Parliament and of the Council of 16 April 2014 on criminal sanctions for market manipulation (Market Abuse Directive) on the same date. Pursuant to Article 14 of the MAR, a person shall not:

- engage or attempt to engage in insider dealing;
- recommend that another person engage in insider dealing or induce another person to engage in insider dealing; or
- unlawfully disclose inside information.

In accordance with Article 3(1) of the MAD, Member States shall take the necessary measures to ensure that insider dealing, recommending or inducing another person to engage in insider dealing as referred to in paragraphs 2 to 8 constitute criminal offences at least in serious cases and when committed intentionally. Article 4(1) of the MAD states that Member States shall take the necessary measures to ensure that unlawful disclosure of inside information as referred to in paragraphs 2 to 5 constitutes a criminal offence at least in serious cases and when committed intentionally.

The central point of reference of these provisions is therefore the existence of inside information, defined more precisely in Article 7 MAR. Article 7(3) of the MAR clarifies that an intermediate step in a protracted process shall be deemed to be inside information if, by itself, it satisfies the criteria of inside information as referred to in this Article. Accordingly, inside information is information of a precise nature, which has not been made public, relating, directly or indirectly, to one or more issuers or to one or more financial instruments, and which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments.

Article 7(2) MAR states that, information shall be deemed to be of a precise nature if it indicates a set of circumstances which exists or which may reasonably be expected to come into existence, or an event which has occurred or which may reasonably be expected to occur, where it is specific enough to enable a conclusion to be drawn as to the possible effect of that set of circumstances or event on the prices of the financial instruments or the related derivative financial instrument, the related spot commodity contracts, or the auctioned products based on the emission allowances. In this respect in the case of a protracted process that is intended to bring about, or that results in, particular circumstances or a particular event, those future circumstances or

that future event, and also the intermediate steps of that process which are connected with bringing about or resulting in those future circumstances or that future event, may be deemed to be precise information.

Finally, MAR clarifies that, for the purposes of Article 7(1), inside information is information which, if it were made public, would be likely to have a significant effect on the prices of financial instruments, derivative financial instruments, related spot commodity contracts, or auctioned products based on emission allowances and that a reasonable investor would be likely to use as part of the basis of their investment decisions.

In addition, Article 15 MAR prohibits market manipulation and any attempt at market manipulation. In accordance with Article 5(1) MAD, Member States shall take the necessary measures to ensure that market manipulation as referred to in paragraph 2 constitutes a criminal offence at least in serious cases and when committed intentionally. Article 12 MAR defines market manipulation. With regard to the arguments considered here, only the definition of market manipulation through information is tackled in more detail.

The MAR states that the notion of market manipulation encompasses disseminating information through the media, including the Internet, or by any other means, which gives, or is likely to give, false or misleading signals as to the supply of, demand for, or price of, a financial instrument, a related spot commodity contract or an auctioned product based on emission allowances or secures, or is likely to secure, the price of one or several financial instruments, a related spot commodity contract or an auctioned product based on emission allowances at an abnormal or artificial level, including the dissemination of rumours, where the person who made the dissemination knew, or ought to have known, that the information was false or misleading (Article 12(1)(c) MAR).

These provisions entered into force on 2 July 2014 and will apply as of 3 July 2016, the date by which the Member States must have adopted and published national laws transposing the MAD.

The provisions as described above, particularly the definition set out in Article 7 MAR, clearly demonstrate the influence that European court rulings have had in recent years. Despite the efforts towards harmonisation, the MAR and MAD still contain many non-specific concepts, which will be interpreted by the national authorities and courts but also by all of those who are bound by these laws (issuers, investors, analysts, etc.).

## SUMMARY

In summary, it should be noted that classifying information as inside information has significant legal consequences. Firstly, if information is classified as inside information, issuers are required to comply with the corresponding publication obligations (ad hoc reports) and are also required to set up confidentiality areas and brief their employees on any trading suspensions. Secondly, those persons with knowledge of the inside information are required to adhere to the ban on misuse of inside information as defined in Article 48b BörseG and/or will be held responsible in the event of any breaches.

Moreover, if information is not classified as inside information, it should be borne in mind that publication of such information could send out signals to the market that mislead investors. In this regard, particular care must be taken to engage in accurate and comprehensible public relations work.

As outlined above, the European legislative process has taken account of developments on the market and previous ECJ judgments and attempted to incorporate these into the newly adopted MAR and MAD. As these legal acts are not due to enter into force until 3 July 2016, it is still too early to say if and how the assessment of whether information qualifies as inside information will change. What is clear is that the interpretations referred to by the ECJ in its judgments have also to be used as the basis for assessing cases in Austria and will continue to be used as such in future.

## The Alternative Investment Fund Managers Act (AIFMG)

### The role of the FMA as supervisor of alternative investment fund managers

**T**he Alternative Investment Fund Managers Act (AIFMG; *Alternative Investmentfonds Manager-Gesetz*) entered into force on 22 July 2013, transposing Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers (AIFM Directive) into Austrian law. The aim of the AIFM Directive was to create uniform rules governing the authorisation and supervision of alternative investment fund managers (AIFMs) across the EU. In particular, the aim was to introduce a coordinated approach towards the risks that AIFMs and their activity pose for the financial system, while also tackling the consequences for European Union investors and markets. The major legal sources in this area, alongside the AIFM Directive and the AIFMG, include Commission Delegated Regulation (EU) No 231/2013 (Level II Regulation), Commission Implementing Regulation (EU) No 447/2013, Commission Implementing Regulation (EU) No 448/2013, the 2013 Regulation on the AIF Warning Notice (*AIF-Warnhinweisverordnung*, Federal Law Gazette II No. 224/2013, as well as the guidelines prepared by the European Securities and Markets Authority (ESMA) on key concepts of the AIFMD, the guidelines on sound remuneration policies under the AIFMD and the guidelines on reporting obligations under Articles 3(3)(d) and 24(1), (2) and (4) AIFMD.

Based on the AIFM Directive, all investment funds within the European Union can be divided into two categories, namely undertakings for collective investment in transferable securities (UCITS) or alternative investment funds (AIFs). UCITS are subject to the terms of Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS Directive), which includes numerous product descriptions as well as rules for the management company.

The AIFMG, which is based on the AIFM Directive, only contains a few rules applicable to AIFs. Most of the provisions relate to AIFMs.

According to the definition, an AIFM is any legal person whose regular business activity consists of managing one or more AIFs.

An AIF is any collective investment undertaking including its investment compartments that gathers capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors. The gathered capital may not directly serve any operational activity, and the fund must not fall under the UCITS Directive.

In order to comply with the statutory obligations created by the AIFMG entering into force, all undertakings

classed as AIFM were required to apply for a licence and also had to apply to have the marketing of the AIF approved pursuant to Article 29 AIFMG. Alternatively, if the thresholds defined in Article 1 para. 5 AIFMG were not exceeded, they were required to register with the FMA.

Under the terms of Article 67 AIFMG, the national lawmaker set a transitional period lasting until 22 July 2014 for certain undertakings in accordance with the AIFM Directive. This transitional period primarily applied to those undertakings that were involved in activities pursuant to the AIFMG in Austria before the cut-off date. A “best effort” principle applied to these undertakings, which meant that they had to do their best to meet the AIFMG rules before the expiry of the deadline or prior to being licensed. By 21 July 2014 at the latest, even those undertakings benefiting from the transitional period were required to have submitted a licence application or registered with the FMA.

### AMENDMENT OF THE AIFMG

The aim of Directive 2013/14/EU of the European Parliament and of the Council of 21 May 2013 was to restrict the over-reliance on credit ratings. As a result, the Member States were required to transpose the EU rules into national law by 21 December 2014. In Austria, this was achieved through the amendment of the AIFMG in the form of Federal Law Gazette I No. 70/2014 of 11 August 2014. The main changes were that AIFMs, when assessing the credit rating of the AIF’s assets, should not focus exclusively and automatically on the ratings provided by credit rating agencies. The FMA monitors the appropriateness of the credit rating assessment processes being used by the AIFMs, assesses the use of references to ratings from the above-mentioned credit rating agencies in the AIF’s investment policy and, where appropriate, encourages reducing the impact of such references as a means of countering the exclusive and automatic use of such ratings.

The amendment also introduces the concept of the “qualified retail customer” in Article 2 para. 1 no. 42 AIFMG. The qualified retail customer is an investor who, in a standalone document, confirms that they are aware of the risks associated with the intended investment and that they have access to unencumbered bank balances and financial instruments as defined in Article 1 no. 6 of the 2007 Securities Supervision Act (WAG 2007; *Wertpapieraufsichtsgesetz*) to the value of more than € 500 000. The AIFM or the natural or legal person carrying out the marketing must assess the expertise, experience and knowledge of the investor and be adequately convinced that the investor is in a position to make investment decisions alone and understands the risks associated with the investment, and that such a level of commitment is appropriate for the investor. In addition, a qualified investor is obliged to invest a minimum of € 100 000 in an AIF. A further condition is that the qualified investor must be making the investment for the purposes of diversifying existing investments and spreading risk. The qualified investor must prove to the AIFM or the natural or legal person marketing the fund that, at the time of investing in an AIF, no more than 20% of their assets comprising financial instruments pursuant to Article 1 no. 6 WAG 2007 is being invested. Subject to the qualified investor meeting all of these conditions, the investor is entitled to acquire shares in an AIF that is authorised for marketing to professional investors and either does not make use of leverage at all or limits leverage to a maximum amount of 30% above the AIF’s net asset value.

In addition, two further categories of AIF have been authorised for sale to retail clients, namely private equity funds of funds and AIFs investing in company holdings, subject to the conditions defined in Article 48 paras. 8a and 8b AIFMG and Article 48 paras. 8c and 8d AIFMG.

Registered AIFMs are not permitted to market any AIFs to retail investors or qualified retail customers as defined in Article 48 AIFMG, or to engage in cross-border marketing or cross-border management under the AIFM regime.

### SUPERVISION BY THE FMA

The FMA is entrusted with the tasks set out in the AIFMG and AIFM Directive and is responsible for monitoring AIFMs to ensure that they are complying with the rules of the AIFMG and AIFM Directive, using appropriate

methods to do so. It is also the authority responsible for the registration of European Venture Capital Fund Managers (EuVECA) and European Social Entrepreneurship Fund Managers (EuSEF). In 2014 there was one instance of registration as manager of a European venture capital fund as part of a registration process pursuant to Article 1 para. 5 AIFMG.

The legal basis for these types of funds is provided by Regulation (EU) No 345/2013 (EuVECA Regulation) and Regulation (EU) No 346/2013 (EuSEF Regulation). The FMA must monitor compliance with the terms of these Regulations on the part of managers of qualified venture capital funds and social entrepreneurship funds. To this end, the FMA holds the powers allocated to it by the Regulations themselves and the powers defined in Article 56 para. 2 nos. 1, 2, 5, 8, 9 and 11 AIFMG.

With the entry into force of the AIFMG, the FMA as competent authority was given a significant role to play with regard to monitoring systemic risks and supervising AIFMs. It has therefore been granted fundamental rights and powers, and the power to issue regulations and implement measures.

## POWERS AND OBLIGATIONS OF THE FMA

The FMA is obliged to revoke an issued licence if it was obtained by providing false information or taking deceptive action, if the AIFM has not made use of the licence within twelve months of its issue, or if the conditions required for the granting of the licence no longer apply. This also applies if the AIFM has seriously or systematically acted in breach of the provisions of the AIFMG, the AIFM Directive or any delegated acts adopted on the basis of the Directive.

Article 50 AIFMG governs the FMA's obligation to prohibit marketing should the AIFM or AIF fail to submit a corresponding application for approval, if the marketing rules set out in the AIFMG are not observed and/or the marketing conditions no longer apply, or in the event of other significant breaches of the statutory rules. Breaches of the conditions listed in Article 60 AIFMG will be the subject of administrative penal proceedings. In accordance with Article 60 para. 6 AIFMG, the FMA as the competent authority may publicise any measure or sanction imposed in response to a breach of the rules adopted pursuant to the AIFMG or AIFM Directive or of the EuVECA or EuSEF Regulations to the extent that publicising the information does not pose a serious threat to financial market stability, is not to the detriment of investors' interests and will not result in a disproportionately high level of damage for those involved.

## THE FMA'S POWER TO ISSUE REGULATIONS

The AIFMG contains numerous provisions authorising the FMA to issue regulations.

With due consideration for the European practices, the FMA may use regulations to stipulate different types of AIFs and their criteria, principles of remuneration policies, more closely defined criteria in relation to efficient portfolio management techniques and more precise criteria with regard to the AIFM's reporting obligations, as well as the reporting type, format and systems. The FMA may also issue regulations governing the form of risk notices as defined in Article 48 para. 5 AIFMG and the warning notices as referred to in Article 49 para. 4 AIFMG.

To date, the FMA has introduced a Regulation on the AIF Warning Notice and amended its Regulation on the Incoming Platform (FMA-IPV; *FMA-Incoming-Plattformverordnung*) based on Article 22 para. 9 and Article 58 AIFMG. A regulation defining more specific criteria in relation to the reporting obligations of AIFMs and the reporting type, format and systems is currently being prepared.

As already explained above, in addition to its tasks resulting from other federal acts and European Union regulations, the FMA is also responsible for monitoring compliance with the relevant statutory provisions by AIFMs, EU AIFMs from other Member States in accordance with Article 55 AIFMG, non-EU AIFMs, third parties in accordance with Article 18 AIFMG and the depositaries according to Article 19 AIFMG, and must introduce all measures required to guarantee the proper functioning of the markets in those cases in which the

activity of one or more AIFs on the market could jeopardise the proper functioning of the market as a whole. For the purposes of performing these tasks, Article 56 AIFMG grants the FMA extensive powers. In addition to its right to inspect any type of document and to obtain copies, the FMA may request information from any person connected to the activities of the AIFM, the manager of a qualified venture capital fund, the manager of a qualified fund for social entrepreneurship or the AIF, and may also summon such persons for questioning. On-site investigations may be carried out with or without advance warning. The FMA may also, for example, implement a temporary ban on exercising the profession, prohibit unlawful practices, and introduce any type of measure required to ensure that the supervised entities are complying with the statutory provisions. It may also order that the issue, repurchase or redemption of units be suspended in the interests of unitholders or the general public. Penalties may also be imposed, and fines of up to € 150 000 may be applied in the case of administrative offences.

### INFORMATION REQUIREMENTS

Both licensed and registered AIFMs are obliged to provide the FMA with regular information pursuant to Article 22 AIFMG, and also Article 1 para. 5 no. 4 AIFMG, and Article 110 of the Level II Regulation. The guidelines prepared by ESMA on reporting obligations under Articles 3(3)(d) and 24(1), (2) and (4) AIFMD provide essential assistance in this regard.

Licensed AIFMs provide notification of the most important markets and instruments and the biggest risks and concentrations of each of the AIFs that they manage, adhering to the time frames specified in Article 110 para. 3.

Registered AIFMs must also brief the FMA annually and upon request on the most important instruments that they trade in and with regard to the biggest risks and concentrations affecting the AIFs that they manage.

This information should be made available to the FMA exclusively via the Incoming Platform. Through the provision of this information, the FMA, working in cooperation with the Oesterreichische Nationalbank (OeNB), should be well placed to monitor systemic risks effectively. The FMA must forward the information compiled pursuant to Article 22 AIFMG to the OeNB for analysis, enabling the latter to determine the extent to which the use of leverage has created systemic risks in the financial system, the risk of market disruptions in individual or several market segments or risks to long-term economic growth. For its part, the OeNB must forward the results of its analysis to the FMA without delay if any of the above risks are detected.

Given the obligation to cooperate enshrined in Article 61 AIFMG, the FMA must, where necessary to perform the required tasks, make all of the above information available to the responsible authorities in other affected Member States, to ESMA and the European Systemic Risk Board.

### FREEDOM TO PROVIDE SERVICES AND FREEDOM OF ESTABLISHMENT

The AIFMG has introduced two passport regimes for AIFMs. Firstly, a passport has been created for the Europe-wide, cross-border management of EU AIFs. Secondly, there is now also a passport for the cross-border marketing of EU AIFs within the EU.

The marketing passport (product passport) enables AIFMs to market EU AIFs to professional investors on a cross-border basis. The relevant statutory provisions are contained in Articles 30 and 31 AIFMG, and transpose Article 32 of the AIFM Directive into national law. The marketing of EU AIFs in other Member States by AIFs licensed in Austria is governed by Article 30 AIFMG. Article 31 AIFMG contains rules on the marketing in Austria of units in EU AIFs from other Member States by an AIFM who has been authorised in another Member State.

The management passport entitles an Austrian AIFM to manage EU AIFs established in another Member State, subject to compliance with the requirements defined in Article 32 AIFMG. Article 33 AIFMG governs the management of EU AIFs in Austria by AIFMs established in another Member State. Articles 32 and 33 AIFMG transpose Article 33 of the AIFM Directive into Austrian law.

The notifications required under Articles 30, 31, 32 and 33 AIFMG are to be submitted to the responsible authority of the AIFM's home Member State. After being checked, the submitted notification and the complete documentation is passed to the responsible authority in the host Member State. The authority passing on the notification must inform the AIFM without delay that the documents have been sent, as the AIFM is permitted to begin providing the services in the host Member State as of the notification date.

## **RULES RELATING TO THIRD COUNTRIES**

Article 34 AIFMG enables EU AIFMs to manage non-EU AIFs that are not marketed in the Member States. Articles 35 to 37 and Articles 39 to 46 AIFMG will only enter into force on the date set in the delegated act adopted by the European Commission. Articles 35 to 37 AIFMG correspond to Article 35 of the AIFM Directive. Articles 39 to 46 AIFMG correspond to Articles 37 and 39 to 41 of the AIFM Directive. These rules govern the "third country passport".

The lack of experience regarding a harmonised regulatory framework at European level and regarding a single market for non-EU AIFMs wishing to engage in management and marketing activities within the EU and for EU AIFMs intending to manage non-EU AIFs has resulted in plans for a review mechanism. This will be used to detect and eliminate any difficulties that arise.

ESMA has until 22 July 2015 to submit a statement to the European Parliament, Council and Commission on the functioning of the passport for EU AIFMs that manage and/or market EU AIFs pursuant to Articles 32 and 33 of the AIFM Directive (corresponds to Articles 30, 31, 32 and 33 AIFMG) and also on the functioning of the marketing of non-EU AIFs by EU AIFMs in the Member States and on the management and/or marketing of AIFs by non-EU AIFMs in the Member States in accordance with the applicable national rules, as listed in Articles 36 and 42 of the AIFM Directive (corresponds to Articles 38 and 47 AIFMG). In addition, ESMA is required to provide a recommendation on applying the passport to the marketing of non-EU AIFs by EU AIFMs in the Member States and on the management and/or marketing of AIFs by non-EU AIFMs in the Member States in accordance with the provisions of Articles 35 and 37 to 41 of the AIFM Directive (corresponds to Articles 35 to 37 and 39 to 46 AIFMG).

Following receipt of a positive recommendation and statement from ESMA, and taking into account the criteria listed in Article 67(2) of the AIFM Directive and the Directive's aims, such as the single market, investor protection and effective monitoring of systemic risks, the Commission will adopt a delegated act within three months. The delegated act will stipulate the date from which the provisions of Article 35 and Articles 37 to 41 of the AIFM Directive (corresponds to Articles 35 to 37 and 39 to 46 AIFMG) should be implemented in all of the Member States.



## The European Market Infrastructure Regulation (EMIR)

The new regulatory and supervisory regime for derivative trading

**T**he European Market Infrastructure Regulation (EMIR) in the form of Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories formally entered into force on 16 August 2012. The requirements defined in EMIR are implemented in the form of technical standards (TS) devised by the European Securities and Markets Authority (ESMA) and have been applicable since either 15 March 2013 or 15 September 2013.

EMIR has its roots in the decision reached by the heads of government and state at the G20 summit in Pittsburgh in September 2009 in response to the worldwide financial crisis of 2008. The G20 leaders agreed that all standardised OTC derivatives should be cleared via central counterparties (CCPs). The aim of the regulatory project was to minimise the risks associated with OTC derivative trading. In particular, efforts have been made to avoid any kind of domino effect on the capital markets should a major participant exit from the market (as happened for example when Lehman Brothers became insolvent in September 2008). Another aim of EMIR is to create more transparency in the previously unregulated area of OTC derivative trading.

All financial counterparties (e.g. banks and insurance undertakings) involved in a derivative contract are affected by EMIR. What is different about EMIR is that, unlike many other regulations, it not only covers the banking sector but also encompasses other enterprises in the real economy (“non-financial counterparties”) in cases where these engage in derivative trading.

### DERIVATIVES AND THEIR ROLE IN ACCELERATING THE 2008 FINANCIAL CRISIS

Derivatives are contracts based on a particular underlying asset that is scheduled for performance at a future date. The underlyings may take the form of securities, currencies, interest rates, commodities and many other assets. Derivatives may be used to hedge against a range of risks (e.g. interest rate risk, currency risk, price risk, etc.) but may also be deployed speculatively. Trading in derivatives can be hugely profitable but, at the same time, there is also a high risk of large-scale losses.

Derivatives are traded both on stock exchanges and over the counter. OTC derivatives in particular are considered to have been a key factor in the 2008 global financial crisis. These individually designed contracts



made it practically impossible for the supervisory authorities to maintain a comprehensive overview of the derivative markets, the related risks and the web of interdependence.

## CORE ELEMENTS OF THE REGULATION

### CLEARING OBLIGATION

One of the central aspects of EMIR is that it requires all standardised OTC derivative contracts to be cleared through a central counterparty (CCP) that is authorised under EMIR. This clearing obligation always applies to financial counterparties. In the case of non-financial counterparties, it only applies if their volume of derivatives exceeds the clearing thresholds defined by ESMA (a gross nominal value of between € 1 billion and € 3 billion). ESMA will be setting technical standards defining which derivative categories are subject to compulsory clearing. It is expected, based on the FMA's current information, that the first clearing obligations applicable to certain interest rate derivatives will come into effect at the end of 2015. For all other OTC derivatives that are not subject to a clearing obligation, all of the counterparties are obliged to apply risk-mitigation techniques in order to reduce counterparty risk. These techniques demand a higher quality of risk management from the counterparties. The provisions of the Regulation essentially relate to the timely confirmation by electronic means of contracts, the valuation of positions, portfolio reconciliation, methods to reduce outstanding positions and mechanisms to resolve any disputes between counterparties.

### CENTRAL COUNTERPARTIES (CCPs)

CCPs form another core element of the Regulation. A CCP is a legal person that interposes itself between the counterparties to the derivative contracts traded, becoming the buyer to every seller and the seller to every buyer. The CCP assumes the credit risk and guarantees performance of the transaction. In order to guarantee performance, CCPs require their members to deposit collateral for any contracts that they enter into. However, should one or more members of a CCP become insolvent, the available collateral may not be enough to guarantee any obligations arising from the cancellation of the insolvent members' contracts. In order to maintain the solvency of the central counterparty in such a case, EMIR requires that CCPs have a default fund in place, into which the clearing members must pay contributions. In the event that this fund does not have sufficient resources, the losses may ultimately be shared across all of the solvent members and/or as a last resort the CCP must have access to sufficient own funds in accordance with EMIR requirements.

Furthermore, EMIR is harmonising the authorisation requirements and the ongoing supervision of CCPs. Cooperation (interoperability) between CCPs requires an interoperability arrangement that is subject to approval. In accordance with EMIR, every CCP must be authorised by the national competent authority in the Member State in which it is established. This means that the FMA is responsible for supervising the Austrian CCP, Central Counterparty Austria GmbH (CCP.A), which is a joint subsidiary of Wiener Börse AG and Österreichische Kontrollbank AG.

CCPs are subject to strict authorisation requirements. Every CCP must, for example, have access to central bank funding, credit lines with commercial banks or a combination of the two. CCPs must also have permanent, available and separate own funds of at least € 7.5 million. The members of a CCP must deposit highly liquid assets (margins) with the CCP. The amount and type of these margins is determined on the basis of models approved by the national competent authority. The establishment of the default fund referred to above is also one of the authorisation conditions. CCPs must also have sufficient financial resources of their own to withstand a stress scenario in which the two largest members of the CCP default.

During the process to authorise CCP.A, the FMA was required to carry out a risk assessment of CCP.A together with the OeNB, to set up and chair an international supervisory college, and to review compliance with all of the requirements of EMIR. The results of the risk analysis showed that CCP.A fulfilled the EMIR requirements. Consequently, CCP.A was awarded EMIR authorisation by means of an FMA administrative decision in summer 2014 following a joint decision of the international supervisory college.

## EMIR REPORTING

The third central element covered by the Regulation is the obligation to report to trade repositories, which are directly supervised by ESMA. The national competent authorities and central banks have direct access to the information contained in the trade repositories. The EMIR reporting system entered into force on 12 February 2014. EMIR requires all counterparties and CCPs to report the conclusion, modification and early termination of any derivative contract to trade repositories authorised by ESMA. There are currently six authorised trade repositories:

- REGIS-TR (Luxembourg): joint venture between Ilberclear (Spanish CSD) and Clearstream (German ICSD)
- UNAVISTA Ltd (UK): member company of London Stock Exchange Group (LSEG)
- DTCC Derivatives Repository Ltd – DDRL (UK): member company of DTCC Group (US)
- Krajowy Depozyt Papierów Wartościowych Spółka Akcyjna – KDPW (Poland): part of Polish CSD/owner of Polish CCP
- ICE Trade Vault Europe Ltd (UK)
- CME European Trade Repository (UK)

## IMPLEMENTATION IN AUSTRIA

EMIR is a European regulation and as such is directly applicable in the EU. This means that it does not need to be transposed into national law. However, there are plans for some of the Regulation's provisions to be implemented in Austrian law. Austria's Federal Act on the entry into force of Regulation (EU) 648/2012 on OTC derivatives, central counterparties and trade repositories, the Central Counterparties Implementation Act (ZGVG; Zentrale Gegenparteien-Vollzugsgesetz) entered into force on 14 November 2012. Under the terms of this Act, the FMA is the competent authority responsible for the tasks arising from EMIR and is required to monitor compliance with the requirements set forth in the Regulation. This means that the FMA must monitor both financial and non-financial counterparties to determine if and how these undertakings are complying with EMIR requirements. It must also take action against any breaches of the rules. Pursuant to Article 2 ZGVG, the FMA is also the authority with responsibility for CCPs in Austria (currently just CCP.A), working in close cooperation with the OeNB in this regard.

### THE ADDED VALUE OF THE REGULATION – WHAT WILL BE THE BENEFITS OF EMIR, CCPS, ETC.?

The stricter rules that EMIR has created for over-the-counter derivative trading in the EU will change the financial sector for ever. Since 2013 a range of new requirements has been imposed on the counterparties involved in trading in derivatives, with further additional tasks still to come in future (e.g. obligation to use a CCP for clearing). For the first time, companies in the real economy (e.g. utility companies and food producers) are being directly affected by an EU regulation.

It is still too early to say what the added value of the new rules will be. The most important changes resulting from the Regulation, such as the obligation to use a CCP for clearing, are not expected to apply until the end of 2015. The obligation to report derivative transactions entered into force in February 2014. In any event, the new Regulation will make the derivatives market more transparent since obligatory reporting helps the supervisory authorities to maintain a full overview of companies' derivative transactions. This will enable the authorities to recognise systemically relevant positions at an early stage and to keep a closer eye on the type and scope of transactions being carried out, as well as on the business relationships between individual contracting parties. Another big advantage is that the clearing obligation will minimise the risk of a domino effect should a major market participant default in future. The obligation to use CCPs and the assumption of the counterparty risk should help avoid a situation in which one party defaulting causes another to follow suit. The impact of EMIR on the derivative market and on the participants on that market will be considered in more detail as follows.

## DERIVATIVES – REPORTING INCREASES TRANSPARENCY

One of the most important changes under EMIR, as already mentioned, concerns the mandatory reporting to trade repositories, which has been in place since 12 February 2014. The aim is to help avoid a repeat of the Lehman Brothers situation in future. Lehman had built up huge unsecured risk positions in derivatives, the extent and impact of which were only revealed when the company filed for bankruptcy. The daily reporting on derivatives is very comprehensive and encompasses such aspects as information on contracting parties, contract content, current market values, margins, contractual amendments and terminated contracts. These reports will provide the supervisory authorities with an unrestricted overview of all derivative transactions and information on all transactions entered into by the companies subject to supervision.

## CCPS ASSUME CREDIT RISK – SYSTEMIC RISK ASSOCIATED WITH CCPS?

Entities wishing to have their derivative transactions cleared through CCPs must be a member of the CCP. They are then referred to as clearing members. It is however also possible for a client of a member to access the CCP's services via that member and to clear its derivative transactions in this way. Under certain conditions, EMIR also provides for "indirect clearing". This means that a client of a clearing member's client may arrange to clear its derivative transactions using the CCP to which the clearing member belongs. As already explained, the CCP is the central counterparty for both contracting parties during the clearing process and assumes the credit risk in the event that one of the two contracting parties becomes insolvent, for example.

In this way, CCPs contribute to a more stable derivatives market. At the same time, however, the systemic risk is now concentrated within the CCPs, which is why the supervisory authorities must also turn their attention to the following tasks in future.

Appropriate recovery and resolution regimes must be in place in the event of a CCP becoming insolvent, in which case the question of how the loss is distributed is paramount. CCPs may only distribute losses among those clearing participants with whom they have a direct contractual relationship and thus among a relatively small group of market participants. These are generally the major banks and, given the global nature of their activity, this could create a domino effect.

## CCP INTEROPERABILITY

Another important area for the supervisory authorities and ESMA to focus on is CCP interoperability. The advantage here would be that market participants would not need to join several CCPs in order to clear transactions with different contracting parties working with different CCPs. For the above reasons it is important not just to consider the benefits for market participants, but also to take the newly created risks into account, namely the possibility of a domino effect if a CCP should default. This would have far-reaching consequences that, as well as impacting on other CCPs, could also impact on their clearing members further down the line. Consequently, interoperability arrangements between CCPs should be considered very carefully, and compliance with the EMIR requirements in this regard closely scrutinised.

## THE ROLE OF THE CLEARING MEMBERS OF A CCP

The supervisory authorities are also required to consider the role of the general clearing members (GCMs), namely those members who are direct CCP members and also offer clearing services via this CCP to their clients. Note must be taken of the danger of the risk exposure being concentrated among a handful of large banks that operate globally and are members of several CCPs. Any turbulence affecting these banks would automatically have the potential to impact on several CCPs at once. In the worst case scenario, were one of these banks to become insolvent, several CCPs and also the clients of the GCMs could be hit at the same time.

## FURTHER POSSIBLE EFFECTS OF EMIR ON THE DERIVATIVES MARKET

As a result of the obligation to carry out clearing via a CCP, it can be assumed that more derivatives will be traded on the stock markets in future while OTC derivative trading is likely to fall. It is still too early however to estimate the extent of any such shift. Customised, non-standardised OTC derivative contracts will only be possible in exchange for higher transaction costs in future and may not be as attractive a hedging instrument as they have been in the past. This could mean that some companies refrain from using derivatives as hedges altogether.

### EFFECTS ON NON-FINANCIAL COUNTERPARTIES

Companies in the real economy that trade in derivatives are required, in the capacity of non-financial counterparties, to comply with the rules of EMIR and, since the introduction of EMIR, have also moved into the financial market supervisors' field of vision. These companies include for example major energy firms and oil companies, but also companies in the food industry through to individual businesses that also trade in derivatives. Even non-financial counterparties must comply with various risk management requirements and observe reporting obligations. They will also be obliged in future to clear all OTC derivatives through a CCP if they exceed the clearing threshold defined in EMIR. OTC derivatives that are traded by companies for risk hedging purposes are however not included in the calculation of this threshold. The resulting conclusion is that EMIR will also have far-reaching consequences for non-financial companies and in some cases will result in internal risk management being restructured.

## SUMMARY

EMIR will change the derivatives market for good. The counterparty credit risk and related domino effects should be avoided by means of obligatory CCP clearing. The added transparency provided by EMIR-compliant reporting is designed to be an important early warning system for the financial sector in future. Meanwhile, the long-term aim of EMIR is to recognise and eliminate systemic risks at an early stage. The supervisory authorities will also be focusing particularly strongly on CCPs, viewed as one of the major market infrastructures in EMIR, which are associated with a high risk. In its capacity as the supervisory authority responsible for financial and non-financial counterparties, as well as for CCPs, the FMA will be monitoring compliance with the requirements of ZGvG and EMIR on an ongoing basis, thereby making its contribution to implementing the G20 objective, namely the desire to make derivative trading more transparent and more secure.



