

# FACTS AND FIGURES TRENDS **2020** AND STRATEGIES



# **FACTS AND FIGURES, TRENDS AND STRATEGIES 2020**

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FMA Executive Directors

# THE FMA'S MEDIUM-TERM SUPERVISORY STRATEGY (2020–2024)

Supervision of the financial markets should never become static, regulations need to be continuously adapted to reflect the latest developments in the markets. Regulators must keep finding answers to the new challenges, all the while continuing to advance and improve themselves. After all, financial markets are undergoing constant change, and regulators and supervisors need to be able to keep up.

**T**he Austrian financial market has recovered fairly well overall from the turbulence of the global financial crisis: regulatory loopholes have been closed, existing regulations revised in light of the lessons learned, and the supervisory system Europeanised. Both the European and Austrian financial market are much more resilient and shock-resistant nowadays than they were before the global crisis.

However, we are facing huge new challenges, in terms of the economy, society and technology. This is why the FMA conducts a medium-term risk analysis every year in order to get a better grasp of future challenges, to identify opportunities and risks, to analyse trends and to find concrete answers to those challenges. Based on this, we then develop our medium-term supervisory strategy (2020-2024), using it to prepare our priorities for supervision and inspections for the coming year.

Our medium-term risk analysis (2020-2024) found that regulators, supervisors and financial market participants are facing highly challenging times:

- The economy is slowing down, with dark clouds gathering and some experts already predicting a looming “geopolitical” recession in the global economy.
- Persistently low interest rates, at times already moving into the negative zone, are threatening to turn our economic system upside down, to cause individual products and even whole sectors to lose out, and to drive many market participants to take on disproportionate risk as they look to secure yields.
- Climate change impacts on our daily lives, challenges states and societies, and does not stop at financial markets either, bringing with it new risks and opportunities.
- The digital revolution is also constantly evolving, with digitalisation itself being a disruptive technology that is making many established and tried-and-tested solutions in the analogue world obsolete while creating new digital ones. However, we still need to analyse and understand its effects on the economy and society.

- The economic, social and technological changes create new spaces for creativity and innovation, making room for new innovative businesses such as FinTechs and platform economies, while omnipresent BigTechs are suddenly also starting to offer financial services. However, these developments also create obscure and dark corners in which regulation and supervision are ignored and where anarchic or even criminal structures are spreading. Some are calling into question our type of economy and our social order, while others are ruthless in securing their own advantage, particularly to the detriment of the weak and naive.

These trends also have a severe impact on financial markets and their participants. They come in various different forms, and we need to identify and analyse them together with our stakeholders to ensure that regulation and supervision can find appropriate, forward-looking and sustainable solutions to these new challenges. And these solutions must then be implemented and enforced in a transparent and consistent manner, and strictly too, where necessary.

The challenges that market participants, regulators and supervisors are facing have not become any smaller. New risks have arisen, and the upswing has led us to lose sight of some of the old ones, which increases the risk of turbulent times ahead of us.

## THE CHALLENGES OF A LOOMING GEOPOLITICAL RECESSION

The economic parameters are likely to be more difficult in the coming years. A downturn is already in evidence, and all over the world economists are revising their forecasts downwards. Some experts do not regard this as the usual cyclical downturn but the precursor to a geopolitical recession, a recession that is being triggered and exacerbated by geopolitical tensions and by the crisis in multilateralism.

Some of the issues behind all this:

- Escalating trade wars such as that between the USA and China, which are repeatedly imposing punitive tariffs on each other in an increasing downward spiral, have a negative effect on global trade; the same goes for economic tensions between the USA and Europe or between Japan and South Korea.
- Crises and conflicts in the Arabic world unsettle the oil markets, with supply bottlenecks no longer out of the question, while surging oil prices disconcert the markets.
- Brexit, even if there is a deal, will also have negative repercussions that should not be underestimated. It will slow down economic activity in Europe; to what degree will depend on the resulting collateral damage. While bilateral economic relations between the UK and Austria are limited, and disruptions will be negligible or manageable, feedback effects should not be overlooked as our major trading partners in the EU might very well be seriously affected.
- And, finally, multilateralism: it helped us through the global financial crisis a good decade ago, but now, of all times, finds itself in a serious crisis. Multilateralism is increasingly being replaced by the egotism of nation states. The multilateral standards and multilateral institutions that once helped to establish order are now increasingly being undermined.

Looking at all of this objectively, experts who are already warning of a geopolitical recession might be proven right, however regrettable this is.

**We acknowledge that regulators and supervisors must maintain a neutral stance towards technologies. The market will decide which technology prevails. However, regardless of the technology used to offer a financial service, every service must be subject to the same regulation and the same supervision.**



## THE CHALLENGE OF LOW INTEREST RATES

One of the biggest challenges we are facing is the persistently low level of interest rates, which are even falling to negative levels in more and more areas.

Interest rates have by and large ceased to function as classic risk indicators. Furthermore, there is a great deal of liquidity in the markets, with the risk of bubbles being formed in certain assets such as real estate. The glut of cheap money has also led to financial service providers and businesses in the real economy being awarded funds despite no longer having viable business models; those much discussed zombie banks and zombie companies.

In its recent annual reports, the European Systemic Risk Board (ESRB) has consistently been highlighting three key risks to stability in the European financial markets: repricing of certain risks and assets which leads to price bubbles bursting; weaknesses in the balance sheets of some European banks, insurers and private pension schemes; and doubts as to whether some states as well as many businesses and households will ultimately really be able to service their debts.

Persistently low interest rates, and partly negative interest, have an effect on all financial market participants.

Banks whose income is highly dependent on interest rates are called upon to take action, even if they pursue a relatively low-risk business model focusing on savings products and lending. Life insurance is also badly hit by the low interest environment. Existing business models are proving to be less profitable and in some cases unattractive to customers. There is pressure to increase margins and yields, and then there is investment plight – and this induces not only retail investors but also insurers, fund managers and providers of personal pension products to invest in increasingly risky products in order to generate positive yields.

The example of old life insurance contracts shows what can be achieved with a forward-looking supervisory strategy and regulatory policy: anticipating potential prob-

lems, we ordered insurers to establish a separate additional interest provision to ensure that they will be able to fulfil their obligations. To date, a total of € 1.1 billion has been allocated to the provision; the figure for 2020 will be close to € 1.2 billion. Based on current developments, insurance companies will ultimately require a total of € 1.3 to 1.4 billion.

It might sound absurd but it is not only a continued environment of low interest rates that can pose serious challenges for many market participants, rising rates might be challenging too. If interest rates rise, the value of assets bearing low interest rates that had to be acquired over the past few years for lack of a better alternative, will drop dramatically in the balance sheets. And this is a scenario that we, the regulator and supervisor, must also address.

## THE CHALLENGE OF THE DIGITAL REVOLUTION

Aside from these economic factors, the digital revolution is one of the biggest challenges facing financial market participants. Digitalisation is a disruptive technology, fundamentally reshaping the rules of the game in the markets, even though the transformation is evolutionary. Its global reach marks a breakdown of culture and civilisation as we know it, and we are still learning how to deal with this.

Our risk analysis therefore focuses particularly strongly on the challenges and effects of digitalisation, and we consider this to be a central aspect of our medium-term supervisory strategy.

First things first: we acknowledge that regulators and supervisors must maintain a neutral stance towards technologies. The market will decide which technology prevails. However, regardless of the technology used to offer a financial service, every service must be subject to the same regulation and the same supervision. Here, in the digital world, we are taking the first steps towards a new regulatory and supervisory era:

- Exchange platforms and wallet providers, as well as other virtual asset service providers, will be incorporated into the AML regime effective from 2020, which will include mandatory registration of such providers.
- The prospectus regime will also apply to digital assets such as tokens or coins.
- Certain digital assets will be subject to regulation and supervision, e.g. alternative investment funds.

These can, however, only be regarded as first tentative steps. After all, the uppermost credo of regulation and supervision must apply unequivocally to the digital world too: “The same rules for the same business with the same risk.” And this not only applies to the crypto world but also to all of the other numerous and diverse challenges posed by the digital revolution.

This rule is the only way to create a truly level playing field, i.e. fair conditions for all market participants, regardless of whether they are engaged in the analogue or the digital world, whether they are long established or new to the market, and whether they are providers or customers.

Digitalisation calls many business models of many established providers into question. The model of relationship banking, focusing on close, trusted and long-term customer relationships, is frequently being replaced by transaction banking: the customer no longer maintains a bond of trust with the institution and chooses a product

that suits them best from a whole range of standardised products in the digital world. In contrast, the digital revolution also brings many new competitors with creative products, more efficient cost structures or greater market power:

- FinTechs – young, agile start-ups that offer familiar financial services that are cheaper, better or more tailored to the target audience, or even create entirely new services or products. And all of this without costly infrastructures from the past and in a highly specialised manner.
- BigTechs such as Google, Facebook or Amazon armed with enormous amounts of data that are forging plans to offer financial services too.
- Platform economies are also fundamentally changing the whole setting. They not only bring new competitors but sometimes also completely alter the way that services are rendered; the peer-to-peer (P2P) economy would be an example here. Frequently the only service they offer is a marketplace where private sellers are matched with buyers. Uber, Booking.com and Airbnb have fundamentally changed how we travel and how we find a bed for the night. What players will emerge as the Uber, Airbnb or Booking.com of the financial industry? Which financial services will they offer? And how will they redefine these?
- Finally, the sharing economy, where it is no longer about buying and selling but about sharing products and services. Or platforms where one service is exchanged for another, with no money changing hands anymore.

Regulators and supervisors are facing a two-fold challenge. We must make sure that established providers do not lose touch in this environment of rapid technological change, that they address the risks and embrace the opportunities. But we must also make sure that the transformation happens in an orderly manner.

In this way, we can make a significant contribution to ensuring that Austria remains a prime location for economic and financial activity.

Our Digital Roadmap, which we developed back in 2016, has been highly successful. The FinTech Point of Contact was set up at the FMA in this context to provide a single point of contact for FinTechs to enquire about regulatory issues. We have answered queries in more than 300 cases covering all supervisory perspectives. We have also very successfully looked into the matter of regulatory provisions hindering technological progress. For example, we found that the rules for verifying customer identities created obstacles, prompting us to permit the use of video identification. As a result, more than 50 000 new customer relationships have since been established. We are also in the starting blocks to establish a “regulatory sandbox” within the FMA, allowing young, innovative companies to try out their business models within a protected regulatory area for a limited period of time. The related draft legislation has been submitted to Parliament, and we firmly believe that the law will soon be adopted and can then be implemented swiftly. The revised Payment Services Directive (PSD 2)<sup>1</sup> obliges banks to set up standardised interfaces in an open-banking approach to give alternative providers easier access to their customers and enabling them to offer certain services.

A couple of months ago we published our study “Digitalisation in the Austrian Financial Market”, which is the most comprehensive and representative study of its kind; it

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<sup>1</sup> Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC.

showed that the majority of financial service providers view digital transformation positively. Most businesses have done their homework in terms of organisation and strategy, with only one out of every five companies lagging behind. Some figures:

- About half of all companies are offering their services via dedicated online portals, with 39% also having developed apps for mobile devices.
- 48% of providers are using the cloud to deliver IT infrastructure and IT services.
- Nearly every other insurer or bank will be using machine learning in its productive systems by 2020.
- Blockchain technology and artificial intelligence, however, are rarely used – by established providers.

The use of modern information technologies, global networking and the huge amounts of data that need to be processed and stored safely offer many an opportunity, but come with risks too. IT risks and cyber risks are among the biggest risks that have to be managed. Cyber attacks on financial service providers are happening ever more frequently, while IT outages cause enormous damage and undermine confidence among customers and business partners. McAfee and the Center for Strategic and International Studies (CSIS) estimated the global cost of cybercrime in 2017 at \$ 445 to 608 billion, of which \$ 160 to 180 billion related to Europe. According to the Austrian Police Crime Statistics, the number of criminal cyber attacks has more than doubled in just five years, from around 9 000 cases in 2014 to nearly 20 000 in 2018.

One of our priorities for supervision is therefore IT security, and we are continuing to develop, expand and strengthen this area. In 2019 we carried out our first cyber risk stress test in the form of a war game, played by eight representative banks and relevant supervisory authorities. According to international studies, 40% of cyber incidents are caused by misguided employee behaviour, or are at least aided by the actions of employees, which is why this stress test focused on the human factor. We must, and indeed will, develop this tool further, and consistently so. IT security will also be made a standard module in our on-site inspections, and a thematic focus of our market analysis.

As you can see, we are tackling digital transformation hands-on, but some big challenges still lie ahead.

## THE CHALLENGE OF SUSTAINABILITY

Climate, ecological or social changes can pose severe risks for individual financial market players and the financial market as a whole. If these risk materialise, they can not only threaten the survival of individual financial service providers, but also erode confidence in the financial market's integrity, stability and ability to function. These risks posed by environmental, social and governance (ESG) factors must therefore also be addressed by financial regulators and supervisors.

Climate change and measures to curb global warming may, for example, impact financial markets in various ways, both directly and indirectly. Insurance claims may surge due to changes in the climate, while they may go down when those changes are successfully curbed. Additionally, there are also indirect risks: developments such as established technologies becoming stigmatised, framework conditions changing in the short term for political or economic reasons, or ethical and social upheaval might cause large-scale losses in relation to assets that are now being viewed critically

(so-called stranded assets); an example here would be sectors or companies with high carbon emissions. Sectors such as tourism, traffic, energy and agriculture will be hit especially hard by climate change, while consumption, asset allocation and migration are also expected to be highly impacted.

In line with our risk-based approach to supervision, the FMA is therefore obliged to pay greater attention to the principle of sustainability, doing so systematically as part of its continued supervision. Supervised companies must explicitly include current and future ESG risks in their risk management and strategic control in order to contribute to efficient capital allocation and to avoid operational risks such as litigation risk or reputational risk.

For sustainability risks to be managed efficiently and effectively, we have identified three major issues from a regulation and supervision viewpoint: reporting, physical and transition risks, and regulation:

- Market participants need valid and standardised information to adequately consider risks in their internal risk management.
- Standardised information enables market players to assess material sustainability risks and then integrate those into their risk management. Consideration of these risks must be linked to a longer-term approach, since these risks tend to emerge over the medium or long term. In this way, apart from direct physical risk, indirect transition risks, i.e. risks from the transition to a more sustainable economic and business model, can also be identified more easily and incorporated into risk management and strategic control.
- Companies are responsible for their own risk management; therefore they are also obliged to develop independent methods and tools to take account of such sustainability risks. In addition to adjustments to risk models, analysis and stress tests based on certain scenarios may also prove to be appropriate tools to quantify such risks and their impact on overall risk management.

The regulation and supervision of sustainability risks require a coordinated effort internationally, owing to their global dimension, the strong interlinking of international financial markets and of the relevant supranational and international law-making and standard-setting initiatives.

One of the key initiatives at European level is the European Commission's Fiscal Sustainability Report, published in January 2019, on which it based its "Action Plan: Financing Sustainable Growth". The Commission estimates that financing of nearly € 180 billion is required to achieve EU climate and energy targets by 2030. Both of these Commission documents are crucial starting points from which a harmonised European strategy can be derived. Moreover, the Commission proposed explicitly expanding the remit of the three European Supervisory Authorities (ESAs) – the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA) – to include sustainable finance.

To achieve this aim, we need a clear, focused, rules-based and, to the greatest extent possible, internationally harmonised regulation. Only then can we, in our capacity as supervisors, make our contribution to a more sustainable financial industry and, consequently, a more sustainable real economy.

This is not all completely new. Sustainability risks, i.e. ESG factors, are already being accounted for in individual areas of supervision. *Pensionskassen*, for example, are



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already required to consider ESG factors and to include them in their declaration on the investment policy principles. All of the eight Austrian corporate provision funds have also voluntarily incorporated sustainability and ESG criteria into their investment criteria. According to an FMA survey, three quarters of all insurance companies are taking account of ESG risks for their company organisation, with a distinct focus on the environment. And every third company takes account of ESG factors when investing assets. By the end of 2018, Austrian investment fund management companies had issued 57 sustainability funds worth some € 5.8 billion in total; this equates to 3.5% of the overall market. However, private organisations are laying down the criteria, and it is also these organisations that are certifying compliance with those criteria.

## **RISK FACTOR MONEY LAUNDERING – CLEAN FINANCIAL CENTRE**

The United Nations Office on Drugs and Crime, the arm of the UN that fights money laundering, estimates that between \$ 800 billion and \$ 2 trillion dollars in dirty money is laundered worldwide every year. David Lipton from the IMF estimates that 8% of global GDP in the amount of \$ 87 trillion, a whopping \$ 7 trillion in other words, is hidden in offshore centres, with most of this money stemming from organised crime, corruption and tax evasion.

A financial service provider suspected of money laundering will encounter serious difficulties nowadays, to the extent that its very existence may come under threat. Penalties may be harsh, but what is even worse is the loss of reputation. Nobody will want to do business with such a “dodgy” provider.

Ten years ago the Austrian financial market was close to acquiring a serious image and reputation problem. The FATF, the international standard setter in the fight against money laundering, had harsh criticism for the practices in the Austrian financial market, and its reputation threatened to slide into that of a “dodgy” destination.

The Federal Government at that time transferred responsibility for proper AML prevention at the supervised companies to the FMA.

Since then, we have consistently pursued a zero tolerance policy.

We are engaged in an open dialogue with the supervised companies, informing them about their obligations and helping them meet them in the best possible way in practice. Additionally, our risk-based approach means we also inspect them on site, to see whether and how they are actually meeting their due diligence obligations. We sanction breaches consistently – starting with admonitions and extending to the removal of managing directors from their positions and even the withdrawal of licences.

And we have been successful! International institutions have given Austria as a financial centre good marks for its anti-money laundering efforts. If Austrian financial service providers are mentioned in the Panama Papers, Paradise Papers or the Russian Laundromat, this mostly concerns transactions that were carried out years ago.

We must not stop there. Technological advances pose new challenges, as do the seemingly unlimited creativity and criminal energy of perpetrators. The world of cryptoassets has opened up a parallel universe to the established financial industry, with hardly any regulation or supervision so far, except for at just a few interfaces, i.e. prospectus law, regulation of alternative investment funds (AIFs) or the obligation to obtain a licence for certain financial services.

Austrian lawmakers transposed the Fifth Anti-Money Laundering Directive (AMLD5) into Austrian law as of 1 January 2020 through the Financial Markets Anti-Money Laundering Act (FM-GwG; *Finanzmarkt-Geldwäschegesetz*), which extends due diligence obligations in relation to the prevention of money laundering and terrorist financing to include certain virtual currencies and providers engaged in this field, and assigned the task of supervision to the FMA. In addition to exchange platforms (virtual currencies against fiat currencies) and wallet providers, this also affects market participants in Austria who exchange one or more virtual currencies with each other, anyone who provides transfers of virtual currencies and those who provide financial services for the issue and sale of virtual currencies. This means that these service providers will (in the future) – just as credit and financial institutions are obliged today – have to comply with the due diligence and reporting obligations in relation to AML/CFT and will also have to register with the FMA from 10 January 2020 before offering their services in or from Austria.

Registration applications have been accepted since 1 October 2019. A fine of up to € 200 000 may be imposed for failure to register.

These first steps towards regulating the cryptoasset market exceed the requirements of AMLD5 and fulfil the requirements set by the FATF, which go further.

Basically, the FMA is entering a new regulatory and supervisory era, facing up to the challenges with the requisite degree of determination. Our zero tolerance policy in relation to the digital world of cryptoassets underlines Austria's status as a clean financial centre, and it is a policy that we will pursue vehemently.

Money laundering is not just a dirty business, it has also always been a cross-border and international business. However, regulators and supervisors are still greatly hindered by national borders. Competencies are highly fragmented, there are no powerful transnational institutions – particularly where legal enforcement is concerned – and cross-border cooperation is hampered by manifold obstacles and impediments, from the necessity of equivalent official secrecy obligations to equivalent sanctioning regimes.

It is, we believe, of vital importance that transnational conditions be improved, so we can combat money laundering within and outside our borders more efficiently and effectively, at least at the level of the EU. We are proposing an approach based on three pillars:

1. A European Intelligence Unit, which collects, assesses and analyses data across borders and then develops prevention and enforcement strategies.
2. A European Prevention Unit, which ensures that all sectors under threat – and not only the financial markets – do everything in their power to prevent the misuse of companies for money laundering purposes; due diligence obligations must be met without fail.
3. A European Enforcement Unit, which investigates – in cooperation with national authorities – suspected cases of money laundering and ensures that perpetrators are sanctioned with the full force of the law.

If we manage to achieve this at EU level, we will have made a giant leap forward.

## THE CHALLENGE OF COLLECTIVE CONSUMER PROTECTION

Disruptive technologies, internationalisation and globalisation, as well as new risks and challenges, for instance those induced by environmental, social and governance changes, are always difficult for consumers, investors and savers too.

In its capacity as supervisory authority, the FMA must maintain equidistance between its supervised entities and their customers. The FMA is not permitted to assist individuals in enforcing claims for damages; this would be the task of classic consumer protection organisations, lawyers and the civil courts. The FMA is, however, committed to the principle of collective consumer protection: it monitors supervised companies to ensure that they adhere to the relevant statutory information, consultation and distribution requirements, sees to transparency on the markets through valid, fair and comparable information, and warns of highly risky products, as well as providers on the Austrian market that are fraudulent or have not been granted a licence to trade.

The digital revolution poses particular risks in relation to consumer protection. We want to highlight just four aspects here:

1. It has created a gargantuan parallel universe of financial services – the vast field of cryptoassets – which is barely regulated and only supervised on its fringes. In this field the principle of “the same rules for the same business with the same risk” is yet to be enforced to protect consumers. Providers of cryptoassets must be included in regulation and supervision in the same way as their analogue, licensed counterparts that provide financial services, and awareness of the specific risks associated with cryptoassets must be raised.
2. Digitalisation is also creating a whole range of challenges in relation to consumer protection in the regulated sector. Customer relationships as we know them are ceasing to exist. Financial services used to be distinctly shaped by long-term, personal and trusted customer relationships (relationship banking). In the digital world, the de-humanised single transaction rules: customers choose a product from a seemingly endless universe on the basis of just a few standardised criteria, possibly using a comparison site. How can we make sure that customers really take advantage of available transparency, and do not simply ignore pop-ups containing important information? How can we make sure that they do not waive their protec-

**Only if we look at the big picture in its entirety, and from all angles, can we take the right measures to safeguard the stability of the financial market and strengthen market participants' confidence in it.**



tion rights because they are used to just clicking to get rid of additional information? How should we regulate liability, legal venue and protection schemes in a digital world where goods cross all borders? We have only just started finding answers to this long list of questions.

3. The digital transformation is also causing a social divide. There are people who have grown up with digital technologies and who use them, and then there are others who simply feel overwhelmed by the technology or plainly disapprove of it. We must safeguard the level of consumer protection that we have worked to achieve in the analogue world over many centuries in the digital world too. At the same time, we need to make sure that, with progressing digitalisation, entire groups of the population, e.g. the ever growing group of older customers, are not cut off from financial services altogether. Payment transactions are today almost exclusively processed electronically, and even wages, salaries and social benefits are only paid electronically, while levies, taxes and other fees can also no longer be paid in cash. It has therefore become necessary to enshrine a legal right to a basic payment account in order not to leave whole groups of the population behind or exclude them altogether. We will have to be careful and consider how we can ensure that all population groups in all regions are given access to at least basic financial services in this increasingly digital world.
4. The digital world is a global world with practically no borders. How can we as national supervisors, or at least those at European level, protect Austrian consumers against dubious or even fraudulent providers?

The digital world, be it regulated or not, poses many challenges. However, we must not overlook the fact that the dated analogue world continues to create new challenges for collective consumer protection too. For instance, the new resolution regime for banks, which was introduced only a few years ago, has made us stop and question apparent certainties in relation to how we distribute and handle bank securities. Such securities have up until now been considered safe investments as investors – at least

in the case of larger institutions – could rely on an explicit or at least implicit government guarantee. This meant that if a bank failed, the government would step in, using tax revenue to do so. In this way, it was also bailing out investors in these securities, freeing them from the risk of loss. The new resolution regime no longer allows such bailouts. Owners and creditors, i.e. the holders of securities of the bank in question, will now be the first ones to be asked to pick up the bill. Therefore, investors in such securities need to be properly informed of the opportunities and risks, and these securities should only be sold to investors who are really prepared to assume the higher risk that comes with the higher yield.

Similar considerations apply to investments and securities that are sold as particularly “sustainable” products, taking account of environmental, social or governance developments. Greenwashing needs to be kept in check, where ESG factors are solely used to increase sales without foundation.

In the context of collective consumer protection we therefore need to consistently continue with our transparency initiative, and expand it to new fields too. We need to define and prescribe uniform information standards that apply prior to contracts being entered into, during the term of these contracts and when the provision of financial services is being terminated. Criteria and key figures need to be clearly defined, facilitating valid comparisons. Opportunities and risks need to be presented fairly, and costs and fees must also be fully transparent. Ultimately, however, it is the customers alone who choose: they decide on the type of financial service or product, because only they know which risk they are prepared to accept in exchange for which opportunities. To be able to make well-informed decisions, we need responsible consumers who are prepared to inform themselves properly. It is our goal to aid them, with a financial literacy initiative, explaining the important features and effects of certain financial products and services in simple terms, thereby imparting the knowledge required to make risk-based decisions suitable for their needs on the basis of standardised, valid and comparable information.

## **THE INTEGRATED SUPERVISION APPROACH**

As can be deduced from our medium-term risk analysis and supervisory strategy, the FMA, in its capacity as integrated supervisory authority, monitors and analyses Austria’s financial market as a whole and from all angles: from the micro and macroprudential perspective, from the perspective of analysed figures and monitored conduct of managers and employees, as well as from the perspective of providers and of their customers. We contrast the financial market’s perspective with that of the capital market, and weigh up the protection of creditors against that of investors and customers. As well as monitoring banks, we also keep a close eye on insurance companies, *Pensionskassen*, investment firms, investment funds and alternative investment providers. We observe interactions and analyse contagion channels critically.

Finally, we put together the individual pieces of the puzzle to form a bigger picture.

Only if we look at this big picture in its entirety, and from all angles, can we take the right measures to safeguard the stability of the financial market and strengthen market participants’ confidence in it. This is the aim of our medium-term risk analysis and supervisory strategy (2020-2024).

# PRIORITIES FOR SUPERVISION AND INSPECTIONS IN 2020

**T**he FMA is committed to the principle of transparency, engaging in open dialogue with the market and the supervised companies. It shares the main findings of its annual analysis, provides information on the main risks it has identified on the financial markets for the coming years, and gives updates on its medium-term supervisory strategy based on this analysis. Every year the FMA also publishes in detail its priorities for supervision and inspections in the coming year. These are explained in its “Facts and Figures, Trends and Strategies” publication and on the FMA website. The aim is to alert the supervised entities to the risks applicable to their area of business and to give them an opportunity to prepare in a targeted way for the risk-based priorities set for the coming year. This raises awareness of risk and creates transparency around the challenges that the supervisory authority has identified and wishes to focus on. In this way, the supervised entities are also given a clear indication of which areas they should be particularly focusing on.

The state of the economy as a whole highlights the challenging nature of the current situation as the FMA looks to next year. While the economic upturn of recent years boosted profitability and capitalisation in the financial sector, a loss of momentum has again increased the pressure on traditional players on Austria’s financial market. Moreover, this pressure is only growing, as more and more new players and digital business models force their way on to the market.

As far as the FMA is concerned, this means it must, firstly, continue with the work it has started and further improve companies’ resilience and corporate governance. And secondly, it must place an additional focus on new players, new business models and their impact on the financial market of old.

As far as operational supervision is concerned, and based on its medium-term risk

analysis and supervision strategy (2020-2024), the FMA is therefore setting the following priorities for its inspection and supervision work in 2020:

1. Expanding collective consumer protection
2. Strengthening the governance of supervised companies
3. Embracing the opportunities of digitalisation while addressing the risks
4. Making financial service providers more resilient
5. Providing a regulatory and supervisory context for new business models
6. Securing the clean status of Austria’s financial centre.

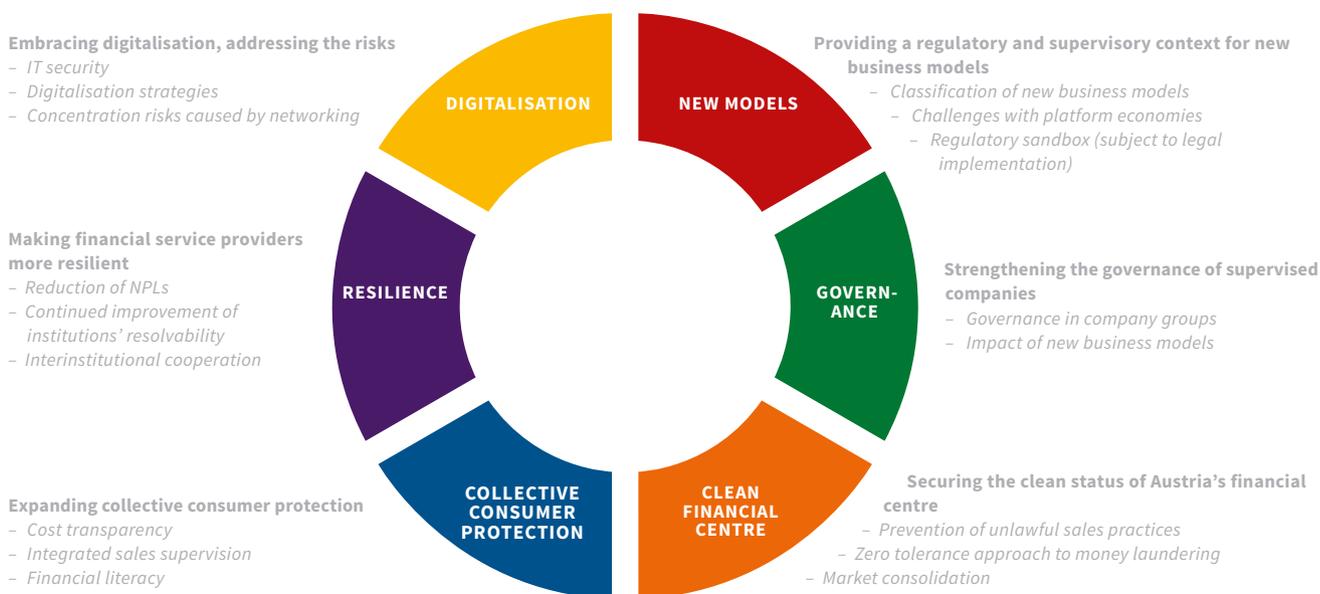
These main priorities in operational supervision activities will also be supplemented during the coming year with a diverse range of activities to expand and develop the regulatory framework and with numerous supervisory policy initiatives.

As it works closely on a number of regulatory projects in 2020 in an advisory capacity, the FMA will be focusing, for example, on helping to shape the sustainable finance rules, on developing the FMA’s position to Basel 3.5, and on preparing the FMA for the changes to EBA, EIOPA and ESMA. The FMA has a seat and a vote at each of these European supervisory authorities and contributes proactively to their work in the interests of Austria as a financial centre. The ESA Review, which has analysed and evaluated the efficiency and effectiveness of these institutions on the basis of their practical work in their early years, provides a good starting point in this regard. Another focus will lie in strengthening international cooperation across all areas of supervision, particularly in terms of the working relationship with partner authorities in Central, Eastern and South-Eastern European countries (CESEE region).

Yet the economic, technological and social changes also affect the FMA itself, and that is why we have set the following in-house priorities for 2020 based on our overriding goal of becoming “ever better, ever more efficient and ever more effective”:

- **Internal organisation:** In order to be optimally prepared for the future in every area of its work, the FMA has laid the groundwork for a comprehensive mapping of all of its processes in 2019. This will be implemented during the coming year. Based

Figure 1: Supervision priorities for 2020



on an agile approach to projects in 2019, which proved successful, a further priority will lie in strengthening project management skills on a broader basis. The ongoing development of compliance within the FMA is a further goal.

- **Information and communication technology:** The designated areas of attention in relation to the FMA's IT system in 2020 include the technical upgrade of the Incoming Platform, including the expansion of the end-to-end digitalisation of workflows, the expansion of real-time reporting, and the related automation of internal reporting.

As it strives to promote transparency in its regulatory and supervisory work, the FMA publishes its priorities for supervision and inspections for the coming year as part of its operational supervision remit. The aim is to clearly explain to the supervised entities, FMA employees, the general public and the market why certain priorities are being set in regulation and supervision, and which goals are being pursued through them. These are derived from the FMA's medium-term risk analysis and strategy, which is revised annually, and focus on the major and specific challenges facing the supervisory authority and market participants in the years to come.

### **PRIORITY FOR SUPERVISION AND INSPECTIONS: EXPANDING COLLECTIVE CONSUMER PROTECTION**

The consistently low level of interest rates, the existence of negative rates in some cases, and the digital revolution in the financial markets are all creating particular challenges when it comes to protecting savers, investors and other users of financial services. Through its collective consumer protection concept, the FMA is making a key contribution in this regard.

#### **LOW INTEREST RATES**

For consumers, low interest rates are a double-edged sword. Consumers who borrow money benefit from low rates. However, the same consumers may also be investors, and will be adversely affected by low rates and low returns.

Borrowers are taking advantage of the favourable deals available to them, as shown by the development of real estate and consumer loans. From the perspective of collective consumer protection, it is important to make sure that these loans are not being granted too freely and that the consumers who borrow money would still be able to afford the interest and repayments were rates to rise again. With this in mind, the FMA has made sustainable lending standards one of its supervision priorities for the past two years.

For savers and investors, and with regard to retirement provision, the situation when interest rates remain persistently low is a gloomy one. The interest rates on safe investments in particular are tending towards zero and for some products, such as government bonds with high credit ratings, are actually already negative. Moreover, the nominal interest rate is not the end of the story, as there will often be expenses and fees to pay too. The main issue, however, is how the value in today's money of the invested assets changes over time. This value is based on the real return, in other words the amount left over after deducting inflation from the nominal rate of interest. This not only impacts on consumers' saving deposits, the nominal return on which, weighted by volume across all tie-in periods, has fallen from a very modest 0.6% in

2014 to below 0.2% by 2018. It also affects low-risk government bonds and retirement provision through products from life insurers, *Pensionskassen* and corporate provision funds, which are coming under huge pressure in terms of the returns for investors. Another factor is that interest rates are losing their function as a risk indicator as more and more financial products have an interest rate of zero or even in some cases a nominal rate of less than zero.

Despite interest rates remaining low, and despite negative real returns in many areas, the majority of Austrians continue to be risk-averse and very conservative in their investment behaviour. The total volume of savings deposits of Austrian households has risen consistently since 2014, from approximately € 217 billion to € 255 billion, while the proportion of fixed-term savings has fallen and the volume of overnight deposits has grown by a good € 65 billion. The fact that the erosion of nominal interest on savings causes a real loss of assets affects Austrian households particularly badly, as savings deposits have a particularly high significance, accounting for 38% of total assets.

In contrast, investments in securities are much less significant by comparison and have actually fallen over recent years. In 2018 Austrian consumers barely made any additional investments in equities compared with 2014 levels. Overall, listed equities account for just under 3.4% of households' total assets, despite the fact that investments in shares have been profitable overall over the past five years. The total assets invested in listed equities by households during this period did actually rise by just under 40% to approximately € 25.5 billion, but 90% of this increase was attributable to exchange rate and price gains and not to the purchase of additional shares. The volume of securities issued by credit institutions and held by private individuals fell particularly strongly during this period, plummeting by around one third.

In other words, securities investments generally became less important to Austrian households in 2018.

Another effect of low interest rates has been that the interest rate has lost its significance as a risk indicator. As they seek out higher returns, more and more investors are turning to riskier and in some cases very risky financial products, many of which are also highly complex. They are often doing so without actually understanding how the products work or being familiar with the associated risks and opportunities. Since being given the legal authority to intervene, the supervisory authority has been required to prohibit the sale of binary options to retail investors and to greatly limit the sale of contracts for difference (CFDs) to this same group.

## COLLECTIVE CONSUMER PROTECTION

In 2020 the FMA will be focusing on:

- The ongoing development of cost transparency initiatives that have already been successfully implemented.
- The continuation of integrated sales supervision.
- The expansion of the marketing report in order to detect trends for supervision work and to be able to adopt appropriate measures in relation to products that are particularly risky for retail investors.
- The utilisation of the wealth of information available from supervisory activity in order to improve consumers' financial literacy in an increasingly challenging market environment.

However, the low rates of interest and return available with low-risk and traditional financial products are pushing many retail investors towards dubious providers, particularly via the Internet and social media, as they hunt down a better return. These providers promise high yields in exchange for low risk, but are actually hoping to rip off unsuspecting investors or even defraud them. Consequently, the number of investor complaints submitted to the FMA has soared in recent years, and the number of investor warnings published by the FMA in relation to disreputable providers in Austria has tripled to 65 in the space of five years. More than half of the complaints already relate to cryptoassets. The complaints received by the FMA in 2019 revealed losses for investors that averaged € 26 500 per head, more than the average annual income in Austria.

### THE DIGITAL REVOLUTION

As the digital revolution has taken hold, we, as the supervisory authority, are witnessing a far-reaching structural transformation of the financial world. While the business models and financial services of established providers are being forced into change, the new situation is also creating new providers in the form of FinTechs, BigTechs and platform economies, as well as entirely new financial services and products, such as initial coin offerings (ICOs), innovative payment services and cryptoassets. The market for cryptoassets is one that has developed particularly dynamically, from virtual currencies like Bitcoin to brand new digital stocks or security tokens, designed along the lines of traditional financial products. The European Central Bank (ECB)<sup>1</sup> estimates the volume of cryptocurrencies in circulation to be \$ 165 billion (April 2019), with Bitcoin accounting for 50% of this amount.

However, in a digital world, access to financial services is also fundamentally changed. Even complex, high-risk financial products are available via electronic banking or the Internet at any time of day or night, and are easily accessible from the comfort of consumers' own homes. It only takes a few clicks, possibly without really thinking about it, to buy these products. Yet this also means that all of the communication about the product (product features and key information, opportunities and risks, consumer protection information) takes place digitally. This presents a completely new challenge, as digital communication is just not the same as a face-to-face discussion. To take just one example: How can we make sure that customers do not simply ignore risk warnings and consumer protection information provided in the form of pop-ups? And what happens if consumers waive all their rights as they frantically click to get rid of these "annoying" pop-ups?

Another potential problem associated with digitalisation is that large population groups that are not IT savvy, such as older people or those who live in rural areas where bank branches and other financial providers are closing down, risk being denied access not just to innovative products but also to basic financial services. This is another area in which a creative response is required.

As these cursory examples show, the digital revolution in the financial sector must be accompanied by constant, focused and technology-neutral collective consumer protection.

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<sup>1</sup> ECB Economic Bulletin, Issue 5/2019.

## **FINANCIAL EDUCATION**

The way in which consumers have responded to the challenges of both low interest rates and digital change confirms the FMA's experience, namely that many Austrians have insufficient financial knowledge in order to be able to assess whether a particular product meets their specific financial requirements. Several studies show that many Austrians prefer to stick with simple savings accounts, not understanding other investment options due to their lack of financial knowledge and therefore feeling uneasy about them. Analysis of the investor complaints received by the FMA also shows that dubious and fraudulent providers specifically target people with little financial knowledge, deceiving them with unrealistic promises and their supposed expertise.

Financial education can therefore protect against investment fraud and also help create a situation in which more private investors have the freedom to make their own financial decisions and access a broader range of investment products.

Through its initiative of using the wealth of supervision information to improve consumers' financial expertise, the FMA wants to help raise levels of financial literacy among Austrian consumers. The aim is to enable consumers to make fully informed decisions and take care of their own financial affairs. For its part, the FMA has no position on risk. All investors should assume the level of risk that they judge to be right for them.

Meanwhile, the European institutions also view financial education as an important issue. The European Banking Authority (EBA) has already expressed its concern at the level of financial education in some Member States, highlighting the fact that the elderly, immigrants, low earners, young people and the unemployed are particularly vulnerable to financial exclusion, and recommending a targeted education campaign to tackle the problem. The major changes sweeping through the product and service landscape (new and more complex products, digitalisation) make this even more of a necessity in the EBA's view. It is also calling for financial service providers to make clearer information available to consumers that should also be easier to understand and better tailored to the target groups. After all, as well as sufficient financial knowledge, consumers need fair, transparent and comparable information about a product in order to make the right decision for them.

## **MARKET TRANSPARENCY**

In the context of collective consumer protection, the FMA is therefore also focusing on improving market transparency, doing so, for example, by adopting minimum standards on the information provided to customers prior to contracts being entered into, during the term of these contracts and when the provision of financial services is being terminated; and by means of ongoing monitoring of compliance with the regulatory information obligations, particularly with regard to transparent costs.

In accordance with the European consumer agenda, the FMA is also extending its market monitoring activities (including market studies) and adopting a more in-depth approach. The aim is to identify market trends and particular risks so that supervision priorities can be set and measures introduced in good time. Integrated sales supervision is a particular priority. In terms of transparency and information, the particular sector and supervised company from which a consumer chooses to acquire a financial product should be irrelevant.

## OPERATIONAL MEASURES AND INSPECTION PRIORITIES

### MARKET TRANSPARENCY

The FMA is merging existing ongoing analysis (e.g. cost analysis of investment funds, closet indexing analysis) with new analysis (e.g. cost transparency of performance information in unit-linked life insurance, transparency of fee models for online consumer credit) from the perspective of collective consumer protection and evaluating the results. The results are being incorporated into supervisory activity and are also being prepared for consumers in a readily comprehensible, clear format. Another priority is compliance with cost transparency rules, as well as the proper provision of information to customers in the event of supervisory measures.

### MARKET MONITORING AND THE NEW MARKET REPORT

Market studies and market monitoring are carried out in accordance with European requirements. This means preparing a market report that also covers findings from the evaluation of MiFIR data, complaints data, the survey on investment recommendations as defined in MAR, the leverage analysis, the various different stress tests, the analysis questionnaire and the common supervisory action (ESMA-CSA). Information from prospectus and fund supervision, as well as from on-site inspections, is also taken into account and included. This guarantees market monitoring as required under MiFIR.

The market report is used internally as a supervisory tool to build up common knowledge and a shared understanding beyond sector-based supervision and, where applicable, to identify areas requiring supervisory action. The findings, market trends and resulting risks are also shared with investors and consumers.

### INTEGRATED SALES SUPERVISION

Integrated sales supervision will also, as part of a significant addition, monitor sales models to determine whether supervised companies are circumventing consumer protection rules. Practices that disadvantage investors and consumers will be identified across all sectors and consistently followed up. Additionally, compliance by banks with the statutory rules on the sale of insurance will be reviewed, thereby completing the integrated approach to conduct and sales supervision in this area.

### FINANCIAL LITERACY

The FMA will use its broad pool of information to help boost the financial literacy of investors and consumers. This should enable consumers to assume even more personal responsibility. The FMA designed and launched a dedicated “A-Z of Finance” consumer web page for this purpose in 2019. This page will be expanded, while additional communication channels such as newsletters, how-to videos and subject folders are used to reach as many consumers as possible. All of the FMA’s financial literacy measures, old and new, are implemented under a single banner.

## PRIORITY FOR SUPERVISION AND INSPECTIONS: STRENGTHENING THE GOVERNANCE OF SUPERVISED COMPANIES

Weak governance that does not go far enough damages public confidence in the

financial market. One of the causes of the financial crisis was credit institutions' inadequate governance structures. The crisis also revealed questionable corporate cultures, flagging up such issues as a lack of AML due diligence, extending as far as facilitating money laundering; systematic concealment of ownership structures and assistance in tax evasion (just the publication of the Panama Papers triggered penalties and back payments of approximately € 1.1 billion); the manipulation of critical benchmarks for financial transactions, including LIBOR, at the time the most important benchmark rate, and foreign exchange rates; or the deliberate exploitation of retail customers' lack of financial expertise. And these are just a few examples of the type of inappropriate behaviour by major players on the financial market. Since the outbreak of the financial crisis, banks alone have already paid more than € 270 billion in fines due to misconduct across the world.

As part of its 2016 stress tests, the EBA found that the operational risk costs of Europe's 51 leading banks totalled € 105 billion, of which as much as € 71 billion was attributable to failure to apply due diligence, for example in relation to money laundering.

Incidents like these dealt a severe blow to the financial sector's reputation in the years following the crisis, also damaging confidence in the ability of the financial market and financial players to function properly and provide a proper service.

### **INSUFFICIENT GOVERNANCE**

While the specific causes varied from one bank to another, weak and insufficient governance certainly created an atmosphere conducive to negative developments and thus contributed to the real economic damage suffered by the institutions in question. The problems in some companies stemmed from a failure to pass on information correctly and to fully involve the relevant decision-making bodies (e.g. supervisory boards). Risky investments were made despite the supervisory board not having all of the facts, or weak internal control functions were not in a position to detect or avoid the long-term risks being created for the company. In other banks, slow and complex decision-making structures made it impossible to react quickly to changes in the economic environment or basic parameters. This type of governance shortcoming ultimately created actual risk costs and ate into profits.

Consequently, from a regulatory perspective, a great deal of attention has been paid in recent years to improving internal governance and corporate and risk cultures. The following questions are especially relevant to supervisors:

- It is easy to spot misconduct in hindsight. However, what does a corporate culture need to look like to make sure such misconduct cannot happen in the first place?

### **GOOD GOVERNANCE**

In 2020 the FMA will be focusing on:

- Governance in company groups.
- The interaction between different compliance functions in companies.
- The impact of new business models on the governance of these companies.
- Dedicated governance workshops with the supervised institutions.

- What basic parameters are needed to ensure that the responsible decision-makers can make proper decisions?
- What does a feasible risk culture from both a profitability and supervisory perspective look like in practice?

### PRINCIPLES OF GOOD GOVERNANCE

The European lawmakers, the EBA and the supervisory authorities have attempted to address these questions in a comprehensive set of rules, notably the EBA's Guidelines on internal governance and on the assessment of the suitability of members of the management board and key function holders. The following principles in particular are key to sustainable and effective corporate governance in the interests of all stakeholders:

- Appropriate, sound and transparent **internal governance** of executive and monitoring structures within the company as well as the corresponding reporting and decision-making channels.
- **Diverse composition** (e.g. in terms of area of expertise, experience, age, gender etc. of the responsible persons concerned) **of the executive and supervisory boards** and suitability of the individual members. This creates scope for critical discourse and guarantees informed decision-making. Moreover, having independent members in the supervisory body is crucial to ensuring high-quality debate. The regulatory and supervisory efforts of recent years to create more professional supervisory boards in Austria are already bearing fruit.
- A **“three lines of defence” model** within a company has proven to be an appropriate approach to tackling risk: the identification, assessment and management of risks begin in the respective departments, at an operational level. This is enhanced by the risk management and compliance function at company level. Finally, the internal audit department performs planned and ad-hoc ex post audits of individual areas so that any shortcomings can be remedied quickly and appropriately.
- The company's risk culture must be reflected in its **risk appetite statement** and in the risk management strategy. As well as holding overall responsibility for the risk culture, the managers must also help establish this culture on a long-term basis by setting an example for the rest of the company to follow (tone from the top), thereby building an appropriate corporate culture.

One very effective way of enforcing rules of conduct, and thus good governance, is through punishments that hurt and that act as a deterrent. The range of possible penalties includes the imposition of fines on natural or legal persons, in millions of euros if necessary, and in the case of Austria amounting to up to ten per cent of the company's total (net) sales, as well as the dismissal of managers or withdrawal of a licence to operate.

Breaches of the governance rules themselves are however generally tackled with qualitative measures. In Ireland, for example, a large-scale behaviour and culture review was carried out at the five biggest retail banks, on the basis of which very specific individual measures were derived and implemented.

The findings of the regular supervisory review and evaluation process (SREP) in the banking sector reveal, however, that many Austrian banks are still lagging a long way behind in terms of their governance structures. This is partly because many of the new rules are only starting to take full effect, but the banks are also taking their time

and still have a lot of ground to make up. With the implementation of the new Solvency II regime a few years ago, Austrian insurance undertakings overhauled their governance structures and have made good progress. This must now be reviewed and analysed in theme-based analytical surveys and on-site inspections, before being developed further.

Strong corporate governance is a basic prerequisite of stable, resilient companies. Consequently, the FMA will be focusing particularly strongly on governance in 2020, ensuring the effective and targeted implementation and fine-tuning of the regulations created in response to the impact of the financial crisis. By setting this priority for its supervision activities, the FMA is also sending out a clear signal to the market regarding the importance of this area of regulation.

## **OPERATIONAL MEASURES AND INSPECTION PRIORITIES**

In 2020 the FMA will therefore be setting the following priorities for inspections as part of its focus on good governance:

### **INTERNAL CONTROL FUNCTIONS**

It will focus particularly strongly on internal control functions, such as internal audit and compliance, and step up its dialogue with the responsible persons. Well linked, active key functions (e.g. compliance, AML, internal audit) that are familiar with what the supervisory authority expects of them make a key contribution to a company's healthy risk culture.

### **GOVERNANCE IN AFFILIATED COMPANIES**

The FMA will focus on governance within company groups across all areas of supervision. Strong corporate governance must be a day-to-day reality at all levels of the group.

### **NEW AND ENHANCED BUSINESS MODELS**

Economic, social and societal change mean that the business models of many supervised entities need to be updated and adapted, as innovative newcomers enter the market with new models. The FMA will be reviewing whether companies have also made the required adjustments to their governance structures and whether the governance rules are compatible with the new business models. It will also be checking whether any required changes have been made in time, also relying on findings from conduct supervision. In the securities sector, where digital business models are already subject to a licensing procedure with new demands made of executive staff, the FMA will be checking that the rules are being observed.

### **DATA GOVERNANCE**

Data is now one of companies' most valuable commodities and a key factor in their success. It must, however, be handled with particular care at all levels. Consequently, data governance will be made a specific focus of inspections. In the case of banks that are supervised by the ECB directly (significant institutions, SIs), compliance with the BCBS 239 (Basel Committee's Principles for effective risk data aggregation and risk reporting) will be evaluated and audited.

The FMA will also be applying the following operational measures in 2020:

#### **GOVERNANCE WORKSHOPS**

The FMA will hold governance workshops with selected credit institutions and insurance undertakings. The relevant governance structures will be analysed in more detail and the institution or undertaking provided with tailored information on the supervisory authority's expectations.

#### **DIALOGUE BETWEEN COMPLIANCE FUNCTION, INTERNAL AUDIT AND SUPERVISOR**

The dialogue between compliance function, internal audit and supervisor will be stepped up, as efficient internal control functions play a key role in a healthy risk culture in banks. These functions are also upstream of the supervisory authority in terms of their control activity, making them an important point of contact. At the same time, clear communication of the supervisor's understanding of the roles to be played by individual control functions should also help to avoid redundancies.

#### **MARKET INFRASTRUCTURES AND PORTFOLIO MANAGERS**

The governance structures of market infrastructures and portfolio managers will be evaluated and ideas for improvement proposed.

### **PRIORITY FOR SUPERVISION AND INSPECTIONS: EMBRACING DIGITALISATION, ADDRESSING THE RISKS**

New technologies are increasingly leaving their mark on the economy and society, and thus also on the financial sector. The digitalisation of financial services means that the basic conditions on the financial market are changing as quickly and as fundamentally as they have for decades. In the wide field of these developments, it is important to both market participants and the FMA that the risks, as well as the opportunities, associated with the changes are detected and analysed in as much detail as possible, with appropriate measures then being introduced.

The financial sector has been in a state of flux caused by increasing digitalisation for many years now. Alongside improving efficiency and saving costs, quickly identifying and better serving the changing needs and preferences of potential customers are of key importance. Greater demands are being made of companies in terms of their strategies, which require ongoing adjustment and alignment. If changes are not made to these strategies in good time, established companies risk being pushed out of the market by new, innovative rivals. The supervised companies must focus in particular on the question of what changes are needed to their corporate strategy and the way they interact with customers, and on whether it might make sense for them to cooperate with new providers on the market.

#### **FMA STRATEGY**

As far as the FMA is concerned, it is important that it observes and analyses how the supervised companies deal with the risks associated with digitalisation, quickly implementing any required measures. It is also essential in this regard that the FMA has appropriate supervisory tools for the digital world. The FMA consequently focuses on considering the digitalisation of the Austrian financial market from a risk perspective.

In a comprehensive study published in July 2019, the FMA investigated and analysed the state of digitalisation, the current areas in which digital technologies are being deployed and the key effects of these technologies on the Austrian financial market. The study is based on far-reaching information provided by the supervised companies, with almost complete market coverage achieved for many sectors of the financial market in terms of data collection. In this way, an integrated view of digitalisation and its risks has been obtained. This is highly important not least given the major degree to which the Austrian financial market is interconnected, even across different sectors.

The results of this study, the findings from current monitoring and auditing of supervised entities, the experiences of the FMA FinTech Point of Contact, and European and international developments all provide the FMA with the basis on which to set its priorities for supervision and inspections, also ensuring that its tools favour a risk-based approach. Current, reliable information on technologies being used in practice enables the FMA to effectively implement the principle of the same supervisory requirements for the same risks as well as the principle of technology neutrality as it carries out its supervisory work in practice.

As far as the FMA is concerned, digitalisation, together with its risks and current and potential future impact on the Austrian financial market, therefore remains a priority for supervision in 2020.

## **OPERATIONAL MEASURES AND INSPECTION PRIORITIES**

In 2020 the FMA will therefore be setting the following priorities for inspections as part of its focus on digitalisation:

### **IT STRATEGY AND IT SECURITY**

The FMA will be focusing in particular on supervised companies' IT strategy and IT security, having published its expectations in the 2018 IT Guides. Practical implementation will therefore now be the main focus.

### **IT INFRASTRUCTURES**

As part of assessing the supervised entities' IT strategies, the FMA will also be focusing on analysing and inspecting IT infrastructures. As well as looking at IT planning and future investment requirements, it will also evaluate whether a company's future plans for IT infrastructure are compatible with its business model and advances in digitalisation.

## **DIGITALISATION**

In 2020 the FMA will be focusing on:

- The further development of inspections relating to IT security.
- The analysis of risks arising out of companies' digitalisation strategies.
- The digital link-up of market participants and the ensuing concentration risks.

**CLOUD SERVICES**

Given the related outsourcing, concentration and data security risks, cloud services will be another key inspection focus. The FMA will look at whether these comply with supervisory rules and whether the related risks are adequately covered in the company's risk management. The FMA study clearly showed that cloud services are widely used by the supervised entities.

**DIGITAL INTERCONNECTIVITY**

The digital world, with its many new players, is also creating new links and dependencies between market participants, an evaluation of which by the FMA is key to assessing the microprudential and macroprudential risks. Reviewing digital interconnectivity, which must take equal account of regulated and unregulated companies, should identify the relevant intersections and critical infrastructures that are essential to the proper functioning of Austria's financial market. By evaluating the market as a whole across all of its sectors, the FMA will also obtain an overview of potential contagion risks and channels, so that it can take steps to mitigate these risks.

**CYBER RESILIENCE**

The FMA will continue with its activities to review the cyber resilience of supervised companies and also expand these to include new sectors.

**MARKET ABUSE**

In the area of securities supervision, the focus will lie on the functionalities (data sets, logic) of the systems required under the Market Abuse Regulation (MAR), such as suspicious transaction and order reporting (STOR) and investment recommendations, as well as on processes, and the related assessments in terms of risk and business continuity management (BCM).

The FMA will also be applying the following operational measures in 2020:

**MAPPING**

In addition to existing mapping, the FMA will also specifically record and systematically present the mutual dependencies and links, as well as risk concentrations, arising from digitalisation, so that potential contagion channels can be detected at an early stage.

**PRIORITY FOR SUPERVISION AND INSPECTIONS:  
MAKING FINANCIAL SERVICE PROVIDERS MORE RESILIENT**

Major progress has been made in strengthening the financial sector's resilience at both European and national level since the global financial crisis. Further efforts are still required, however. The FMA has therefore, in harmony with the authorities within the European Single Supervisory Mechanism (SSM) and Single Resolution Mechanism (SRM), also set a supervision priority in this area for the coming year. Three areas will be focused on: reducing NPLs, improving cooperation in the event of a crisis and developing integrated turnaround strategies.

**REDUCTION OF NON-PERFORMING LOANS**

The action plan agreed by the European Council in March 2017 to tackle the problem

of non-performing loans (NPLs) has not yet been fully implemented or concluded. The work that has been started must be continued. Within the European Union, NPL ratios are still very unevenly distributed across the individual countries: Greece has a ratio of 41.4% compared with 0.5% in Sweden. While the NPL ratio has been falling consistently since 2014, this is only the result of the significant increase in the lending volume. NPL exposure rose again in 2018, with a slight increase recorded in the volume of NPLs in the eurozone for the first quarter of 2019. The further reduction of and the creation of provisions for existing NPLs, as well as avoiding the build-up of new NPLs over the next two years, are therefore key supervision priorities within the SSM as a whole.

Although the average NPL ratio of Austrian banks, at 2.6%, is comparatively low, approximately 40 Austrian institutions were still classed as “high NPL” banks as at May 2019. This means they have an NPL ratio of more than 5% and are subject to particularly close attention by the supervisory authority. The FMA will therefore make consistent support for NPL strategies pursued by Austrian banks one of its priorities in 2020.

#### **THE RESOLVABILITY OF AUSTRIAN INSTITUTIONS**

The resolution plans within the SRM, and in Austria, have progressed substantially over recent years but have not yet been finalised. The main focuses within the SRM over the next few years will include assessing resolvability and addressing obstacles to resolution. Banks should be given close support as they work to identify and then remove any obstacles. This applies to banks for which the Single Resolution Board (SRB) is responsible and to supervision at a national level.

As a central element in the credibility of the resolution strategy, credit institutions must apply and adhere to their minimum requirement for own funds and eligible liabilities (MREL). The aim of the MREL is to ensure that an institution has sufficient funds to absorb its losses and for the subsequent recapitalisation in the event of a crisis.

Within the SRM, the MREL shortfall for banks under the responsibility of the SRB was approximately € 170 billion as at 31 December 2018, of which around € 70 billion in the form of subordinated liabilities. Making up this shortfall will be a challenge for banks and the capital markets alike. The revised Bank Recovery and Resolution Directive (BRRD II) introduces binding subordination requirements for at least some of the MREL for certain institutions, as a result of which there could be a further major impact on individual banks. The Austrian banking market will be no different in this regard.

## **RESILIENCE**

In 2020 the FMA will be focusing on:

- Continuing to consistently support the reduction in banks’ portfolios of NPL.
- Strengthening interinstitutional cooperation in the area of resolution (Federal Ministry of Finance, OeNB, deposit guarantee institutions, market infrastructures).
- Carrying out the first resolution scenario dry run.

Given that the FMA has opted for a staggered approach in its area of responsibility, binding MREL requirements were imposed on those Austrian credit institutions that fall under the direct responsibility of the FMA as the national resolution authority (less significant institutions, LSIs) in 2019 for the first time. No subordination requirement has been defined as yet. However, following implementation of BRRD II, a subordination requirement will also apply to certain LSIs taking into account the preferred resolution strategy. Austrian institutions must be prepared accordingly. In light of the recent banking crises, international discussions on how to deal with medium-sized, deposit-rich banks have yet to reach a conclusion, and the issue remains on the agenda, not least because these banks can expect to feel a major impact on their business models.

### **PREPARING AUSTRIAN INSTITUTIONS FOR A POTENTIAL CRISIS**

As the Financial Stability Board (FSB) wrote in its report on the implementation of resolution reforms in November 2018 (“Keeping the pressure up”), further work is needed on the implementation and putting into practical effect of the resolution tools. In addition, preparations drawing on experience from the successful national application of wind-down units to deal with crisis-hit institutions must be stepped up. The SRB has already been focusing particularly strongly on the issue of preparedness for future resolution cases, the related coordination with the national resolution authorities, and the operationalisation of a resolution procedure in the context of its work priorities for 2019. This focus must be implemented accordingly at national level, particularly as the FMA remains the authority responsible for implementation of the resolution strategy, even in relation to banks for which the SRB holds responsibility.

Furthermore, at both national and international level, policy work is increasingly stressing the fact that successful resolution is not just dependent on the work of the resolution authorities and the relevant banks, but also involves a number of other key stakeholders (e.g. deposit guarantee institutions, financial market infrastructures, central banks, financial ministries, competition authorities). Consequently, dialogue with these stakeholders is being viewed as increasingly important in order to reach a shared understanding of resolution issues and, where necessary, to develop processes that span more than one institution.

### **CRISIS COOPERATION AND INTEGRATED TURNAROUND STRATEGIES**

During a financial crisis, time is an extremely limited resource. Cooperation processes that save time during a crisis are an essential component of good crisis management. The current FMA Crisis Management Manual dates from the period during which the Bank Recovery and Resolution Act (BaSAG; *Bankensanierungs- und Abwicklungsgesetz*) was being implemented and does not cover current cooperation issues in the SSM and SRM. It must therefore be revised.

The new Crisis Cooperation Manual must also cover the identification and regulation of internal and external interfaces and the establishment of sensible, straightforward cooperation rules for the smooth flow of information and efficient liaison in the event of a crisis. The Manual should include the required processes and also cover the turnaround strategies for banks, the resolution of which is likely to be in the public interest. An approach agreed between those responsible for supervision and resolution

should be guaranteed, covering the recovery, early intervention and resolution phases.

The FMA's goal is therefore to improve and strengthen the resilience of Austrian institutions in particular and the financial market in general. Banks' balance sheets should be tidied up by reducing NPLs and by means of consistent value adjustments. Any renewed build-up of NPLs in future as a result of relaxed lending standards and the associated risk should be avoided. At the same time, the resolvability of Austrian institutions should be improved. Obstacles to resolution should be addressed, action plans developed and finally the build-up of MREL – and of subordinated MREL in particular where required on the basis of the resolution strategy – should be driven forward in accordance with the principle of proportionality. Finally, the FMA's preparatory work and cooperation with the SRB and with key external stakeholders at national level to overcome future crises must be intensified.

## **OPERATIONAL MEASURES AND INSPECTION PRIORITIES**

In 2020 the FMA will therefore be setting the following priorities for inspections as part of its focus on resilience:

### **REDUCTION OF NPL RATIO**

Based on the findings of an evaluation of measures to reduce the NPL portfolio of LSIs (in line with the ECB's measures as part of the SREP), a structured dialogue is taking place with LSIs that have particularly high exposure to NPLs with the aim of reducing this exposure to below the 5% mark. The NPL guidelines are being implemented and monitored, while existing lending standards are being maintained in order to avoid any relaxing of the requirements.

The ECB's survey of credit underwriting standards is in progress with any outliers being identified and addressed as part of the supervisory process.

### **STRESS RESISTANCE OF THE INSURANCE SECTOR, CORPORATE PROVISION FUNDS AND INVESTMENT FUNDS**

Insurance stress tests are being developed further, with management actions to be included in future in the post-stress situation in the model and taken into account when implementing the 2020 stress tests. Additionally, stress testing is also being carried out in relation to corporate provision funds and investment funds, with the results being fed into supervisory activities.

### **THE RESOLVABILITY OF INSTITUTIONS**

As part of national resolution planning, reorganisational resolution strategies are being developed for medium-sized, deposit-rich banks in particular, with the results being fed into the resolution plans and MREL targets. Potential legal, economic and technical obstacles to resolution are identified and addressed with the institution in question, so that action plans for their elimination can be devised and implemented. With regard to the transposition into Austrian law of BRRD II, the FMA's policy on the MREL will be extended to include a subordination requirement in line with the terms of BRRD II and international development, applying the principle of proportionality. The first MREL targets will be prepared on this basis. Additionally, for the first time, an

MREL will be prescribed for certain LSIs in a solo capacity once the planning cycle is concluded.

#### **RESOLUTION PREPAREDNESS**

In order to prepare and apply effective resolution measures, the credit institutions must be subject to data requirements. Appropriate minimum standards in relation to the MIS (management information system) will be drawn up based on the FMA standards. At the same time, there will be more intense dialogue with external stakeholders (deposit guarantee institutions, market infrastructures, Oesterreichische Nationalbank and the Federal Ministry of Finance), developing a shared understanding of resolution issues. The aim is to ensure familiarity with all aspects of the process workflows in a crisis, as tested and analysed during a national dry run (simulation of a resolution scenario).

#### **INTERNATIONAL COOPERATION**

The FMA will be further embedded in the international resolution environment. Cooperation with the SRB will continue. This relates both to the implementation of SRB measures in relation to SIs, and to dialogue on LSI policies. Cooperation on European initiatives and promoting their implementation will remain a guiding principle.

#### **CRISIS COOPERATION MANUAL**

A mutually agreed and updated Crisis Cooperation Manual will be developed. Based on the special requirements of cooperation in the SSM and SRM, the manual will first be written with banks in mind before being extended to include other financial market participants. For banks, the resolution of which is likely to be in the public interest, integrated turnaround strategies will be devised, based on an approach agreed between those responsible for supervision and resolution, and covering the recovery, early intervention and resolution phases.

Additionally, work will continue within the FMA to improve the processes, with a particular focus on how to portray the information relevant to resolution in securities prospectuses.

#### **DEPOSIT GUARANTEE INSTITUTIONS**

Targeted measures such as on-site inspections, supervisory dialogue and stress testing are used to ensure that the deposit guarantee institutions are suitably prepared for a deposit guarantee event.

### **PRIORITY FOR SUPERVISION AND INSPECTIONS: PROVIDING A REGULATORY AND SUPERVISORY CONTEXT FOR NEW BUSINESS MODELS**

The increasing presence of companies with technology-based business models on the financial market has already triggered a series of adjustment and dynamic innovation processes. As integrated supervisory authority, the FMA's role in response to the establishment of new business models on the financial market is firstly to address the resulting technology-based risks across all sectors and to minimise these while ensuring a fair framework for all capital market participants in the context of its integrated,

technology-neutral approach to supervision under the existing regulatory conditions. The major importance of the FMA's integrated approach to supervision is very clearly evident from the cooperation arrangements already in place between companies on the market offering new technology-based business models and more established providers across all sectors. These projects are emerging in the form of cooperation based on partnership and under company law. The study into digitalisation on the Austrian financial market conducted by the FMA and published in July 2019 revealed that it is primarily banks and insurance undertakings that are turning to joint ventures with companies in the financial services or insurance sector.

More than half of banks (52%) and almost one third of insurance undertakings (30%) stated that they cooperated with at least one FinTech or InsurTech. These cooperation partners in turn include companies that, based on their business model, are required to have their own licence and are thus directly supervised by the FMA. Alongside the sometimes disruptive character of these business models and technologies, this data also highlights the potential of more innovative technologies and their providers to act as a binding link between providers from the different sectors of the financial market.

The FMA expects that new business models, such as robo advisors, will not replace classic financial services but will instead provide customers with an additional level of choice. One economic advantage of digital business models is that providing automated investment advice means that companies save money. Consequently, automated financial services can be offered on more favourable terms and at a more affordable price for the public at large, providing even retail investors with access to the capital market. According to the digitalisation study, 26% of the companies surveyed plan to use a chat bot within the next three years. Asset managers view digitalisation as a source of particularly strong potential for efficiency gains, expecting automated process optimisation to produce cost savings for them of up to 75%.

Market participants also expect to see an evolutionary development over the medium term, rather than any disruption due to new, technology-based business models and applications. The possibility of companies' current core business being completely replaced in the space of three years was largely dismissed as inconceivable by all of the financial sectors that took part in the digitalisation study.

Meanwhile, the implementation of innovative technologies on the financial market means that new players are joining the more established providers and are subject to

## NEW BUSINESS MODELS

In 2020 the FMA will be focusing on:

- Analysing and assessing new players and business models, such as security tokens (cryptoassets that imitate traditional securities) as a new asset class on the capital market, exchange platforms, wallet providers and similar from a regulatory perspective.
- Highlighting the challenges caused by platform economies and on their digital platforms.
- Developing an understanding of these business models and their implications for operational supervision.
- Getting ready to operate a sandbox in the event of its legislative implementation.

the existing supervisory framework, such as in relation to money laundering rules for example. In terms of the product universe on offer, changes are also in evidence with the emergence of new asset classes. Blockchain and distributed ledger technologies are being used to create entirely new assets that also attempt to replicate the functions of traditional investment products or forms of payment. As well as resulting in new opportunities for participants in the financial market, this is also creating technology-specific risks, with clearing and settlement being named in the digitalisation study as the securities sector likely to offer the highest growth, followed by greater use of token-based investment products.

The main feature of new business models is that classic financial services tend to be offered via a different technology-based channel or in connection with a different channel. The technological aspect and in-house IT constitute a key pillar of the respective company's business model.

From a regulatory perspective, the FMA supports both established and new providers with the implementation of new business models. It upholds the principle of technology-neutral access, treating all providers equally regardless of whether they use innovative technologies to provide their services or rely on classic channels. In terms of the development and implementation of new business models and technologies on the financial market, the FMA sees its role as being to create transparency, clarity and legal security so that financial innovations that contribute to a sustainable financial market are not impeded and, at the same time, to address the potential risks to the stability of the Austrian financial market and the risks for consumers. Another goal is to ensure equal and fair competition conditions for all capital market participants.

In this regard, the FMA also engages in European and international committees and works in cooperation with other supervisory authorities.

## OPERATIONAL MEASURES AND INSPECTION TOPICS

In 2020 the FMA will therefore be setting the following priorities for inspections and introducing the following measures as part of its focus on new business models:

### **IDENTIFICATION, EVALUATION AND SUPERVISION OF NEW BUSINESS MODELS**

Based on its technology-neutral approach to supervision, the FMA will proactively contribute to developments on the financial market by carrying out a risk identification and evaluation of relevant business models. The FMA will also focus on licensed providers with an interface to new technologies or new investment tools. In supervising new technology-based business models, the FMA will operate according to the principle of "same service, same rules"; making sure that all financial service channels are subject to the same regulatory requirements. It will monitor compliance with the statutory rules both during on-site activities and as part of its off-site supervision. To ensure that members of the management body and key function holders meet the fit and proper requirements, the profile needed for technology-driven business models will be extended to include technological expertise in addition to knowledge and experience of the financial sector, thereby ensuring the collective suitability of the management. As cooperation and outsourcing arrangements between licensed legal entities and unlicensed, technology-based companies increase, the actual provision

of the service will be reviewed during on-site activities and also as part of off-site supervision measures. This should help avoid the creation of “licensing shells”.

### **COMMUNICATION AND COORDINATION**

The FMA will offer established providers and those new to the market supervisory guidance on technology-related regulatory issues, issuing publications and making information available on its website. This will mean that innovative, technology-based business models can be subject to a (risk) evaluation that also considers the related supervisory requirements. For new, not yet supervised players and their planned business models, the FMA has established a single point of contact for FinTechs, a coordination and communication tool for supervisory issues, which it will expand and continue to develop. Subject to its adoption in law, a regulatory sandbox will be set up at the FMA in which selected innovative companies can trial their business model for a limited period of time in a protected regulatory environment.

### **AML/CFT SUPERVISION AND VIRTUAL CURRENCIES**

With effect from 10 January 2020 the legislator will be adding virtual currencies and certain related service providers to the statutory obligations to prevent money laundering and terrorist financing. It has transferred responsibility for supervision to the FMA. As a result the FMA has all of the supervisory powers defined in the Financial Markets Anti-Money Laundering Act (FM-GwG; *Finanzmarkt-Geldwäschegesetz*) that it already holds in relation to credit and financial institutions. The FMA will therefore be focusing on implementing the rules to prevent money laundering in this new area of supervision. It will also be working to promote a uniform interpretation and application of these new definitions in a money laundering context at European and international level in order to create legal security for the newly obliged entities and to take proactive action against potential supervisory arbitrage.

### **PRIORITY FOR SUPERVISION AND INSPECTIONS: SECURING THE CLEAN STATUS OF AUSTRIA'S FINANCIAL CENTRE**

A clean financial market is an essential condition in order to guarantee confidence in its proper functioning, its stability and a sufficient supply of financial services to the real economy and consumers. Low interest rates, ongoing technological innovations in sales and product design, as well as proper access to trading in financial instruments are currently creating particularly challenging circumstances.

### **CLEAN FINANCIAL CENTRE AUSTRIA**

In 2020 the FMA will be focusing on:

- Systematically identifying and combating unlawful sales practices in all sectors including cross-border operations.
- Consistently advancing our zero tolerance approach to the prevention of money laundering and terrorist financing in cross-border groups.
- Sounding out the Austrian market on a consistent basis for unlicensed providers, so that these can be removed.

Interest rates are expected to remain low for some years still. According to the financial news service Bloomberg, the volume of government and corporate bonds with a negative yield is already in excess of € 11 trillion. In Europe alone, a good three quarters of all outstanding government bonds (measured in terms of volume) have a negative yield. In Germany, 88% of all outstanding Bunds already have negative yields. The low or lacking yield opportunities in the classic forms of investment are prompting investors to seek out alternatives, in a search for yield. This poses the risk, in both the regulated and unregulated sector, that the elevated risks associated with higher yields will not be recognised or adequately assessed by investors.

At the same time, with interest rates remaining low, many financial service providers are coming under increasing pressure to find new, additional sources of income, and push the supervisory laws in place to protect consumers to their limits or circumvent them altogether (unlawful sales practices). This starts at the marketing stage, and is particularly obvious in online advertising. Access to appropriate and clear information in this situation is critical.

Many investors are also tempted, as they hunt out higher returns, to deviate into unregulated areas despite the fact they are exposing themselves to very many dubious and fraudulent providers. The huge increase in the number of FMA warnings on unauthorised business operations and regarding dubious providers and business practices are evidence of this. Investors are running the risk that they will be unable to properly assess the risks inherent in the unregulated sector, such as with regard to their legal status in the event of bankruptcy. Furthermore, it is often already difficult enough for investors to know whether a product is being offered by a regulated provider or not.

The FMA is therefore also monitoring developments in the areas of the markets bordering supervised activity very closely so that it can detect any efforts to avoid supervisory rules as soon as possible and consistently remove any providers that are not permitted to be there from the financial market.

The ongoing digital revolution has also lowered the practical hurdles to sales. The volume of new consumer credit has been rising consistently for years now, for example. At the same time, the increasing availability of robo advice is also changing the way in which customers are advised and informed. This creates reciprocal effects and risks for a “clean financial centre”, and these need to be addressed.

In addition, the Internet and new technologies are cutting the distances between consumers and companies physically located beyond their countries’ borders. Consumers in Austria are increasingly being targeted by foreign providers that offer products and loans on a cross-border basis. This has serious consequences in terms of responsibility for supervisory and intervention systems. Austrian authorities, but also the courts, only have limited responsibility (if any) for foreign providers. Yet it is not always clear to consumers who their contractual partner is and whether that partner is based abroad or not. In the event of problems, conflict resolution can prove difficult, due to different legal systems for example, or different lending customs. It is often difficult or even impossible to get in touch with contact persons or contractual partners abroad. Such risks must be addressed in the interests of a clean financial market.

Moreover, a clean financial centre also means that any licensed providers of financial services that do not play by the rules must be removed from the market. Just as important is that a clear dividing line is established between regulated and unregu-

lated activity on the financial market. In this regard the FMA also supports reputable providers by consistently prohibiting the unauthorised provision of business that requires a licence.

Global discussions about dirty business practices, triggering the publication by journalists of the Panama Papers and the Russian Laundromat and Ukio stories, show how important compliance with due diligence requirements for the prevention of money laundering and terrorist financing is for a financial centre built on clean operations. In Europe, responsibility for such compliance is however still fragmented, although the importance of effective prevention for the reputation of the financial market has been recognised and is increasingly being tackled. The standards in place to prevent money laundering that we in Austria take for granted are not necessarily comparable to those applicable in other countries in which Austrian financial providers operate. It is therefore important that the FMA's zero tolerance strategy is extended to subsidiaries in these countries by means of group compliance.

As of 2020, virtual currencies and certain linked service providers will be incorporated into Austrian due diligence obligations to prevent money laundering and thus, at least in this one area, subject to regulation. This also means that dubious or even criminal providers (pyramid and ponzi schemes) that also offer their products online must be clearly identified.

## **OPERATIONAL MEASURES AND INSPECTION TOPICS**

In 2020 the FMA will therefore be setting the following priorities for inspections and introducing the following measures as part of its focus on Austria as a clean financial centre:

### **UNLAWFUL SALES PRACTICES**

The FMA will be focusing on unlawful sales practices. It will be reviewing the advertising used to sell consumer credit online and the marketing used to sell bail-inable financial instruments. With regard to insurance undertakings, the focus will lie on direct selling via the web. Cross-border sales structures will also be examined. Another focus of inspections will be compliance with the FMA Regulation on Product Intervention Measures (FMA-PIV; *FMA-Produktinterventionsverordnung*), focusing on the monitoring of market practices in the case of product intervention. Conduct supervision in market integrity will focus on the Market Abuse Regulation (trading bans, STOR etc.).

### **ENTERING AND LEAVING THE MARKET IN THE REGULATED SECTOR**

A clear distinction must be made between regulated and unregulated activity. Market participants that do not play by the rules must be consistently kept out of the market. The areas of the markets bordering supervised activity must also be monitored so that any efforts to move investors out into unregulated areas can be detected at an early stage and consumers provided with appropriate information.

### **ZERO TOLERANCE APPROACH TO FAILURE TO MEET AML OBLIGATIONS**

The FMA will continue with its resolute zero tolerance approach towards money laundering and will also be extending its policy by means of group compliance to the

subsidiaries of Austrian financial service providers based in other countries. New online banks will come under particular scrutiny as their business model (business relationships and transactions without personal contact) presents a higher risk of being abused for the purposes of money laundering or terrorist financing.

Another key focus will be the supervision of compliance in practice with the due diligence obligations to prevent money laundering via virtual currency exchange platforms and wallet providers. As well as the registration of new providers, this will also entail the consistent removal of unregistered providers. In order to create legal certainty, a clear distinction will be made between those providers that are subject to registration obligations and regulation, and those that operate outside of these controls.





# MARKET MONITORING

How the FMA monitors Austria's financial market in the interests of collective consumer protection

**P**rotecting consumers – and investors, bank customers and insurance policyholders in particular – is one of the FMA's core tasks. There are two elements to this task, namely prudential supervision and conduct supervision. The former involves monitoring the economic robustness of the companies that the FMA has licensed and in this way ensuring that these entities are able to fulfil their commitments. Conduct supervision, meanwhile, relates to the precise rules imposed on the supervised companies and on how they provide their services. These rules cover such areas as the design of financial products, the type of consumers targeted with these products, the information that must be provided to customers at certain times, and the proper processing of a financial transaction. Conduct supervision involves monitoring compliance with all of these rules.

As part of the development of supervisory law through the application of the revised Markets in Financial Instruments Directive (MiFID II) and its associated Markets in Financial Instruments Regulation (MiFIR), the concept of collective consumer protection has been extended further and strengthened, with the addition of new tools such as product governance and product intervention. Since January 2018, the competent authorities have been allowed to prohibit or restrict the marketing, distribution or sale by supervised companies of certain particularly risky and complex products.

To date, supervision in relation to collective consumer protection has focused on transparency and companies' adherence to their obligations to provide customers with information. Now, however, the supervisor has been given a new power in the area of collective consumer protection, which although intended as a last resort is nevertheless a very important power, namely the FMA may now ban or place restrictions on certain financial instruments.

This represents a paradigm shift in supervisory law, requiring a new approach to

**The FMA established its own Market Monitoring team in 2018, the remit of which is to collate information relevant to consumers from all areas of supervision and, at the same time, to set its own risk-based monitoring and analysis priorities on the financial markets.**

supervision in the area of collective consumer protection. On this basis, the FMA established its own Market Monitoring team in 2018, the remit of which is to collate information relevant to consumers from all areas of supervision and, at the same time, to set its own risk-based monitoring and analysis priorities on the financial markets. The information fed into these processes includes findings from ongoing supervision, such as off-site analysis of the various areas of supervision, as well as relevant information from on-site inspections, consumer enquiries and reports, and whistleblower reports, in addition to ad-hoc market surveys and thematic studies alongside information acquired from structured dialogue between the FMA and market participants, consumer protection organisations and stakeholder groups. Ongoing market monitoring, including data collection and analysis, and an integrated view of all sectors and products, makes it easier to identify problems and risks for investors at an early stage and delivers valuable information that can also be incorporated into the FMA’s strategy, its setting of priorities and its supervisory activity. The FMA will be producing an annual report in future on how the Austrian financial market has developed from the perspective of collective consumer protection. Early insights and findings from the initial phase of market monitoring are, however, already pointing to significant challenges in consumer protection on Austria’s financial market.

**THE AUSTRIAN FINANCIAL MARKET IN 2018 – THE COLLECTIVE CONSUMER PROTECTION PERSPECTIVE**

Security is fundamentally important to consumers on the Austrian financial market as they tend to be very conservative and risk-averse in their approach to finance. Austrian households hold more than 40% of their financial wealth in cash or savings (2018 figures), with just over 20% held in insurance products and less than 17% invested in securities.

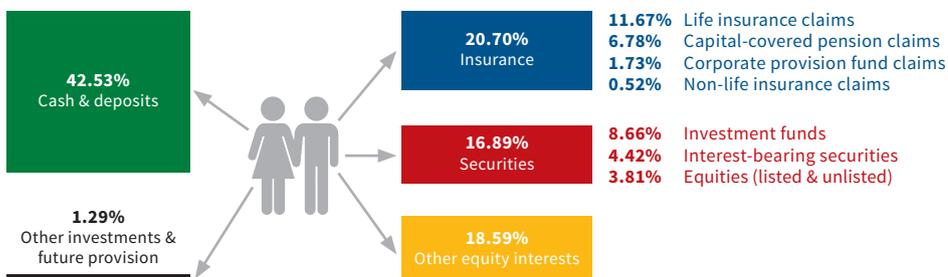
The financial assets of households in Austria in 2018 could be broken down as shown in Figure 2.

**INVESTMENTS**

**SAVINGS DEPOSITS**

Despite the fact that interest rates have been persistently low since the global financial crisis of 2008 and continue to fall, levels of saving in Austria are on the increase. Savings deposits have grown from approximately € 217 billion in 2014 to € 255 billion by 2018. Yet the tie-in periods have shortened over the same period, with more than

Figure 2: Austrian household investments 2018



€ 150 billion now being held as sight deposits. Long investment terms are no longer really worth it, with consumers favouring easy access.

The volume-weighted deposit rate has declined from just over 0.6% in 2014 to just below 0.2% in 2018 (> Chart 1). In effect, savers have been putting up with a real loss in income for years now, as the rate of inflation outstrips the rate of interest paid on savings. This is a particularly relevant effect with savings deposits accounting for around 38% of all of households' assets.

From the perspective of consumer protection, there were barely any problems in relation to savings deposits in 2018. One-off complaints were made about the time taken to cancel accounts and for the money in savings accounts to be paid out, but no specific deadlines for payout are actually stipulated in supervisory law.

Over the same period, the number of newly agreed building loan contracts has fallen, as has the overall number. There were only 4.4 million such contracts by 2018, compared with just over 5 million in the savings stage in 2014. Only 610 175 new contracts were taken out in 2018, down by a third on 2014 levels.

### BONDS

Interest-bearing securities have also ceased to be as important as a form of retail investment. The volume of bonds held by Austrian households has fallen from approximately € 43 billion to just under € 30 billion over the past five years. Securities issued by credit institutions have fallen particularly markedly, halving in volume to around € 14 billion over this period. By European standards, it is notable that Austrian households hold a disproportionately high volume of bail-inable securities. These are securities that can be used to absorb losses in the event of a crisis or the bank becoming insolvent. Every year banks place more than € 2 billion (2018: € 2.3 billion) of this type of security, of which 80% unsecured, with private individuals. The FMA has therefore made it one of its supervision priorities to review the avoidance of conflicts of interest and check that private customers are being properly informed of the associated risks. If fixed-income securities that are held indirectly, via *Pensionskassen*, corporate provision funds, investment funds, insurance products and similar, are included in the figures, about 20% of households' total assets are invested in this type of security.

Problems have arisen repeatedly in recent years in relation to unsupervised companies in the real estate sector selling their own bonds. In some cases unusual circumstances have raised the suspicion that the sales were being used to circumvent regulations, with denominations of more than € 100 000 for example, or an offer limited to fewer than 150 people. The FMA is focusing its attention on specialist market practices that could be detrimental to investor protection.

### EQUITIES

Equities continue to be of minor significance in Austrians' investment portfolios, accounting for a mere 3.4% of households' total assets in 2018. While there was a rise of almost 40% to € 22.5 billion in assets invested in equities in the five years leading up to 2018, 90% of this rise can be attributed to price and exchange rate gains rather than to the purchase of more shares. The small number of shareholders are loyal to the equities of Austrian companies, and their investments have been consistently



Chart 1: Development of deposits

profitable over the past five years. The FMA has received a few isolated complaints from investors who were unhappy about the way in which the banks executed their orders or in relation to suspected price manipulation in the run-up to a delisting.

### INVESTMENT FUNDS

Assets invested in the 1 120 Austrian retail funds at the end of 2018 totalled approximately € 89.76 billion, which marks a decrease of € 7.28 billion or 7.5% compared with the previous year. These fund assets are predominantly held by Austrian households. It is striking that four out of the top five products are Austrian products, with a risk rating of low to medium risk.

The most commonly held investment fund in Austria is a real estate fund that is eligible as trustee stock. This eligibility is defined in Austrian civil law (in the General Civil Code – ABGB; *Allgemeines Bürgerliches Gesetzbuch*). Whether or not a fund is deemed to be eligible as trustee stock is not determined by the FMA but by the fund issuer itself, with this status being stipulated in the fund's investment strategy. Whether the fund manager adheres to the investment guidelines is reviewed annually by the fund's auditors.

It is noticeable that robo advice models, providing computer-assisted advice on investment and portfolio management, are very highly focused on exchange traded funds (ETFs) in the case of sales to retail investors. These ETFs are index funds traded on the stock exchange that track the performance of a benchmark index such as the ATX or DAX. Analysis shows that, after equities, ETFs represent the financial instrument most frequently traded on an exchange by private customers.

### CERTIFICATES

Investors are also increasingly interested in certificates, structured products issued by banks that provide a way of investing capital transparently and without major costs. Rather than focusing on earning interest, certificates are based around participating in a certain performance. They certify the right to share in the performance of an underlying, be it a share, index, currency, commodity, future or other financial instrument, and are tailored to match customer requirements, market expectations, attitude to risk and investment horizon. Austrian retail investors in this sector have a preference for non-leveraged products (i.e. certificates that pose a lower risk) that have equities, indices and commodities as their underlyings. The total volume of outstanding certificates for retail investors on the Austrian market in 2018 was as high as € 13.5 billion (up 5.7% year-on-year).

It is noticeable that the FMA receives barely any consumer complaints on trading in certificates. This is probably because, specifically in the certificates segment, 65% of retail investors have been dealing with the products for more than five years, with 44% having been investing in certificates for more than ten years. Efforts to tighten up the regulations regarding the sale of financial instruments (MiFID II/MiFIR) mean that certificates are primarily sold on a no-advice basis.

### EQUITY CROWDFUNDING

Austria's equity crowdfunding market is recording major growth rates every year. The total volume of this market in 2018 was just € 37 million, but an average of eight projects are now being offered every month (measured on the basis of the information documents issued pursuant to the Alternative Financing Act – AltFG; *Alternativfinan-*

zierungsgesetz). Of the total capital raised in 2018, 75% related to the financing of real estate projects. The average investment amount per investor was between € 1 500 and € 2 000.

Nearly all equity crowdfunding projects are financed in the form of qualified subordinated loans, which grant the investors the lowest level of creditor status. The Austrian Consumers' Association (VKI) has found a frequent lack of transparency in this sector. This means that the risks are often not understood by investors, and providers avoid having to offer an appropriate level of return. In particular, the huge differences in the level of investor protection between the supervised and the unsupervised market, as in the case of equity crowdfunding, are often not obvious to investors.

## **CRYPTOASSETS**

There are no reliable figures for the volume of cryptoassets, such as Bitcoin, owned by Austrian households. However, market studies indicate that interest in this category of assets in Austria is below average by international standards. The Dutch banking group ING has carried out a representative European market study<sup>1</sup>, according to which only 8% of Austrians own cryptoassets and only 17% could imagine investing in them (around half the European average). This is despite the fact that Austrians lead the way in terms of the percentage (79%) claiming that they have already heard of or read about cryptoassets.

Meanwhile, on the cryptoassets market, product development is progressing at high speed, with new types of coins being added to the product offering all the time. Stablecoins, to take just one example, are generally pegged to the value of state currencies and therefore offer a popular alternative as a form of protection against the highly volatile prices on the crypto market.<sup>2</sup> Also in evidence on the market is the ongoing tokenisation of physical assets. Another trend that remained very much in evidence in 2019 was security tokens. These are cryptoassets that digitally represent traditional securities by tokenising similar rights (e.g. voting rights, rights to profit-sharing etc.).

## **INSURANCE PRODUCTS**

As interest rates remain low, insurance-based investment products have ceased to be as attractive to investors. The volume of life insurance premiums written dipped from just over € 6.5 billion in 2014 to € 5.5 billion in 2018. State-sponsored retirement provision schemes, with their tax incentives, have also undergone a long-term decline. Premiums written in 2018 totalled some € 500 million, compared with € 650 million in 2014. Meanwhile, investment fund management companies have now fully withdrawn from this product. There are, however, six insurance undertakings still offering the product, selling around 15 000 new policies in 2018.

The new product information documents for consumers, as prescribed and defined by law, have proven their worth. The obligatory Key Investor Information Document (KIID) for packaged retail and insurance-based investment products (PRIIPs) in accordance with the PRIIPs Regulation<sup>3</sup> is one such example, providing the investor

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<sup>1</sup> ING International Survey. *Mobile Banking – Cryptocurrency*. June 2018.

<sup>2</sup> *Blockchain. The State of Stablecoins*.

<sup>3</sup> Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs).

with standardised, generally comprehensible and concise information on the fundamental characteristics and risks of such products and enabling the insurer to make an informed decision. The same purpose is fulfilled by the information documents that must be made available to consumers under the Insurance Distribution Directive (IDD)<sup>4</sup>, namely the Insurance Product Information Document (IPID) for non-life insurance products and the Life Insurance Product Information Document (LIPID). The FMA has made this a priority for supervision and inspections and found that these documents are generally being properly prepared and made readily available online.

## FINANCINGS

### CREDITS

As lending rates remain at historically low levels, household borrowing has been rising consistently for some years now. While private borrowing totalled € 164.3 billion in 2014, this figure had risen by 11.6% to € 183.3 billion by the end of 2018. Housing loans were up by as much as 22% or € 25 billion to € 139 billion, accounting for around 73% of all borrowing at the 2018 year-end. It is noticeable that the average effective interest rate applicable to housing loans has fallen by a third over these five years, from around the 3% mark to just under 2%, while the average rate for consumer credit has remained more or less unchanged, oscillating at +/-7% over the medium term. The amount of short-term loans as a proportion of the total volume is also falling. Consumers are being granted ever longer loan terms, in some cases up to 40 years, especially with regard to home loans. This is partly due to the fact that redemption-free years are being agreed when the repayment plan is initially set.

The supervisory authority is critical of these developments and made lending standards for real estate and consumer loans one of its priorities for supervision and inspections a few years ago. It is calling for reliable and cautious budget calculations, appropriate deposits, and loan-to-value ratios, debt service ratios and debt ratios that are tailored to the customer's economic situation. The FMA also urges caution. The potential consequences of changing interest rates, and of any sudden, large increase in rates, should be taken into account when considering the affordability of the loan. Generally speaking, a long-term loan should be arranged such that it will have been paid off or can be repaid at the time of the customer's retirement. The main factor when granting a loan should be its affordability for the consumer and not the security that that consumer can deliver to the bank.

### CONSUMER CREDITS

The example of consumer credits shows clearly how the approach to financing has completely changed. Just a generation ago, anyone who needed to borrow money had to apply in person at a bank. Loans were almost exclusively taken out by private individuals to finance a home or for home improvements, which meant that the borrowed funds were also being used to create value. Today, the focus has shifted. Consumers are using loans to finance purchases of consumer goods, which often lose value quickly.

**The supervisory authority made lending standards for real estate and consumer loans one of its priorities for supervision and inspections a few years ago. It is calling for reliable and cautious budget calculations, appropriate deposits, and loan-to-value ratios, debt service ratios and debt ratios that are tailored to the customer's economic situation.**

<sup>4</sup> Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution.

Moreover, consumer credit can be three times as expensive as a housing loan. Nevertheless, the volume of new lending has grown steeply over recent years. When making purchases online, consumers often see offers for loans directly alongside the item they want to buy. They can calculate their loan instalments immediately online, watch a video explaining how easily flexible repayments can work and get themselves a loan with just a few clicks of the mouse. Blatant sales advertising at the point of sale in retail stores (“zero interest”, “buy today, pay in three years’ time!”), aggressive online marketing and the accumulation of consumer credits involve huge risks of excessive consumer borrowing. In addition, the costs incurred by late payment are particularly prohibitive in the case of consumer credit (penalty interest, legal fees, reminder costs etc.).

### **FOREIGN CURRENCY LOANS**

The proportion of household borrowing in the form of foreign currency loans has plummeted since the FMA banned any new loans of this type in 2008 and also introduced measures at the same time to limit the risk associated with existing loans. The outstanding volume, adjusted to allow for exchange rate fluctuations, had fallen by € 32.8 billion by early 2019, representing a decline of 70.5%. In absolute terms, the total outstanding foreign currency loans held by private borrowers at the end of 2018/ start of 2019 was € 14.82 billion, compared with € 38.8 billion when these loans reached their peak in 2006. This means that foreign currency loans have been slashed in the space of ten years. Having previously accounted for nearly one third of total lending to households, they now make up less than one tenth (as at 2018 year-end: 9.6%). Since the height of the foreign currency loan boom in 2008, the Swiss franc has appreciated by 49% (compared with the end of Q2 2019). This means that a borrower who took out a loan for € 100 000 would have to repay € 150 000 before interest.

### **SUPERVISED MARKET, GREY CAPITAL MARKET, BLACK CAPITAL MARKET AND FINANCIAL FRAUD**

There is a huge disparity in investor protection between the area of the market supervised by the FMA and those areas that are not subject to supervision. The main differences relate to companies that act as issuers, as well as to issued products and bonds in particular, and how these are launched on the market and sold.

The supervised area of the market, within which licensed companies operate, is subject to a specially designed, high level of investor protection. In particular, the European lawmakers have implemented a whole series of regulatory measures over the past few years in a bid to make financial products more transparent, comprehensible and comparable for retail investors. Information documents such as the KIID, IPID and LIPID referred to above are just some examples of this. The new regulatory regime for markets for financial instruments in the form of MiFID II<sup>5</sup>/MiFIR<sup>6</sup> focuses on investor protection, from the product design stage, through to sales and the subsequent customer service: financial products must be designed in such a way as to meet the

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<sup>5</sup> Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU.

<sup>6</sup> Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012.

**Financial products must be designed in such a way as to meet the needs of the customers to whom they are sold; information given to customers must be honest and clear and must not be misleading.**

needs of the customers to whom they are sold; information given to customers must be honest and clear and must not be misleading.

With regard to the companies that it licenses and thus supervises directly, the FMA can make use of a comprehensive and carefully developed set of tools to protect consumers. It also has direct access through its ongoing supervision activity.

It is also one of the supervisor's key goals in the area of collective consumer protection to provide savers, borrowers and investors with greater transparency and objective information so that they are able to better assess the risks and prospects of financial products and protect themselves from a loss.

With this in mind, the FMA has created a dedicated section for consumers on its website in the form of its "A-Z of Finance", providing definitions of basic financial market terms and explaining the key properties, structure, opportunities and risks of certain types of financial product in clear language that is easy to understand. Infographics are also provided, with videos to be added in future (see Financial literacy box on opposite page).

#### **THE GREY FINANCIAL MARKET**

The "grey" financial market is the area of the market in which the providers are not subject to any official ongoing supervision by the FMA and are regulated by much more lenient, general statutory provisions compared with supervised companies. Investor protection is much weaker, the information and transparency obligations are less strict, and the requirements made of advisory and selling activities are less demanding. Investors are often not aware of the lack of any specific supervisory rules to protect investors in this part of the market, and do not know that the FMA is not engaged in ongoing supervision.

Time and time again, providers and business models emerge that cause investors to suffer significant losses and shake the confidence of all consumers, not just those who are directly affected. While the FMA has been given additional powers in recent years and may intervene in the case of misleading advertising in some circumstances, the level of investor protection differs greatly and we are a long way from a level playing field.

#### **THE BLACK FINANCIAL MARKET**

The "black" financial market can be divided into two parts. Firstly, it comprises those providers that offer a financial service that requires a licence without being in possession of such a licence from the FMA. Secondly, it also contains a large number of fraudulent providers.

In this regard the FMA has the power to investigate and intervene in order to prevent such activity where possible. The supervisory authority may ban an activity, impose hefty fines or even institute criminal proceedings. However, such FMA measures only have an impact on those providers that have operated on the market without prior fraudulent intent. Financial fraudsters generally operate on the Internet and are often more elusive.

What the FMA can do is issue warnings about specific providers that are offering financial services that require a licence in Austria without having been authorised by the FMA to do so, or about providers that launch a public offering for a financial product without having published the required prospectus. It can also warn investors by

## RISK FACTOR: POOR FINANCIAL LITERACY

By international standards, Austrians are good at saving. This can partly be explained by a high need for security, and the fact that Austrian consumers are very risk-averse. At the same time, the love of saving also stems from the fact that many people feel ill-equipped to cope with other forms of investment or to understand the associated risks. This also makes them vulnerable in that they may not recognise risks or underestimate their severity, as demonstrated in the case of foreign currency loans. Austrians themselves admit in a variety of surveys and studies to being too poorly informed about financial products and the financial markets to be able to make use of alternatives to savings accounts or simple loans. This is also how they explain their reluctance to invest directly in equities or bonds.

According to a study conducted by ING-DiBa AG<sup>7</sup>, approximately 45% of Austrians, so nearly half, claim to have received no financial education. This ING International Survey was carried out in 13 EU countries, with a total of 13 000 respondents, of which 1 000 in Austria. Austria ranks roughly mid-table in terms of levels of financial knowledge across Europe. This matches the findings of studies by Annamaria Lusardi, a professor at George Washington University and pioneer in financial literacy research. She found that 53% of Austrians had sufficient financial knowledge to be classed as “financially literate”.

The Vienna Stock Exchange arranged a financial literacy survey of 800 Austrians in 2017<sup>8</sup>. 83% of the respondents expressed the opinion that good financial knowledge was a prerequisite in order to invest in securities, such as equities. Only 8% of those who took part in the survey ranked their own financial knowledge as “very good”. More than two thirds said that they found choosing the right financial product difficult. In a joint study carried out by St. Pölten University of Applied Sciences and the University of Lucerne<sup>9</sup> in 2016, 37% of the survey respondents in Austria said that their lack of knowledge about equities as an investment was the reason why they did not invest in shares. 39% stated that they did not invest in equities because the risk was too high.

Oesterreichische Nationalbank (OeNB)<sup>10</sup> published the first major study on financial literacy in Austria in 2015, as part of an OECD project.<sup>11</sup> This study highlighted key gaps in financial knowledge: even basic economic concepts such as inflation, interest rates, risk diversification or the impact of fluctuating exchange rates are not understood by many. It is above all women, young people and the elderly, as well as the poorly educated, who are affected. As well as gender, education and income also have a significant impact on financial literacy. At the same time, the study<sup>12</sup> shows that a higher level of financial literacy and a longer-term approach to financial behaviour go hand in hand. Typically, those people who have greater financial knowledge tend to be familiar with more financial products, make use of more sources of information when making financial decisions, and also have a rainy day fund. They are also less likely to take out loans for short-term purposes, such as their normal living expenses, spontaneous purchases, gifts or a holiday. The OeNB/OECD studies also prove that there is a positive relationship between financial literacy and financial behaviour.

### EXPENSIVE, RISKY INCOMPETENCE

All of these studies tell the same story. (Too) many Austrians do not feel confident making an independent decision about their own financial affairs, beyond putting their money in a savings account. Their financial literacy does not extend to understanding how even simple financial instruments and investment products work, never mind being

<sup>7</sup> ING-DiBa Austria. *Half of Austrians lack financial education. Press release of 14 November 2017.*

<sup>8</sup> Vienna Stock Exchange survey gives poor marks for financial literacy – Austrians miss out on economic and financial education in school. Press release of 8 September 2017.

<sup>9</sup> Tatjana Aubram, Monika Kovarova-Simecek, Gabrielle Wanzenried. *Financial Literacy und ihre Implikationen. Eine komparative Studie für Österreich und die Schweiz [Financial literacy and its implications. A comparative study of Austria and Switzerland]. 20 April 2016.*

<sup>10</sup> Maria Silgoner, Bettina Greimel-Fuhrmann, Rosa Weber: *Financial literacy gaps of the Austrian population.* OeNB, *Monetary Policy & the Economy* Q2/15, p. 35.

<sup>11</sup> Organization for Economic Cooperation and Development. *OECD INFE International Survey of Adult Financial Literacy Competencies; Finanzwissen in Österreich [Financial knowledge in Austria].* OeNB jointly with IFES, 2000 personal interviews, OECD/INFE financial literacy toolkit. Autumn 2014.

<sup>12</sup> Maria Silgoner, Rosa Weber. *Das Finanzwissen der österreichischen Haushalte [The financial knowledge of Austrian households].* OeNB Statistics for Q3/15.

able to assess the opportunities and risks at stake. Consequently, they either completely ignore such products when making a decision about their finances or take on risks that they do not understand. As a result, a large portion of Austrian investors are basically automatically excluded from the securities market due to a lack of financial knowledge, which means they are missing out on the possibility of wealth creation through investments in securities.

### **FINANCIAL LITERACY INITIATIVE**

In the interests of collective consumer protection, the FMA therefore regards it as its duty to help improve the financial literacy of Austrian consumers. With this in mind, it has set up a dedicated consumer information page on its website ([www.fma.gv.at](http://www.fma.gv.at)). Using simple language and basic financial terminology that the general population are familiar with, this “A-Z of Finance” explains how certain financial instruments and products work. It is regularly updated and extended, and provides clear and easy-to-understand information to the questions most frequently asked by consumers, with infographics and how-to videos. Current topics covered include old-age provision, investments, accounts, loans, insurance and spotting financial fraudsters.

In striving to improve Austrians’ financial literacy, the FMA is not just interested in encouraging investors to turn to investment forms other than savings accounts. Rather, it wants to help enable investors to make decisions on their financial affairs freely and independently, and based on their financial needs. Its aim is to ensure that investors are not automatically excluded from a large part of the financial and capital market due to a lack of financial knowledge. Financial literacy means being able to understand how financial products work, being able to assess the risks and opportunities, and being able to use this information as the basis for an appropriate and independent decision. Another factor driving the need for financial literacy now more than ever is the rapid pace of digitalisation and resulting stream of new processes and financial products. Over the next few years the FMA will therefore be focusing its consumer information activities on financial literacy and helping to improve the financial expertise of participants in Austria’s capital market.

The plans include how-to videos and surveys on the best ways to prevent investment fraud. The FMA will look at where people see adverts from scammers and how contact is made between fraudulent providers and consumers. It is on these platforms and communication channels in particular that the FMA wants to tackle the root of the problem through better information and education. The FMA will also be looking to work with a range of players and stakeholders on the market as preventing investment fraud must be the shared goal of state institutions, stakeholder representatives and consumer organisations.

publishing details on its website of measures and sanctions that it has introduced in respect of market participants.

Yet too many investors are still being drawn in by investment fraudsters. Typically, they are lured by supposed insider tips, innovative financial products and miracle products that offer a high return for low risk. Sadly, many victims of fraud only turn to the FMA after having already parted with their money, by which time the “business partner” has suddenly vanished. This is an area in which the FMA receives numerous enquiries and complaints, as well as reports. The number of reported cases of investment fraud in particular has risen strongly.

### WHISTLEBLOWING

The FMA’s whistleblowing system, implemented in 2014, has grown increasingly important. Whistleblowers can use the system to provide the FMA with entirely anonymous reports, tips and information about an irregularity that they are aware of in a supervised company or on the financial market. The identity of anonymous whistleblowers who use the system is protected so that nobody, not even the prosecuting authorities, is aware of it. The FMA’s investigations can be greatly helped by the setting up of a postbox, through which the authority and the whistleblower can then communicate in full anonymity.

The number of whistleblowing reports submitted to the FMA has soared from 140 in 2015 to 239 by 2018 (> Chart 2). The quality of the information being reported has also consistently improved, with ongoing increases in the proportion of relevant and targeted information, now at in excess of 90%. The fact that reports of investment fraud have increased significantly over recent years is striking. It is now the case that 57% (2018) of all reports in the whistleblowing system relate to investment fraud, compared with slightly over 20% back in 2015.

Every second such report on investment fraud relates to cryptoassets, in other words digital financial products offered via the Internet. A further increase can be expected as the market for digital financial products continues to grow at record pace. However, regulations only apply to a limited extent and the products on offer, with just a few exceptions, are not subject to supervision.

At the same time, the number of enquiries about dubious companies and fraudulent practices has also risen strongly. The number of enquiries almost doubled in the first nine months of 2019 compared with 2017 levels (> Chart 4).

Enquiries and information from investors regarding offers made to them, but also information from financial market participants who have already been the victims of scams, are an important source of information for the supervisor. They help to ensure that the illegal business activity can be stopped as quickly as possible and also mean that other consumers can be warned about disreputable providers or risky, if not dangerous, financial products.

### INVESTOR WARNINGS

The number of investor warnings by the FMA has almost doubled in the space of three years to 71 (2018). These involve the FMA issuing a warning about a specific provider that is operating on the Austrian market and offering a financial service that requires a licence from the FMA without being in possession of such a licence.

In the course of its supervisory activity, the FMA also consistently encounters circum-

Chart 2: Whistleblowing 2014–2018

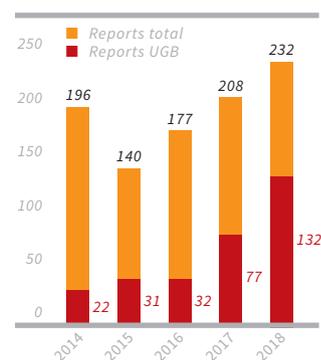


Chart 3: UGB reports by whistleblowers (2018, in %)

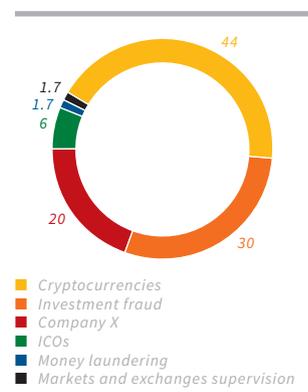
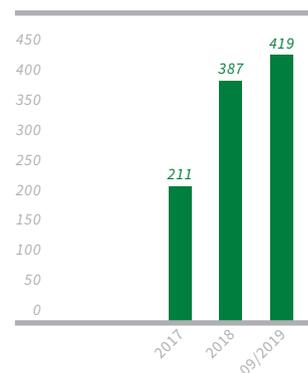


Chart 4: Enquiries 2017–2019



stances that lead it to suspect the occurrence of a criminal offence. In such a case it must report its suspicion to the responsible authority, generally the public prosecutor's office. In 2018 the FMA referred 120 cases to the public prosecutor, 75 of which related to crimes such as fraud or breach of trust in relation to financial services.

Austrian consumers are being hit hard by investment fraud. The average losses of victims of fraud who have contacted the FMA since the beginning of 2019 are in the region of € 25 000, which is more or less the average net annual income in Austria. And it is not just a case of money being taken from Austria's financial market either. The investors concerned lose confidence in the market, which also impacts seriously on the regulated market.

# BASEL I, II, III

Strengthening the quality and quantity of bank capital 2008–2028

**B**anks form the circulatory system of an economy. Crises – not to mention bankruptcies – can therefore shake the stability of financial markets, trigger economic crises and have serious consequences for government institutions. Moreover, the risk of contagion is high and transcends national boundaries, as banks have complex business relationships with each other and are intertwined on many levels.

Thus, in 1974 – as a lesson from bank failures and financial market crises – the international community set up the Basel Committee on Banking Regulations and Supervisory Practices at the Bank for International Settlements (BIS) in Basel, which subsequently developed into a global standard setter in the realm of banking regulation. The task of this committee, which today is simply called the Basel Committee, is to develop rules that improve the resilience of individual banking institutions in periods of stress, strengthen the stability of financial markets and prevent cross-border distortions of competition caused by different regulations at national level.

The Basel Committee identified risk-based capital adequacy as one of the most important factors in strengthening a bank's ability to withstand crises and absorb losses. With the Basel Capital Accord, presented in 1988 and implemented in 1992, the Basel Committee created the first minimum standard targeting an adequate capital regime for banks, which ultimately found worldwide acceptance.

## EVOLUTION OF THE LEGAL FRAMEWORK

### BASEL I (BASEL CAPITAL ACCORD)

The core of the Basel Capital Accord, which was originally only aimed at internationally active banks, was built around risk weighting of liabilities (i.e. outstanding loans and other receivables) and uniform capital adequacy requirements.

- For the risk assessment of all liabilities, a uniform risk weighting scheme was created with four categories: 0% risk weighting, e.g. cash, central bank and safe government debt; 20% risk weighting, e.g. triple-A bonds, multinational development bank debt, OECD bank debt, OECD public sector debt; 50% risk weighting, e.g. mortgage loans; 100% risk weighting, e.g. corporate bonds, consumer loans, non-OECD government debt, corporate loans.
- The minimum capital ratio was set at 8% of risk-weighted assets (RWAs). In addition, clear rules were laid out regarding the quality of own funds. At least 50% had to consist of Tier 1 capital, i.e. equity capital and reserves disclosed in the balance sheet. The rest could come from Tier 2 supplementary capital, i.e. undisclosed reserves, revaluation reserves, impairment allowances, hybrid instruments and similar sources.

Basel I was subsequently revised and expanded several times. In 2006, however, there was a fundamental reform, dubbed Basel II.

### **BASEL II**

The fundamental reform adopted in 2004 and implemented starting 2007 ushered in a change from a purely quantitative risk assessment to a 3-pillar system of qualitative risk assessment. In addition to the revised quantitative minimum capital requirements (Pillar 1), the supervisory review and evaluation process (SREP) was introduced as Pillar 2 alongside Pillar 3 disclosure requirements designed to promote market discipline. The SREP determines a bank's individual risk and incorporates additional criteria, including the quality of the risk management system, business strategy or operational risks, such as legal or misconduct risks. The higher the bank's risk, the higher its individual capital ratio is set over and above the minimum requirements set out in Pillar 1. In this way, the own funds requirements were made more risk-sensitive.

### **BASEL III**

Basel II proved inadequate to withstand the shocks caused by the global financial crisis. Talks on another reform were already started in 2007/2008, and the new framework was published in 2010. The aim of Basel III was to improve the quality and quantity of banks' own funds and to set out uniform standards for calculating capital ratios that are transparent for all market participants. These objectives were achieved through stricter requirements for the eligibility of regulatory capital, precise and

## **BASEL COMMITTEE**

The Basel Committee was founded in 1974 by the governors of the central banks of the then ten most important industrial nations (G10) as the Committee on Banking Regulations and Supervisory Practices and was based at the Bank for International Settlements (BIS) in Basel. Today, it comprises 45 institutions from 28 countries. Although the principles, guidelines and standards it develops on banking regulation and supervision are not legally binding, they have now been established as global minimum standards. The rules on minimum own funds requirements and risk limitation for banks drafted and continuously updated by the Basel Committee are known according to their development stage as Basel I (Basel Capital Accord), Basel II, Basel III.

harmonised deduction rules for calculating the capital base, expanded disclosure requirements and a higher Tier 1 capital ratio.

## PRINCIPLES OF THE EU CAPITAL REGIME

### LEGAL FOUNDATION

The European Union (EU) transposed the Basel III framework into EU law through the Capital Requirements Regulation (CRR)<sup>1</sup> and the Capital Requirements Directive (CRD)<sup>2</sup>. While the CRR is directly applicable EU law, the CRD was integrated into national law via an amendment to the Austrian Banking Act (BWG; *Bankwesengesetz*). In addition, the FMA issued the CRR Supplementary Regulation (CRR-BV; *CRR-Begleitverordnung*)<sup>3</sup>, which exercised and more closely defined some of the optional requirements provided for in the CRR (in particular those relating to the transitional provisions between Basel II and Basel III). In order to more closely specify the requirements set forth in the CRR, the European Banking Authority (EBA) developed further regulatory (RTS) and implementing technical standards (ITS) based on the first broad banking package. The EU Commission raised these to the level of binding supervisory regulations under EU law by means of several delegated regulations<sup>4</sup>.

### IMPROVING THE QUALITY OF OWN FUNDS

A key element of the CRR is to improve the quality of regulatory capital, in particular Common Equity Tier 1 capital, through granular recognition criteria in accordance with Article 28 et seq. CRR.

During the banking crisis, weaknesses in loss absorption became apparent, particularly as a result of hybrid instruments. These are financial instruments that can act as either equity or debt capital (e.g. convertible bonds, bonds with warrants, certificates of participation, participating bonds) depending on the concrete treatment or situation. This prompted European lawmakers to put a particular emphasis on this component of Tier 1 capital.

- **Common Equity Tier 1 capital:** Although the CRR permits Additional Tier 1 (AT1) capital, formerly hybrid core capital, in addition to Common Equity Tier 1 (CET1) capital, AT1 capital is subject to very strict requirements (> *Chart 6 on Page 60*). The sum of the Common Equity Tier 1 capital and Additional Tier 1 capital form Tier 1 capital, which is designed to fully absorb losses and prevent insolvency without disrupting operations (going concern capital).
- **Tier 2 capital:** Stricter criteria were applied to the structure of the other previously recognised components of own funds. The division (Upper Tier 2 and Lower Tier 2) within Tier 2 capital was abandoned, leaving only one category of Tier 2 capital, which creditors can only use in the event of resolution (gone concern capital). In particular, Tier 2 capital is meant to be available to absorb losses (point of non-viability). Tier 2 capital is attractive for banks, especially given the prevailing view that (currently) interest payments on these funds are tax-deductible in Austria (no participation in winding-up profit).

<sup>1</sup> Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms.

<sup>2</sup> Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms.

<sup>3</sup> Federal Law Gazette II No. 425/2013.

<sup>4</sup> Commission Delegated Regulations (EU) No 241/2014, 2015/488, 2015/850 and 2015/923.

Tier 3 capital, which before 2014 was reserved to cover market risks, has been completely eliminated from the capital structure under the CRR.

### NEW CAPITAL RATIOS

The general own funds requirement was maintained under Basel III (CRR/CRD) at 8% of risk-weighted assets (RWAs), but the structure was changed: at least 6% of risks must be backed by Tier 1 capital, of which at least 4.5% by CET1 capital. As a further separate provision for unforeseen risks, additional buffers of Common Equity Tier 1 capital, including a capital conservation buffer set at 2.5% of RWA, must also be maintained.

The following minimum capital ratios therefore currently apply for the own funds of banking institutions:

- **Common Equity Tier 1 (CET1) capital:** 4.5% – plus combined buffer requirement
- **Tier 1 capital:** 6%, of which at least 4.5% CET1 – plus combined buffer requirement
- **Total capital:** 8%, of which at least 6% Tier 1 capital – plus combined buffer requirement.

Furthermore, regulatory deductions apply in order to ensure, among other things, that there is no artificial increase of Tier 1 capital in the financial sector.

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

In order to promote market-based and uniform application of the CRR and CRD throughout Europe, the EBA continuously develops and publishes technical standards, reports, guidelines and recommendations. In this way, the EBA curbs regulatory arbitrage in the capital regime, promotes the harmonisation of the various legal systems of the Member States and contributes to a level playing field for banks throughout the EU.

The EBA has created a single set of harmonised prudential rules to ensure uniform application and interpretation throughout the EU, the Single Rulebook. It also publishes its interpretations of individual provisions of the CRR/CRD in question/answer form via a dedicated “Q&A Tool”<sup>5</sup> on its website. It also regularly publishes a CET1 Report<sup>6</sup> and an AT1 Report<sup>7</sup>. The CET1 Report summarises the results of the EBA’s monitoring of CET1 capital instruments<sup>8</sup> in accordance with Article 80 CRR, highlighting any deviations from best practice and any non-compliance with the rules. This report also contains the current EBA list of CET1 instruments<sup>9</sup>. In the AT1 Report, the EBA presents best practice examples of standardised templates for AT1 instruments. In order to ensure that banks are given sufficient time to adjust their capital ratios to meet the stricter Basel III requirements, the CRR contains transitional provisions relating, in particular, to the stricter qualitative requirements for own funds instruments. These are set to expire in the coming years. The EBA therefore announced in September 2019 that it would publish guidance on how banks could best deal with expiry of the transitional provisions.<sup>10</sup>

<sup>5</sup> Single Rulebook Q&A; <https://eba.europa.eu/single-rule-book-qa>.

<sup>6</sup> <https://eba.europa.eu/-/eba-updates-on-monitoring-of-cet1-capital-instrumen-1>.

<sup>7</sup> <https://eba.europa.eu/-/eba-updates-on-monitoring-of-additional-tier-1-instrumen-1>.

<sup>8</sup> The EBA’s monitoring of capital instruments describes a process by which the concrete design of own funds instruments at banks in the Member States is reviewed and analysed.

<sup>9</sup> Article 26(3) CRR.

<sup>10</sup> <https://eba.europa.eu/eba-will-clarify-the-prudential-treatment-applicable-to-own-funds-instruments-at-the-end-of-the-grandfathering-period-expiring-on-31-december-2021>.

## 2019 BANKING PACKAGE AND BASEL 3.5

On 7 June 2019 the EU published a further comprehensive package of measures revising the rules for banks. The 2019 banking package comprises the revised Capital Requirements Regulation (CRR II)<sup>11</sup>, the Fifth Capital Requirements Directive (CRD V)<sup>12</sup>, the revised Bank Recovery and Resolution Directive (BRRD II)<sup>13</sup> as well as the Single Resolution Mechanism Regulation (SRMR II)<sup>14</sup>.

Among other things, the CRR II and CRD V revise the regulatory capital regime; they have been in force since 28 June 2019. Broad implementation begins on 28 July 2021, though numerous exceptions require later, earlier and, in some cases, immediate application of certain parts. In addition, individual provisions still need to be further specified in regulatory technical standards (RTS) to be drawn up by the EBA.

With regard to own funds requirements, the package brings in simplifications to the recognition and reduction of own funds instruments. Provided there is no significant change in the conditions, subsequent issues of capital instruments already authorised will no longer have to be re-authorised, but will only have to be reported. The process for reducing own funds instruments has also been simplified. It is now up to the competent authorities whether or not to allow an institution to buy back own funds up to one year in advance. Here, banks must comply with the general criteria for reducing own funds as well as specific requirements, in particular any set limit on amount<sup>15</sup>. In addition, the revised standards contain a clarification that own funds instruments that have not been fully paid in are only eligible up to the amount paid in. It is also explicitly stipulated that profit and loss transfer agreements within groups do not affect the recognition of the corresponding CET1 instruments.

While the CRR and the banking package have brought about changes in the qualitative and quantitative own funds requirements, the work on “Basel 3.5” (Basel III: Finalising post-crisis reforms) focuses on the calibration of own funds requirements, for example the standardised approach to credit risk. Currently, it appears developments in the area of regulatory own funds requirements per se will be limited to the expiry of the transitional periods.

## DEVELOPMENT OF AUSTRIAN BANKS' CAPITAL RATIOS 2008–2018

The development of capital ratios (> *Charts 5 and 6*) shows a steady improvement in the ratios of own funds and CET1 at Austrian banks from 2008 to 2017, with a slight decline in the ratios in 2018. This can be explained in part by the first-time application of the new financial instruments accounting standard (IFRS 9), which contributed to a moderate decline in the capital ratios of Austrian banks. In addition to the super-

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<sup>11</sup> Regulation (EU) 2019/876 amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements, and Regulation (EU) No 648/2012.

<sup>12</sup> Directive (EU) 2019/878 amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures.

<sup>13</sup> Directive (EU) 2019/879 amending Directive 2014/59/EU as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms and Directive 98/26/EC.

<sup>14</sup> Regulation (EU) 2019/877 amending Regulation (EU) No 806/2014 as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms.

<sup>15</sup> Range as specified in Article 78 CRR.

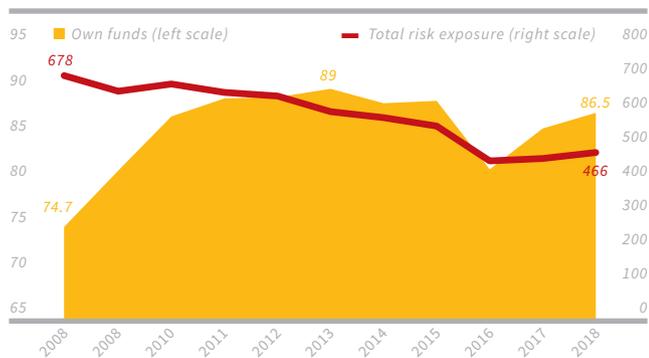


Chart 5 (left): **Development of own funds and total risk of Austrian banks at consolidated level** (in € billions)

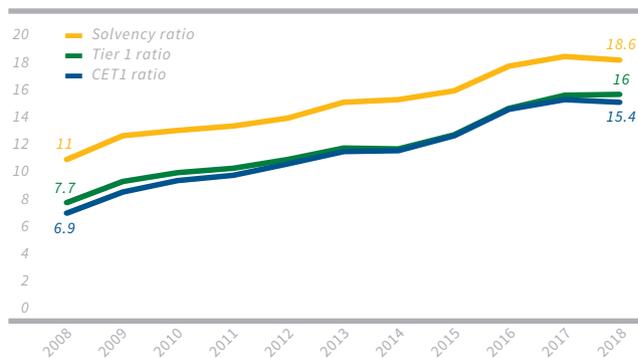


Chart 6 (right): **Development of Austrian banks' capital ratios at consolidated level** (in %; source: OeNB)

visory, granular requirements, the capital adequacy of the institutions is also determined by aspects of accounting, such as the accounting standards and methods to be applied.

**EFFECTS FROM FIRST-TIME ADOPTION OF IFRS 9**

The International Financial Reporting Standards (IFRS) are the accounting principles relevant for banks today. IFRS 9 sets out the rules for recognition and measurement, as well as derecognition and hedge accounting, of financial instruments. It introduced far-reaching changes and has significant effects. The standard applies to financial years beginning on or after 1 January 2018.

In Austria, the application of IFRS 9 reduced the Common Equity Tier 1 (CET1) capital ratio by an average of 21 basis points (bps); this is significantly less than the European average of 51 bps, according to an EBA impact study. With changes of between -118 bps and +114 bps, the effects were broadly varied across individual banks in Austria. A full one third of domestic banks even saw a positive effect on their capital ratios from IFRS 9 (> Chart 7).

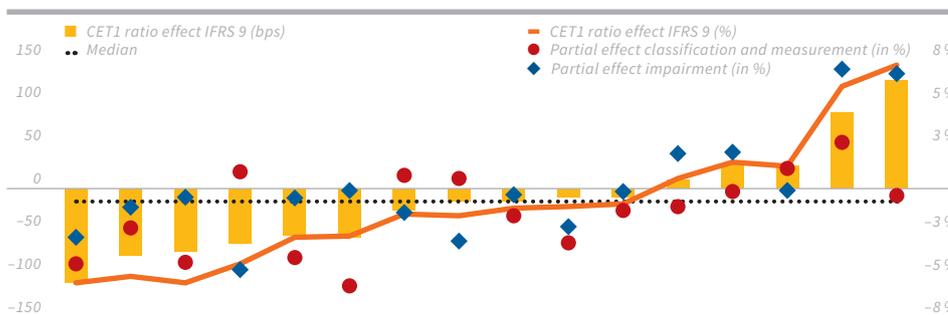
The impact on bank capital can be attributed to two primary effects:

1. The effect of recognising impairment based on expected credit loss.
2. The effect of the new rules on classification and measurement.

In the case of Austrian banks, the effect of classification and measurement is more significant than the effect from the change in impairment rules. On average, own funds were 1.4% lower as a result of the new classification rules; the effects of the new impairment rules are zero for Austrian banks on average.

The effects of the new impairment model on the capital of Austrian banks were fostered in large part by the positive economic environment at the time of first-time adoption. The proportion of instruments classed as credit-impaired (stage 3) aver-

Chart 7: **Capital ratios – IFRS 9 first-time adoption effect** (individual banks and median)



aged 2.5% (compared with 7% European average). In the event of a significant increase in credit risk, IFRS 9 requires an expected credit loss allowance covering the entire lifetime of the asset. The share of these stage 2 instruments was also low, at 8.5% on average (European average: 8%). However, more than 80% of the total loss allowances were attributable to instruments classed as stage 2 and stage 3 (> Chart 8).

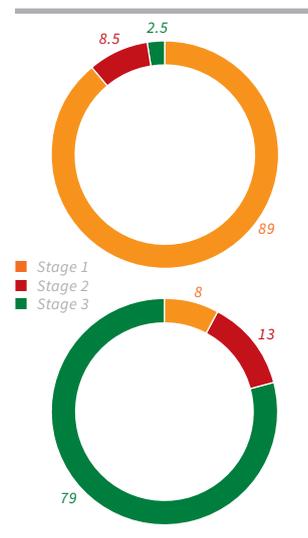
### REGULATORY TRANSITIONAL PROVISION RELATING TO IFRS 9

Since the transition to IFRS 9 was expected to have potentially serious direct effects on CET1 capital in some cases, European lawmakers included a transitional provision in Article 473a CRR. It allows some of the effects on CET1 capital from transition to the expected credit loss model to be spread over a period of five years.

Application of the transitional provision is optional and was originally used by two banks in Austria. In the meantime, both banks have revised their original decision and now fully include the effects from the application of IFRS 9 in their handling of regulatory capital.

The financial markets are dynamic and innovative, and the capital regime must therefore be constantly adapted to market developments and technological progress. The crucial factor is that as many states as possible accept and implement a common and uniform set of rules so that competition – especially cross-border competition – is not distorted by a relaxation of requirements at national level. The European Union is setting a good example in this respect, and the Basel Committee has, over the years, gained worldwide acceptance for its standards.

Chart 8: **Stage allocation of exposures** (above) and **allowances** (below; in %, as at 31 December 2018)



# THE SHIFT FROM RELATIONSHIP TO TRANSACTION BANKING

Challenges for Austria's banks

**T**he digital revolution is calling into question the business models of many established providers, and is changing the competition situation. New, nimble start-ups and FinTechs<sup>1</sup> are forcing their way on to the market with their innovative technical solutions and products, while the BigTechs<sup>2</sup> – Google, Facebook and Amazon – are using their market dominance and data wealth to offer financial services now too. Meanwhile, the platform economy is also fundamentally changing how business is done, not only creating new competitors but sometimes also completely altering the way in which services are provided. Peer-to-peer is the latest buzzword, in other words the direct arrangement of a financial service at a private level between provider and customer.

In this way, digitalisation is revolutionising many well-known financial services and creating new ones.

Many aspects of the relationships between customers and financial service providers are also being redefined. This is particularly significant in banking where traditional relationship banking, based on long-term mutual trust, is increasingly being joined by transaction banking, a form of banking focused on individual transactions regardless of provider.

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<sup>1</sup> *Opinions in the FinTech debate vary strongly, including those of supervisory authorities. Despite “FinTech” no longer being such a new term, there is no uniform definition of what it actually refers to. For many, it means start-ups and small to medium-sized innovative founders, while others also use the term in relation to established banks that launch ground-breaking digital business models. See also <https://www.fma.gv.at/en/cross-sectoral-topics/fintech-navigator/what-is-fintech/>. From the FMA's perspective, FinTech refers to IT-based financial innovations that are frequently although not always developed by unlicensed companies. These typically take the form of interfaces to licensed undertakings, bringing long-term changes to the way in which the financial sector functions.*

<sup>2</sup> *BigTechs are technology giants with global operations that hold a relative competitive advantage in the digital technology sector. They often provide web-based services (including search engines, social networks, e-commerce services) to end users via the Internet or IT platforms, or they set up and maintain infrastructures (e.g. data storage and processing capacity) that other companies can use to offer their products and services.*

## RELATIONSHIP BANKING VERSUS TRANSACTION BANKING

Relationship banking refers to the traditional, long-term relationship between customers and their house bank, in the context of which the customer procures all, or at least most, of the financial services needed from the same bank. These services cover everything from account management and payment transactions, to loans and securities accounts, investments in financial instruments and the purchase of insurance products, in short the bank's full product range.

In contrast, the focus of transaction banking is the interaction between customer and bank in relation to a single transaction or service. There is no focus on maintaining a long-term business relationship.

Relationship banking is founded on a personal relationship based on trust between the customer and their bank, and often a particular advisor in that bank. The trust that is created can even help to offset any negative experiences that might arise in relation to individual transactions. Additionally, the close relationship with the customer is also economically beneficial to the bank. The (confidential) information that the customer's house bank builds up over the years of the comprehensive, long-term relationship provides the bank with a better overview of the customer's economic situation and real financial needs. In turn, this means it can operate in a more risk-sensitive way and also offer the customer additional services tailored to their personal needs, the key term being "cross-selling". As well as the special relationship based on trust between the bank and the customer, real factors also favour traditional relationship banking such as geographical proximity to the bank or its branches, the time and effort needed to obtain information about alternatives or the hassle for customers of switching bank account.

Generally, the global financial crisis has shaken customers' confidence in the established providers on the financial markets. In parallel, the increasing digitalisation of financial services has also increasingly driven the customers of established providers out of bank branches and away from personal advice, and thus away from this personal trust-based relationship. Self-service machines, electronic banking and banking apps have all come into play. As trust-based relationships are eroded, the link between customers and their house banks is becoming less of an obstacle to other providers.

At the same time, more and more information is being made accessible thanks to technological developments and less restrictive regulations, making it easier for customers to find out what they need to know. New regulations are standardising key figures, prescribing minimum information obligations and thus making it easier to compare different products and suppliers. More and more customers are using the Internet to get the information they need in advance. Comparison sites can also be used to easily check the details of and compare different offers, making it easier for customers to switch providers.

### BIGTECHS, FINTECHS, ECOSYSTEMS

Thanks to their large digital ecosystems<sup>3</sup> and innovative offers, BigTechs are able to

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<sup>3</sup> *Ecosystems are solutions in which not just financial services are offered. Instead, the financial services are embedded in a broader range of other services and offerings. BigTechs, for example, integrate their payment solutions and credit options directly into their existing web shops. Extra content can also be embedded in online banking systems, including news, social media and other content such as travel offers, links to comparison sites, bonus point programmes, household calculators and much more.*

target customers using a range of different channels, especially at the point of sale (POS), and in this way earn their loyalty. They can also usually offer a larger, more diverse and broader package of services than “conventional” banks can achieve in the context of traditional relationship banking. For their part, FinTechs can create attractive service offerings using innovative technical solutions, lower costs and greater flexibility, and are often able to react more quickly to changes on the market. Both of these groups – BigTechs and FinTechs – can also hold an advantage in terms of consumer confidence. Firstly, they are not perceived as forming part of the traditional financial market, the image of which has been hit hard by the financial crisis. Secondly, BigTechs in particular will often have stored their users’ payment information and details on their platforms for many years and therefore gained trust in exchange for their reliability.

Banks can face up to this challenge either by trying to create their own ecosystems or by establishing themselves as the partners of existing or new ecosystems owned by other providers. The latter can be developed on the basis of their current business model, as an additional sales channel for example. By combining the traditional with the innovative, banks can give themselves a competitive edge over both established competitors and new players. The platform’s gigantic data pool can also be used for big data analytics, and customer loyalty can be consolidated. As shown by an FMA study<sup>4</sup>, big data analytics is currently mainly being used by banks and insurance undertakings in the areas of customer relationship management, sales, risk management and fraud detection, reporting and IT security.

Working with these new providers, however, means that the financial market participants must have a higher level of risk awareness, particularly in relation to risks caused by third parties, such as outsourcing risk. Ideally, the customer will not notice that, for reasons of cost or efficiency (access to external expertise), third parties are providing the financial service or parts of it in the background. However, in accordance with the Austrian Banking Act (BWG; *Bankwesengesetz*), and the applicable EBA Guidelines on outsourcing arrangements<sup>5</sup>, banks are obliged to identify, measure and manage the corresponding risks. In terms of new technologies, particular attention must be paid to any concentration risks (on the offer or supply side). Any civil-law liability issues that arise in relation to outsourcing must be resolved by the responsible courts.

### **CHANGING CUSTOMER REQUIREMENTS**

Even if it is assumed that new providers are not going to fundamentally change the structure of the existing financial system, they are already having a significant impact on the market. They are changing both expectations and needs. For customers, having simple digital access to financial services is almost taken for granted. More and more contracts are being concluded online in the space of a few minutes without any human interaction and often without any advice. Ideally, customers want to be able to access all of their services through a single platform. They expect user-friendly interfaces and intuitive applications. As well as scoring highly for cost and performance, products must also be competitive when compared against rival offers.

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<sup>4</sup> See “How digital is Austria’s financial market? – A review of the current situation” on page 109.

<sup>5</sup> The EBA/GL/2019/02 have been applicable since 30 September 2019.

All of these developments are helping to erode the stable customer relationships of traditional relationship banking. Geographical proximity to a bank or its branches is becoming less and less important to customers. In a digital world, their PC or mobile phone gives them access to a practically limitless selection of providers, from one corner of the globe to another and even in the most remote of locations, and it only takes a few clicks to compare them. Changing provider is also much easier now. It does not require much time or effort or entail high costs, and in some cases the new provider will even take care of all the switching arrangements, such as when changing current account in accordance with the Consumer Payment Accounts Act (VZKG; *Verbraucherzahlungskontogesetz*)<sup>6</sup>. This does not automatically mean that customers will change banks but it does mean that there is less of a barrier to switching to a more competitive rival, at least as far as individual financial services are concerned.

Currently, these new basic conditions relate most specifically to payment transactions and account management, but new business models and players are increasingly making inroads in the investment sector too, in the form of robo advice and social trading, for example.

Yet not all customers are keeping up with the pace of digitalisation in society and on the financial market, and some are actively choosing not to join in. Around 40% of customers still do not use any form of electronic banking. Experts are already talking about a digital divide between digital natives and those whose life has not (yet) been taken over by technology. Relationship banking is therefore set to remain significant. In the first instance it remains relevant to those people who are not IT savvy, such as older people, a group of consumers who often have good incomes, considerable assets and a real need for traditional (or new) financial services. At the same time, it remains relevant in terms of advisory-intensive, customised and complex financial services, such as residential mortgages and retirement planning.

What this means is that despite ongoing digital advances, there will still be a need for full coverage of such services.

Transaction banking is, however, set to continue to grow in importance. The providers of this type of service – banks, FinTechs, BigTechs or platform economies – are more interested in the benefit of the individual transaction to the customer than in a long-term customer relationship. Factors such as the conditions on offer, availability and option of on-demand services are all key factors as providers compete for custom. Customers now expect fully functional online services to be available 24/7, 52 weeks of the year. Any technical problems or issues with IT security can quickly trigger a loss of confidence and push customers away.

In transaction banking, the size and growth of a bank are no longer determined by its branch network but by how user-friendly its website and app are, how well and securely its IT systems perform, and how competitive the cost structure of its product proves to be. Yet this also lowers the barriers for new competitors.

## **TRANSACTION BANKING – CHALLENGES FOR COLLECTIVE CONSUMER PROTECTION**

The digital revolution in general and transaction banking in particular are throwing

**Geographical proximity to a bank or its branches is becoming less and less important to customers. In a digital world, their PC or mobile phone gives them access to a practically limitless selection of providers, from one corner of the globe to another and even in the most remote of locations, and it only takes a few clicks to compare them.**

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<sup>6</sup> Article 14 et seq. VZKG, *Federal Law Gazette I No. 35/2016*.

**The FMA engages in collective consumer protection, protecting all consumers as a whole. It strives to create greater risk awareness using targeted information, higher levels of trust through product transparency, and greater fairness by means of the best possible quality in sales.**

up many new questions in relation to consumer protection. In its capacity as supervisory authority, the FMA must maintain equidistance between the supervised entities and their customers. It must never take sides and is therefore unable to perform the function of a consumer protection organisation in the classic sense, namely helping consumers to enforce individual claims.

Consequently, the FMA engages in collective consumer protection, protecting all consumers as a whole. As an integrated supervisory authority, bringing together supervision for the entire financial market under one roof, the FMA monitors whether licensed companies are also in a position economically to meet their obligations to their customers (prudential supervision), while at the same time ensuring that they adhere to the principles of good conduct, particularly with regard to proper information and advice, and compliance with the rules on customer protection when selling financial services (conduct supervision). One of the FMA's key goals is to ensure that the providers give consumers access to all of the required information fairly and properly so that they can make a decision based on their specific needs and attitude to risk. The FMA strives to create greater risk awareness using targeted information, higher levels of trust through product transparency, and greater fairness by means of the best possible quality in sales. This helps to protect individual consumers while also strengthening confidence in the financial market and its providers as a whole.

#### TRANSPARENCY INITIATIVE

Collective consumer protection revolves around transparency, in turn created through the provision of information. Over recent years the European lawmakers have been evaluating and revising existing rules to protect consumers in light of the experience of the financial crisis, as well as on the basis of technological advances. They have also identified loopholes and taken action to remedy these. The most relevant of these with regard to banks are listed here:

- MiFID II<sup>7</sup>, the Markets in Financial Instruments Directive, regulates such areas as the information obligations applicable to those who offer and sell financial instruments.
- PSD2<sup>8</sup>, the Payment Services Directive, ensures harmonisation in the single market for payments and provides competitors with access to customer accounts and data at banks.
- CCD<sup>9</sup>, the Consumer Credit Directive, and MCD<sup>10</sup>, the Mortgage Credit Directive, govern the information obligations and transparency requirements applicable to lending.
- PAD<sup>11</sup>, the Payment Accounts Directive, ensures the comparability of fees, creates a customer-friendly account switching service and offers access to basic payment accounts to all consumers.

<sup>7</sup> Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC. It is transposed into Austrian law through the Securities Supervision Act (WAG; Wertpapieraufsichtsgesetz).

<sup>8</sup> Directive (EU) 2015/2366 on payment services in the internal market (PSD2). It is transposed into Austrian law through the 2018 Payment Services Act (ZaDiG; Zahlungsdienstegesetz).

<sup>9</sup> Directive 2008/48/EC on credit agreements for consumers. For its implementation see Consumer Credit Act (VKrG; Verbraucher kreditgesetz).

<sup>10</sup> Directive 2014/17/EU on credit agreements for consumers relating to residential immovable property. For its implementation see Mortgage and Real-Estate Credit Act (HlKrG; Hypothekar- und Immobilienkreditgesetz), Austrian Banking Act (BWG; Bankwesengesetz) and Trade Act (GewO; Gewerbeordnung).

<sup>11</sup> Directive 2014/92/EU on the comparability of fees related to payment accounts, payment account switching and access to payment accounts with basic features. See national implementation in Consumer Payment Accounts Act (VZKG; Verbraucherzahlungskontogesetz).

- DGSD<sup>12</sup>, the Deposit Guarantee Scheme Directive, governs how banks must secure their deposits and up to what amounts.
- The PRIIPs Regulation<sup>13</sup> as well as IDD<sup>14</sup>, the Insurance Distribution Directive, and the UCITS Directive<sup>15</sup> define the basic information that must be provided to consumers to enable them to understand and compare products; including in the form of the PRIIP-KID (Key Information Document), the UCITS-KIID (Key Investor Information Document), the IPID<sup>16</sup> and the LIPID<sup>17</sup>.

PSD2, the revised Payment Services Directive, now obliges banks to provide certain third party providers (TPPs) with access to customers' payment accounts and data. This open banking concept means that what was once a purely "bilateral interface" between customers and their house bank is now available to third parties, with the latter able to use this information as requested by those customers.

Pursuant to PSD2, the bank can enable the TPP to access the customer's payment account using standard online banking, or may opt to set up a dedicated application programming interface (API).<sup>18</sup> The advantage of an API from the bank's perspective is that the TPP will only see the information required to perform its service. However, this interface must offer the same level of performance and availability as the usual customer interface so that the TPP is not impeded in the performance of its business activity.

The fact that third parties can access accounts means that traditional house banks have lost an important competitive advantage. At the same time, however, these banks also have the option of integrating accounts from other financial providers into the customer's online interface, such as the mobile app, and in this way creating and offering an "ecosystem" of their own.

In keeping with the principle of technology neutrality in regulation and supervision, the rules on information, transparency and advice apply regardless of the business model's technical implementation. However, they must be adjusted to the specific requirements imposed by certain technological applications.

Their design and intensity are therefore dependent on the manner in which the service is to be performed. In areas where traditional customer relationships are disappearing and the use of digital systems is making contact between the bank and its customers briefer and less intense, it is particularly important that the information given to customers is comprehensive, honest, clear and not misleading. In particular, the language used, verbally or in written documents, must be easy for consumers to understand. In digital communications after all, there is no direct feedback on the

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<sup>12</sup> Directive 2014/49/EU on deposit guarantee schemes. See *Deposit Guarantee Schemes and Investor Compensation Act (ESAEG; Einlagensicherungs- und Anlegerentschädigungsgesetz)* and *BWG*.

<sup>13</sup> Regulation (EU) No 1286/2014 on key information documents for packaged retail and insurance-based investment products.

<sup>14</sup> Directive 2015/97/EU on insurance distribution; partly transposed through the *Insurance Supervision Act 2016 (VAG 2016; Versicherungsaufsichtsgesetz)*.

<sup>15</sup> Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).

<sup>16</sup> *Insurance Product Information Document*.

<sup>17</sup> *Life Insurance Product Information Document*.

<sup>18</sup> With effect from 14 September 2019, account servicing payment service providers are obliged under PSD2 to provide the TPP with access to the payment accounts that they manage (via the existing customer interface or via a dedicated interface). If the account servicing payment service provider decides not to set up the contingency mechanism for the dedicated interface, it may apply to the FMA for an exemption from the requirement to do so pursuant to Article 33(6) of Commission Delegated Regulation (EU) 2018/389. The application must be submitted using the official form (available on the Incoming Platform) and the FMA will issue an administrative decision.

comprehensibility of language and information, as would have been possible in a face-to-face meeting. Additionally, the information must be designed to be easily comparable with other providers' information.

#### **INFORMATION TAILORED TO THE TYPE OF MEDIA AND TECHNOLOGY USED**

It is therefore essential that the information required by law is prepared in line with the relevant customers, media and technology, which can also create a competitive advantage. Targeted and clear information makes it easier for customers to understand the offer and product, improves comparability with other providers, enables well-informed decision-making and thus also helps to build up trust in transaction banking.

As well as business models that involve personal interaction between the advisor and the customer, those that are fully or partly automated, in other words have little or no human interaction, are also affected by the above requirements.

Even in those areas in which traditional relationship banking (still) dominates, the changes triggered by digital communication and interaction cannot just be ignored, be it in relation to home loans, investment advice or asset management<sup>19</sup>. Even if the focus is still on human interaction, care is needed to ensure that the processes are strictly geared around customer requirements and that a balance is struck between personal contact and digital support when providing information, taking account of the particular target group. The processes can be used to reduce the bank's costs but also, at the same time, to save the customer time and improve the quality of customer care. Customer information in particular can be made easier to understand and interactive, by including short review questions or integrated videos for example. Another option is to have a multimedia communication strategy, with customer advisors simply helping customers to use this information properly.

Business models that do not make provision for any personal interaction with customers face similar challenges. This is particularly true of services for which user-friendliness is a priority and to services regarded by customers as less sensitive, for example payment transfers. It also applies to services that were previously only available to a limited group of customers for cost reasons but that can now be offered digitally and more affordably to a broader range of customers. Traditional asset management services, for example, have typically only been available for portfolios of € 100 000 or more, but robo advice can be provided for amounts of € 10 000 upwards. The lower emotional and intellectual input from the customer in many of these cases means that appropriate ways must be found of informing them about the risks, opportunities and costs of the service on offer.

If the customer feels unable to cope with the information provided, the interaction could be disrupted or incorrect details could be provided. This would mean either the loss of the customer or the provision of incorrect advice with a corresponding liability risk. If the information is provided in a way that creates a tangible added value for the customer, this can represent a competitive advantage and help to build trust. Hybrid advisory models are also already in evidence, based on a fully automated process but with the ability to consult a suitably qualified customer advisor should the need arise.

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<sup>19</sup> *Wealth management, private banking, high net worth individuals, family offices etc.*

## **STRUCTURAL CHANGE**

Regardless of their business models, banks are well advised to consider compliance, good conduct and information obligations as an integral part of their business model and not as some annoying rule that they have to follow. In this way, the costs that are in any case incurred in fulfilling statutory requirements can be spent in the interests of strengthening the business model, creating a more attractive product offering and raising customer satisfaction.

New technical developments and trends, and a change in customer requirements, are opening up scope for innovative business models and efficiency gains. There is the potential for added value for both customers and providers. At the same time, however, the barriers to market entry are being lowered, enabling new players to join the market, as direct competitors or as potential cooperation partners. Improved comparability also pushes down margins.

The traditional banking sector as a whole is therefore facing major challenges. Austrian banks will be able to successfully tackle these challenges if they consistently address the changes and focus heavily on customer confidence, particularly through the provision of targeted information.

**Regardless of their business models, banks are well advised to consider compliance, good conduct and information obligations as an integral part of their business model and not as some annoying rule that they have to follow.**

# CLEAN FINANCIAL CENTRE AUSTRIA

Prevention of money laundering and terrorist financing under the FMA regime

**The United Nations Office on Drugs and Crime, the arm of the United Nations that fights money laundering, estimates that \$ 800 billion to two trillion dollars in dirty money is laundered worldwide every year.**

**I**n recent years, the international community has continuously intensified efforts to prevent money laundering. Originally directed against organised crime, human and drug trafficking, these efforts gradually expanded to include other objectives; first stopping the illegal proliferation of weapons of mass destruction, then thwarting terrorism and terrorism financing and, finally, fighting against corruption, capital flight and tax fraud. From what was originally a purely forensic investigation strategy (“follow the money”), an elaborate global regulatory framework for the prevention of money laundering and terrorist financing was developed.

The aim and purpose of these preventive measures is:

- To ensure that every financial transaction leaves a clear trail, that its economic beneficiary can be readily identified and that the funds can be tracked back from their end use to their origin.
- At the same time, it is vital to prevent misuse of the global financial system for criminal purposes and to ensure that dirty money from illegal activities is not channelled into the legal economy, i.e. laundered.

The constant tightening of global standards for the prevention of money laundering and terrorist financing in turn put increasing pressure on financial centres which had previously focused largely on discretion and secrecy in financial transactions, anchored by law, and developed a corresponding financial market culture. For instance, bearer-passbook accounts, numbered accounts and anonymous financial transactions increasingly came into conflict with global regulatory developments. Austria was slow in adapting to these changes. A fundamental rethink began only in 2009, when the mutual evaluation report (MER) by the Financial Action Task Force (FATF) reported serious shortcomings in Austria’s system for combating money laun-

dering; harsh consequences threatened, in particular a loss of reputation for the country as a financial centre.

## **FATF COUNTRY EVALUATION 2008/2009 – HARSH CRITICISM**

Based in Paris under the Organisation for Economic Co-operation and Development (OECD) since 1989, the Financial Action Task Force (FATF) has established itself worldwide as a standard setter in the fight against money laundering. This intergovernmental body has drawn up Recommendations as to which measures are best when it comes to the prevention of money laundering, which it has continuously developed and expanded. There are currently 40 FATF Recommendations for the fight against money laundering and terrorist financing. Although the focus is on the financial sector, they also include the non-financial sector, such as legal professions, traders, casinos and other gambling operators, accountants, tax advisors and, since October 2018, virtual currencies.

The FATF also conducts regular assessments of the national AML/CFT systems in its member countries. These country assessments analyse how the FATF Recommendations have been implemented in national legal and regulatory frameworks and examine how operational implementation is progressing among market participants. The third round of mutual evaluations was conducted in Austria in 2008. The MER, published in 2009, was extremely critical.

There was a threat that Austria would be placed on a watch list due to insufficient implementation of the AML/CFT standards.

The FATF massively criticised Austria for neither having in place a comprehensive risk analysis system for money laundering and terrorist financing nor having developed a national strategy to reduce such risk. These shortcomings were deemed all the more significant given that Austria, due to its geographical location and the substantial engagement of Austrian banks in Central, Eastern and South-Eastern Europe (CESEE), is particularly exposed to the risk of becoming a transit country for illegal money flows.

Serious deficiencies were also identified in the frameworks for investigating the criminal offence of money laundering, its prosecution and sanctioning by the criminal justice authorities, the public prosecutor's office and the ordinary courts of law.

## **MEASURES TO ENSURE A CLEAN AUSTRIAN FINANCIAL CENTRE**

### **BUNDLING OF COMPETENCIES, EXTENDING THE REMIT, INCREASING RESOURCES**

As a direct reaction to the thoroughly critical 2009 FATF mutual evaluation report, Austria's Parliament adopted a package of measures to ensure a clean Austrian financial centre in 2010. It bundled the competencies for the prevention of money laundering and terrorist financing in the financial market within the FMA, extended the remit of the supervisory authority and ensured that it was given adequate resources.

### **FMA ANTI-MONEY LAUNDERING DIVISION**

In 2011 the FMA set up a separate division for the "Prevention of Money Laundering and Terrorist Financing", which was initially equipped with eight specialists to exercise these competencies and handle the additional tasks. In 2012 the new division

was also given responsibility to inspect banks and insurers in this area, a responsibility it already held for securities supervision. The aim of all of these measures was to bring together AML/CFT supervision for all companies licensed or registered by the FMA under one roof. As an integrated supervisory authority that unites nearly the entire financial market under one supervisory umbrella and analyses participants from all perspectives of the market, the supervisory approach to this topic pursued by the FMA is also integrated and risk-based. In this way, the supervisory authority contributes to a level playing field, whereby the fairest possible competitive conditions apply across industry and product boundaries.

#### **FMA STRATEGY: ZERO TOLERANCE**

Most importantly, the FMA defined a strategy of zero tolerance in the prevention of money laundering and the financing of terrorism: this involves communicating its expectations clearly, unmistakably and transparently, while sanctioning serious breaches consistently and severely.

## **REGULATORY DEVELOPMENTS**

The European Union (EU) has gradually implemented the FATF Recommendations into its legislation to protect the European financial system and the internal market against AML/CFT risks. The Financial Action Task Force, the global standard setter for combating money laundering and terrorist financing, issued the Recommendations in 1990 and has continuously revised and expanded them ever since.

### **FIRST ANTI-MONEY LAUNDERING DIRECTIVE**

A major step in this direction was Council Directive on prevention of the use of the financial system for the purpose of money laundering (91/308/EEC), which was adopted in 1991 and had to be transposed into national law by 1 January 1993. Among other things, it obliged all Member States to prohibit money laundering within their legal systems. It also imposed stricter rules on the financial sector, including how to properly identify customers, documentation requirements, the obligation to establish internal procedures and processes to implement these requirements and the obligation to report suspected money laundering to criminal investigation authorities (suspicious transaction reports). Subsequently, these obligations were continuously developed and tightened up.

### **SECOND ANTI-MONEY LAUNDERING DIRECTIVE**

Directive 2001/97/EC, the Second Anti-Money Laundering Directive, which was adopted in 2001 and transposed into national law by June 2003, expanded the scope of the provisions to include currency exchange offices, payment service providers, investment firms, and notaries and independent legal professions.

### **THIRD ANTI-MONEY LAUNDERING DIRECTIVE**

Directive 2005/60/EC, the Third Anti-Money Laundering Directive, which was adopted in 2005 and implemented nationally in 2008, introduced very far-reaching innovations. In particular, the obligation to identify the beneficial owner, to prepare an internal risk assessment and to introduce the risk-based approach to determining the level of due diligence of supervised entities. In addition, it introduced more specific provisions on the obligation to identify customers, on politically exposed persons (PEPs), correspondent banking relationships and the establishment of the AML officer function. Also new was the mandatory application of measures at branches and subsidiaries in third countries.

For instance, the FMA regularly informs financial market participants about new regulatory developments and explains how to correctly implement them in practice. It performs assessments of proper organisational implementation within companies, evaluates relevant manuals and directives as well as proper training of employees. In addition, the Authority undertakes on-site inspections to verify the correct application of due diligence obligations for the prevention of money laundering and terrorist financing in day-to-day operations, i.e. practical implementation.

#### **INCREASED FREQUENCY AND INTENSIFICATION OF ON-SITE INSPECTIONS**

In reaction to the criticism in the FATF report, the FMA also aimed to generally increase the number and intensity of money laundering and terrorism-related oversight measures and, in particular, to strengthen its on-site presence.

#### **INTRODUCTION OF THE RISK CLASSIFICATION SYSTEM**

The FMA set a further milestone in the efficient and effective prevention of money

#### **FOURTH ANTI-MONEY LAUNDERING DIRECTIVE**

Directive (EU) 2015/849, the Fourth Anti-Money Laundering Directive, was implemented in Austria in large part as of January 2017 via the FM-GwG. For the first time, this law bundled all regulations designed to prevent the use of the financial system for the purposes of money laundering and terrorist financing in a single law, thus creating a uniform and clear legal basis for the supervision of financial market participants.

A central innovation of AMLD4 was the obligation to establish a central register of beneficial owners, which was implemented in Austria via the WiEReG. This also ensured a uniform definition of the term “beneficial owner”. Other changes included the requirement for the concrete formulation of simplified or enhanced due diligence obligations to be based on a corresponding risk analysis. Moreover, a national coordination committee was introduced at the Federal Ministry of Finance to coordinate interaction between all relevant national institutions and oversee preparation of a (joint) national risk assessment. The analysis of the financial sector is the responsibility of the FMA.

#### **FIFTH ANTI-MONEY LAUNDERING DIRECTIVE**

As soon as AMLD4 was implemented, the EU already began working on its fifth revision. Directive (EU) 2018/843 is to be transposed into national law by January 2020. The sections relevant to the FMA were already implemented in Austria in mid-2019 through amendments to the FM-GwG and the WiEReG (Federal Law Gazette I No. 62/2019 of 22 July 2019). The most significant innovation from the perspective of the FMA concerns the supervision of certain virtual currency providers, for which it bears responsibility. Here, Austrian lawmakers have gone even further than what is required under the Fifth Anti-Money Laundering Directive by fulfilling the FATF Recommendations. Moreover, precisely defined enhanced due diligence requirements for transactions and business relationships with high-risk third countries have been introduced, as well as regulatory simplifications to improve cooperation between national authorities and international authorities. Additionally, the register of beneficial owners is to be expanded into a central platform for the storage of documents required for the identification and verification of beneficial owners. This is intended to significantly accelerate the KYC process and significantly reduce the workload for users.

An amendment to the KontRegG will also enable the Financial Intelligence Unit and the FMA to inspect the accounts register in the future.

laundering and terrorist financing in 2015 by developing its own “risk classification system”, which has been actively used since then. For this purpose, the FMA continuously analyses data and information from the supervised entities in order to assess their risk of misuse for money laundering or terrorist financing. This analysis covers, for instance, the regional markets in which the institution operates, the financial services and products it offers (e.g. correspondent banking, fiduciary transactions, back-to-back transactions), who its customers are (e.g. politically exposed persons), with which partners it has business relationships (e.g. partners in offshore centres). Based on the results, a risk score is assigned (low, moderate, increased, high), which determines the frequency, intensity and depth of the supervisory measures, but from which risk-based inspection areas are also derived.

#### **AUSTRIA’S FINANCIAL MARKETS ANTI-MONEY LAUNDERING ACT – A NEW, UNIFORM LEGAL FOUNDATION**

The Financial Markets Anti-Money Laundering Act (FM-GwG; *Finanzmarkt-Geldwäschegesetz*), which transposed the Fourth Anti-Money Laundering Directive into Austrian law effective from 1 January 2017, bundled the provisions previously scattered across various relevant laws into a single framework, thus creating a clear and uniform legal foundation for all financial market participants.

A central innovation of AMLD4 was the obligation to establish a central register of beneficial owners, which was implemented in Austria via the Beneficial Owners Register Act (WiEReG; *Wirtschaftliche Eigentümerregister Gesetz*). This also ensured a uniform definition of the term “beneficial owner”. Other significant innovations include, for example, the requirement for the concrete formulation of simplified or enhanced due diligence obligations to be based on a corresponding risk analysis. Moreover, a national coordination committee was introduced at the Federal Ministry of Finance to coordinate national cooperation and prepare a national risk assessment (financial market analysis is the responsibility of the FMA).

The bundling of competencies and the extension of the FMA’s remit in the context of preventing money laundering and terrorist financing in the Austrian financial centre serves to exploit synergies in this highly specialised area, in terms of expertise and costs, as well as improving the efficiency and effectiveness of regulation and supervision. It also satisfies the FATF Recommendation that the relevant competencies should be pooled in one place.

#### **FATF COUNTRY EVALUATION 2016 – AUSTRIA MAKES GOOD PROGRESS**

In 2016 Austria was again assessed during the FATF’s fourth round of mutual evaluations, which awarded the FMA good marks overall. The results of the country evaluation showed that Austria had established a comprehensive and functioning system to combat money laundering and terrorist financing within the financial market. Yet, some areas were identified that were still lacking: for instance, the national cooperation mechanism was reported to be in need of improvement, the system for reporting suspicious activity needed to be made more efficient and effective, and the prosecution of money laundering was considered not assertive enough. These criticisms mainly concerned those areas that do not fall within the competence of the FMA.

Within the FMA's supervisory remit, it was suggested that inspection capacities be further expanded and that the threats of administrative penalties be tightened so as to have an actual deterrent effect.

Since publication of this mutual evaluation report in September 2016, a number of measures have therefore been taken to remedy the shortcomings identified by the FATF. The Federal Government at the time again adopted its own action plan for this purpose. However, this plan focused primarily on areas outside the FMA's remit – criminal investigation, prosecution and sanctioning as well as supervision of compliance with due diligence obligations in the areas of trade regulations, gambling and the liberal professions.

The FMA further increased its personnel resources in this area to 18 employees (more precisely, 18.25 full-time equivalents). Since establishment of the AML/CFT division, the number of employees working to prevent money laundering and terrorist financing has thus more than doubled. This expansion has also made it possible to further intensify, deepen and increase the frequency of inspections.

The rapid implementation of key recommendations from the mutual evaluation report via the FM-GwG 2017 was very positively highlighted by the FATF in the first follow-up report published in December 2017. Although substantial sections of the WiEReG came into force only in 2018, the new definition of “beneficial owner” applied from the beginning of 2017. This amendment, which was enforced still in 2017, enables deeper insights into opaque ownership structures (especially in the case of letterbox companies) and thus efficiently counteracts concealment.

As a result, in the 2017 follow-up, Austria was able to improve its FATF assessment results in key areas just one year after publication of the 2016 report.

#### **OUTLOOK: SUPERVISION OF VIRTUAL CURRENCIES**

The EU's Fifth Anti-Money Laundering Directive, which is to be transposed into national law by January 2020, further develops AML measures and includes new financial market participants within the supervisory regime. The sections relevant to the FMA were already implemented in Austria in mid-2019 through amendments<sup>1</sup> to the FM-GwG and the WiEReG. The most significant changes relate to FMA supervision of virtual currency providers, the definition of enhanced due diligence requirements for transactions and business relationships with high-risk third countries and the improvement of the FMA's cooperation with other national and international authorities. Specifically, as of 1 January 2020, certain virtual currency providers, in particular providers engaged in exchange services and custodian wallet providers, must register with the FMA and are thereby subject to its supervision.

Additionally, the register of beneficial owners is to be expanded into a central platform for the storage of documents required for the identification and verification of beneficial owners by November 2020 (so-called compliance package). This is primarily intended to accelerate the process of establishing and verifying the identity of beneficial owners and reduce the associated costs. Furthermore, the Financial Intelligence Unit and the FMA will be able to inspect the accounts register as a result of an amendment to the Accounts Register and Inspection of Accounts Act (*KontRegG; Kontenregister- und Konteneinschaugesetz*).

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<sup>1</sup> Federal Law Gazette I No. 62/2019 of 22 July 2019.

**In 2016, the EBA subjected the 51 most important banks in the EU to a stress test, in which it also collected data on the costs of significant operational risks. These totalled € 105 billion, of which € 71 billion were attributable to improper due diligence, particularly in the context of money laundering prevention.**

Ensuring a clean Austrian financial centre is one of the FMA’s primary objectives. Even the suspicion of money laundering can do massive damage to a financial centre, as can serious breaches of due diligence obligations for the prevention of money laundering and terrorist financing. Moreover, lax efforts at money laundering prevention result in serious operational risks and cost burdens, which can seriously impair the equity base and risk-bearing capacity of financial service providers. For example, during the 2018 stress test, the European Banking Authority (EBA) also collected data on costs of operational risks for the 51 most important banks in Europe and quantified them at € 105 billion; as much as € 71 billion of this amount resulted from improper due diligence, particularly in the context of preventing money laundering and financing of terrorism. European banks have often been fined hundreds of millions of euros, and even billions of euros. Many top managers have been fired, some smaller, non-systemically relevant banks have been deprived of their licences due to breaches of AML rules. A bank suspected of money laundering is hit worse by the loss of reputation than by the fine because no serious business partner wants to be associated with such an institution.

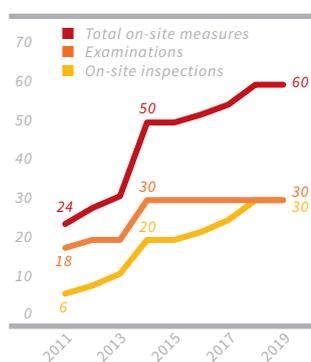
As already mentioned, the FMA therefore consistently pursues a policy of zero tolerance in its supervision of compliance with due diligence obligations for the prevention of money laundering and terrorist financing.

To illustrate: since 2013 the FMA has carried out an average of 175 supervisory procedures per year; in eight years it has more than doubled the number of on-site measures per year from 24 to 60 (> Chart 9); in 2018, together with the responsible local supervisory authorities, it carried out on-site inspections (seven) for the first time in other EU Member States as well as in third countries; it has imposed 91 fines totalling € 5.6 million over the past ten years.

In March 2018 the FMA imposed the highest fine to date, in the amount of € 2.75 million, on an Austrian institution. Another Austrian credit institution received a fine of € 414 000 in 2018 for similar breaches. In the case of two credit institutions, the FMA ensured that the executive board was replaced due to breaches of due diligence obligations; the members of the relevant boards resigned to avoid dismissal by the authorities. One of the two institutions subsequently withdrew completely from the Austrian market.

This consistent supervisory strategy has also led to a number of exposed banks withdrawing from risky markets, products and business relationships; e.g. from business relationships with offshore clients; or from back-to-back transactions, which involve a particularly high risk of being misused for money laundering; or from correspondent banking relationships subject to an elevated risk of money laundering.

Chart 9: Development of AML/CFT on-site measures



### CLEAN FINANCIAL CENTRE AUSTRIA

The consistent addressing of the points of criticism in the FATF reports, the bundling of competencies in the prevention of money laundering and terrorist financing for the Austrian financial centre under one roof, that of the FMA, as well as the consistent

zero tolerance strategy of the FMA have led to Austria positioning itself today as one of the world's cleanest financial centres. The latest revelations through data leaks and research by international journalist networks – from the Panama Papers to the Russian Laundromat, Paradise Papers and the Ukio and Danske money laundering scandals – demonstrate how important these countermeasures were. The fundamental reforms in the Austrian system for combating money laundering and the financing of terrorism have had an impact. This is also confirmed by the latest FATF report. The FMA will continue to work diligently and consistently to ensure that these standards are maintained, and has made ensuring a clean Austrian financial centre a priority for supervision and inspections.

# GREEN FINANCE – THE ANSWER TO CLIMATE CHANGE

Sustainability on the Austrian financial market

**T**he Paris Agreement, which has been ratified by Austria, obliges its parties to markedly lower the increase in global warming compared with pre-industrial levels, to significantly curb carbon emissions and to lead finance towards more sustainability globally. To achieve these goals within the European Union by 2030, the European Commission estimates that at least € 180 billion will be required annually. The Commission has therefore drawn up an “Action Plan: Financing Sustainable Growth”<sup>1</sup>, which it adopted in March 2018. Apart from the Paris Agreement, the EU’s Action Plan also takes account of the UN’s 2030 Agenda for Sustainable Development.

The Austrian Federal Government’s national climate and energy strategy, dubbed “#mission2030”, also includes a thematic focus on green finance<sup>2</sup>. A green finance task force was set up for this purpose, made up of experts from the Federal Ministry of Finance and the Federal Ministry of Sustainability and Tourism, as well as other senior representatives of public and private institutions including the FMA. The task force should give new impetus on how to reach the climate targets from a practical perspective.

Green finance and sustainable finance have been part of the Austrian financial market for quite some time now: some providers have developed green products and marketed them successfully, others have been considering sustainability risks in their risk management policies and/or environmental, social and governance (ESG) factors in their investment strategies.

<sup>1</sup> *Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions – Action Plan: Financing Sustainable Growth, COM(2018) 97 final.*

<sup>2</sup> *See the Federal Ministry of Sustainability and Tourism’s website: <https://www.bmnt.gv.at/english/environment/Climateprotect/sustainable-finances.html>*

Sustainability risks can have a negative impact on the performance of individual assets or even individual financial service providers. They also have the potential to shake up the financial market and adversely affect its stability in the short or even long term. Risks in relation to ESG factors therefore require strong risk management and need to be appropriately incorporated into the regular risk management processes of financial market participants, particularly those companies that are being supervised by the FMA.

The FMA as regulator is committed to providing a clear legal framework.

## THE EU'S ACTION PLAN: FINANCING SUSTAINABLE GROWTH

In March 2018 the European Commission published its Action Plan: Financing Sustainable Growth and concurrently tabled three legislative proposals that should pave the way for the financial sector in the EU moving towards a greener and more sustainable economy.

### Regulation on disclosures relating to sustainable investments and sustainability risks (Disclosure Regulation)

The Disclosure Regulation<sup>3</sup> aims to increase transparency for investors in relation to sustainability too. Harmonised rules will apply to financial market players with regard to the integration of sustainability risks and opportunities. These disclosure rules require consideration of ESG risks in investment (advice) activities, disclosure of how these risks impact on the investment's profitability as well as, in offers for products with environmental or social characteristics, disclosure of their sustainability and climate-related impact. In addition to certain pre-contractual information requirements, general transparency obligations have also been laid down:

- Financial market participants are required – keeping the principle of proportionality in mind – to state on their website whether they consider principal adverse impacts of investment decisions on sustainability factors. If they do not consider these impacts, they need to explain why.
- A consideration of sustainability factors for financial products further requires information about the identification and prioritisation of sustainability impacts and a description of the principal adverse sustainability impacts and of any actions taken or planned.
- An annual report must be submitted detailing how investment decisions and sustainable investments impact on environmental and social aspects, e.g. information on the extent of the positive impact on ESG matters. For financial products that promote sustainable investments, the overall sustainability-related impact must be described by means of relevant sustainability indicators.

These transparency obligations are closely linked to non-financial reporting that public-interest entities are already required to provide. The Regulation therefore allows use of the existing sustainability reporting in the management report or in a separate non-financial report to fulfil these new reporting obligations.

The Regulation spans all sectors, with the European supervisory authorities (ESAs)<sup>4</sup>

**Sustainability risks can have a negative impact on the performance of individual assets or even individual financial service providers. They also have the potential to shake up the financial market and adversely affect its stability in the short or even long term.**

<sup>3</sup> See <https://data.consilium.europa.eu/doc/document/PE-87-2019-INIT/en/pdf>.

<sup>4</sup> European Banking Authority (EBA), European Insurance and Occupational Pensions Authority (EIOPA) and European Securities and Markets Authority (ESMA).

ensuring convergence. This should help achieve a level playing field for all within the EU. The Regulation also aims to prevent greenwashing, i.e. unsuitable products being marketed as sustainable or climate-friendly. The Disclosure Regulation is expected to be published in the Official Journal of the European Union before the end of 2019.

The Joint Committee of the three ESAs has already established a working group to draft the related delegated and implementing legal acts (Level 2); a public consultation phase is scheduled for the first six months of 2020.

### **Regulation amending Regulation (EU) 2016/1011 on low carbon benchmarks and positive carbon impact benchmarks (Benchmarks Regulation)**

The revision of the Benchmarks Regulation<sup>5</sup> is aimed at developing minimum standards for low-carbon investments and introduces two new types of benchmarks: EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks. Both should be able to provide more information and greater detail about an investment portfolio's carbon footprint. While promoting investments in sustainable projects and assets, this should also help prevent greenwashing. The revised Benchmarks Regulation is expected to be published in the Official Journal of the European Union before the end of 2019.

### **Proposal for a Regulation on the establishment of a framework to facilitate sustainable investment (Taxonomy Regulation)<sup>6</sup>**

The aim of such a Taxonomy Regulation is to establish a unified EU classification system to determine which economic activities are considered sustainable. The proposal is still being discussed but the criteria will be based on six environmental objectives: climate change mitigation; climate change adaptation; protection of water; transition to a circular economy; pollution prevention and control; protection of healthy ecosystems. The classification system should provide clarity on which economic activities can be considered environmentally sustainable for investment purposes. However, any activities not corresponding to the system should not automatically be regarded as being environmentally damaging.

This taxonomy can be used as the basis for standards and labels for financial products. The European Commission suggested evaluating by the end of 2021 whether the taxonomy should be expanded to also include other sustainability objectives, particularly social objectives. Political agreement has not yet been reached in trilogue negotiations between the Council, European Parliament and European Commission.

### **European initiatives on an EU Green Bond Standard**

Following its Action plan: Financing Sustainable Growth, the European Commission established a Technical Expert Group (TEG) on sustainable finance in July 2018 and requested that the TEG prepare a report on an EU Green Bond Standard (EU-GBS), building on current best practices. The report was published in June 2019.<sup>7</sup>

The TEG proposes that the Commission create a voluntary EU Green Bond Standard and recommends the alignment of Green Projects with the EU Taxonomy Regulation.

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<sup>5</sup> See <https://data.consilium.europa.eu/doc/document/PE-90-2019-INIT/en/pdf>.

<sup>6</sup> Cf. Legislative Observatory, Framework to facilitate sustainable investment, [https://oeil.secure.europarl.europa.eu/oeil/popups/ficheprocedure.do?reference=2018/0178\(COD\)&l=en](https://oeil.secure.europarl.europa.eu/oeil/popups/ficheprocedure.do?reference=2018/0178(COD)&l=en).

<sup>7</sup> See [https://ec.europa.eu/info/publications/sustainable-finance-teg-green-bond-standard\\_en](https://ec.europa.eu/info/publications/sustainable-finance-teg-green-bond-standard_en).

Based on best practices, the proposed use of proceeds should be disclosed for any bond issue within a Green Bond Framework (GBF). The actual use of proceeds must then be reported annually. Also recommended is the use of external experts to verify conformity with the standard and related reporting on use of proceeds, with these accredited verifiers needing to be authorised and supervised by a supervisory authority.<sup>8</sup>

## CLIMATE-RELATED RISKS

Climate-related risks can be divided into physical risks and transition risks. Where climate-related risks have a material impact on counterparty, market or liquidity risks, they must also be included in financial market participants' risk management processes.

### PHYSICAL RISKS

Physical risks may result directly from climate change, e.g. more frequent natural disasters and increased severity of extreme weather events, such as floods, periods of extreme heat or drought, storms and hail. Sectors in the real economy that would experience the greatest impact include agriculture and mining, the real estate and healthcare sectors, tourism, the energy and water sectors, as well as infrastructure. The potential risk for financial market participants depends on their exposure to assets affected by physical risks. Physical risks are considered to pose a low risk for the financial market in the short and medium term, but will have an increased impact in the long term if the solutions to mitigate climate change and to switch to a lower-carbon economy prove to be inadequate.

Insurance undertakings are particularly affected by physical risks, with extreme weather events becoming ever more frequent and claim amounts rising as a consequence. An FMA survey found that climate-related damage covered with Austrian insurers has mostly occurred within a limited period of time: more than two thirds of all damage claims occurred within the space of just four years between 2009 and 2017, with hail, followed by floods and storms, resulting in the most expensive claims by far (> Chart 10). However, more than half of all the damage was reinsured. One third of Austrian insurers are expecting premiums to rise as a consequence of climate change.

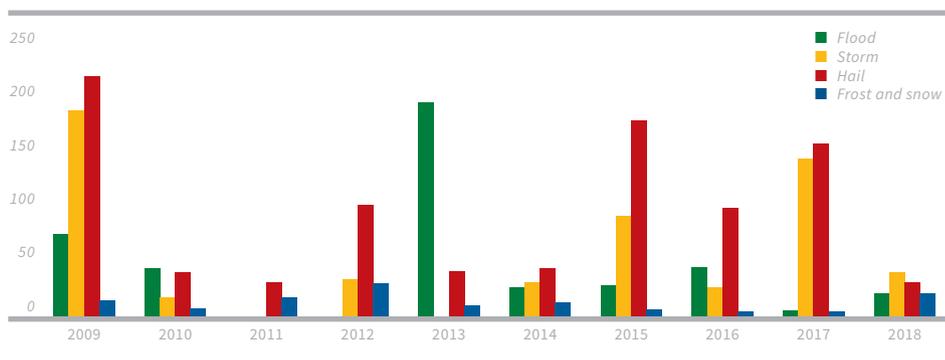


Chart 10: Insurance benefits for climate-related natural disasters (in € millions, as at 30 October 2019)

<sup>8</sup> Overview of the TEG Report on an EU Green Bond Standard, see: [https://ec.europa.eu/info/sites/info/files/business\\_economy\\_euro/banking\\_and\\_finance/documents/190618-sustainable-finance-teg-report-overview-green-bond-standard\\_en.pdf](https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/190618-sustainable-finance-teg-report-overview-green-bond-standard_en.pdf).

<sup>9</sup> See also "Recommendations of the Task Force on Climate-related Financial Disclosures" (TCFD), June 2017: <https://www.fsb-tcfd.org/publications/final-recommendations-report/>.

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### TRANSITION RISKS

Transition risks are risks that arise from the transition or adaptation to a lower-carbon economic system, leading to an unexpected depreciation of assets. This can be due to, for example, changed framework conditions for the real economy, technological innovations and shifts in consumer preferences, and will mostly affect high-emission industries. Stranded assets<sup>10</sup> should be mentioned in this context too. These are investments or assets that can no longer be used due to changed framework conditions and/or that therefore no longer generate revenue.

The potential transition risk for financial market participants therefore depends on their exposure to resource-intensive industries with high GHG emissions within their value chains. While physical risks are considered to pose a low risk for the financial market in the short and medium term, transition risks will have an earlier impact. However, instead of abruptly withdrawing from high-carbon assets, an orderly transition to more climate-friendly investments would be preferable.

### REGULATORY DEVELOPMENTS RELATING TO THE INTEGRATION OF ESG RISKS IN RISK MANAGEMENT

Based on the EU's Action Plan, the first regulatory steps have been initiated to integrate sustainability risks in financial market participants' risk management policies. *Pensionskassen*, for instance, have been required to also address ESG factors in their risk management since the application of the revised IORP Directive (IORP II)<sup>11</sup> with effect from 1 January 2019. The European Insurance and Occupational Pensions Authority (EIOPA) has clearly defined the related requirements in its "Opinion on the supervision of the management of environmental, social and governance risks faced by IORPs" of July 2019.<sup>12</sup>

With regard to banks, the first steps to regulate sustainability risks are reflected in the revised capital requirements rules, bundled up in a package comprising the Fifth Capital Requirements Directive (CRD V) and revised Capital Requirements Regulation (CRR II). The package also includes several referrals to the European Banking Authority (EBA), requesting that it specify the general requirements in practical terms:

- Article 98 CRD V assigns the EBA the task of assessing the potential inclusion in the review and evaluation performed by competent authorities of ESG risks by 28 June 2021 at the latest. Where necessary, this includes a mandate to issue guidelines. ESG risks are therefore expected to be expressly addressed in the supervisory review and evaluation process (SREP) in future, as part of which the bank's own funds requirement is calculated based on risk.
- Article 449a CRR II obliges large institutions which have issued securities that are admitted to trading on a regulated market of any Member State to also disclose information on ESG risks, including physical risks and transition risks from 28 June 2022 onwards. This information is to be disclosed on an annual basis for the first year and then half-yearly.

<sup>10</sup> An example would be a power plant that can no longer be operated due to regulatory changes such as in relation to energy efficiency.

<sup>11</sup> Directive (EU) 2016/2341 on the activities and supervision of institutions for occupational retirement provision (IORPs), OJ L 354, 23.12.2016, p. 37.

<sup>12</sup> See EIOPA-BoS-19-248.

- Article 501c CRR II mandates the EBA to assess whether a dedicated prudential treatment of exposures related to assets or activities associated substantially with environmental and/or social objectives would be justified (green supporting factor). The time frame here with its deadline of 28 June 2025 is longer than with other mandates, as currently available data do not yet allow a robust analysis of the potential consequences of easing the regulations on own funds requirements.

In July 2018 the European Commission asked the European Securities and Markets Authority (ESMA) and EIOPA to prepare technical advice on legislative proposals intended to integrate sustainability risks into the following bodies of law: the UCITS Directive<sup>13</sup>, the AIFMD<sup>14</sup>, MiFID II<sup>15</sup>, Solvency II<sup>16</sup> and the IDD<sup>17</sup>. EIOPA and ESMA submitted their technical advice in April 2019.<sup>18</sup> They included specific proposals about how to treat sustainability risks and counterparty, market and liquidity risks equally in risk management.

The above-mentioned Disclosure Regulation also lays down clear disclosure requirements for financial market participants and financial advisors that apply across all sectors. Information regarding approaches to the integration of sustainability risks must in future be disclosed on companies' websites, and a description of the integration of sustainability risks as well as any adverse impacts must be included in the pre-contractual information for each financial product.

## OVERVIEW OF SUSTAINABLE FINANCE IN AUSTRIA

The Austrian financial market is currently familiar with several sustainability certifications or labels for financial services and instruments. So far the FMA has not been mandated with their supervision or monitoring, and is therefore not responsible for their accuracy or correct application.

### INVESTMENT FUND MANAGEMENT COMPANIES AND INVESTMENT FUNDS

One sustainability label that is frequently used by investment funds in the Austrian market is the Austrian Ecolabel (UZ49). It is based on environmental, ethical and social criteria, and awarded by the Federal Ministry of Sustainability and Tourism, which asked the Austrian Consumers' Association (VKI) to prepare a guideline on the award of the label.<sup>19</sup>

The number of funds that are voluntarily basing their investment policies on the environmental, ethical and social criteria of UZ49 is constantly rising. On 30 September 2019 there were 77 Austrian sustainable funds, 20 more than in 2018. As at that date, these funds were managing € 9.33 billion of assets, which equates to 5.2% of the

<sup>13</sup> Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).

<sup>14</sup> Directive 2011/61/EU on Alternative Investment Fund Managers.

<sup>15</sup> Directive 2014/65/EU on markets in financial instruments.

<sup>16</sup> Directive 2009/138/EC on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II), OJ L 335, 17.12.2009, p. 1.

<sup>17</sup> Directive (EU) 2016/97 on insurance distribution, OJ L 26, 2.2.2016, p. 19.

<sup>18</sup> See ESMA <https://www.esma.europa.eu/press-news/esma-news/esma-submits-technical-advice-sustainable-finance-european-commission> and EIOPA <https://eiopa.europa.eu/Pages/News/EIOPA-submits-advice-on-Sustainable-Finance-to-the-European-Commission-.aspx>.

<sup>19</sup> For more details on the Austrian Ecolabel No. 49 (UZ49) for sustainable finance, see <https://www.umweltzeichen.at/en/products/sustainable-finance>.

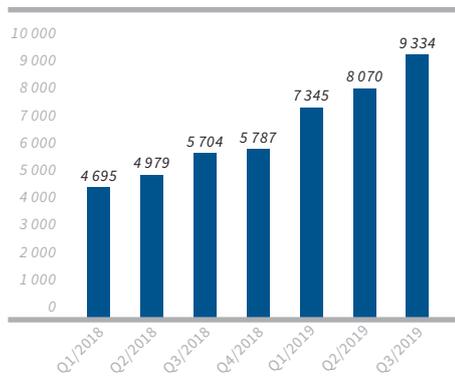


Chart 11: **Fund assets of Austrian funds with Austrian Ecolabel for sustainable finance** (in € millions; FMA, Association of Austrian Investment Companies, 30 September 2019)

total Austrian fund market (> Chart 11). In 2019 alone they had expanded by +61% or € 3.5 billion compared with the end of 2018. All Austrian investment fund management companies, except for one, are currently managing sustainable funds in line with the Austrian UZ49 label.<sup>20</sup>

### GREEN BONDS

Green bonds are bonds, the issue proceeds of which are used to fund climate and environmental projects. These proceeds are therefore earmarked for a specific purpose. There is no mandatory regulatory standard to verify the “greenness” of that purpose. Normally, however, sustainability is verified by external reviewers who draw up a sustainability opinion,

which is published as a Second Party Opinion.<sup>21</sup>

The Vienna Stock Exchange introduced the categories of green bonds and social bonds for bonds listed on its market in March 2018 in order to increase the transparency of sustainable capital markets and to provide international issuers with a platform for sustainable securities.<sup>22</sup>

In this context, mention should be made of the fact that the statutory benchmark for a prospectus to be approved by the FMA does not include an evaluation of the accuracy of the information provided by the issuer; and this also applies to information about ESG factors. Similarly, the currently applicable supervisory regime does not prescribe an evaluation of a green bond’s actual use of proceeds. It is the issuer who is liable for the accuracy of the information provided in the prospectus.<sup>23</sup>

### CREDIT INSTITUTIONS

ESG factors are increasingly being considered in the Austrian banking sector too. Some banks take account of ESG risks in their management of lending risks. Specific lending criteria determine how and when financing is regarded as sustainable, and if it therefore qualifies for more favourable rates of interest. However, there is no empirical evidence that loans that meet ESG criteria are in actual fact less risky.

### INSURANCE UNDERTAKINGS

The FMA and EIOPA conducted an empirical survey, covering both qualitative and quantitative aspects, on whether insurance undertakings are taking account of ESG factors. According to the results, almost three quarters of Austrian insurers are already considering ESG risks in their corporate management or have at least started considering them. However, many European providers have gone further still.

Only three Austrian insurance undertakings stated that they invested more than one third of their total portfolio sustainably. However, every third company differentiates

<sup>20</sup> Up-to-date figures can be found in the FMA’s quarterly reports on asset management (available in German): <https://www.fma.gv.at/investmentfonds-und-verwaltungsgesellschaften/quartersberichte/>.

<sup>21</sup> A Second Party Opinion usually includes a description of how the proceeds from the issue of green bonds are used, with the sustainable use of proceeds being assessed verbally and in the form of a scoring/rating. No mandatory (minimum) standards currently exist, but international best practice standards such as the “Green Bond Principles” drawn up by the International Capital Market Association are usually considered.

<sup>22</sup> See <https://www.wienerbourse.at/en/issuers/bond-admission-listing/green-and-social-bonds/>. Apart from Austrian issuers, the Slovenian SID Bank has also issued a green bond on the stock exchange.

<sup>23</sup> The FMA is required by law to evaluate prospectuses in terms of comprehensibility, completeness and coherence before approving them. Based on the submitted and/or approved base prospectuses, the FMA is currently not able to determine if there is any intention to issue green bonds, as the Prospectus Regulation does not require any such information to be provided in the Annexes.

between “green” and “non-green” assets.<sup>24</sup> There are barely any sustainable funds in the unit-linked or index-linked life insurance segment in Austria compared with the rest of Europe, but about half of all Austrian life insurers are planning to expand their product offer in this respect (> *Chart 12*).

Nearly half of Austrian insurers are using the “green” factor as an incentive in sales and underwriting to get customers to sign up; special rates for electric cars or energy-efficient homes are examples here. At the same time, “brown” factors are also used to show the other side of the coin, e.g. the exclusion of coal or banned weapons. At a European level, this only applies to one in four large insurance companies.

### PENSIONSKASSEN

*Pensionskassen* (pension companies) have been required to disclose ESG factors in their declaration on the investment policy principles since 2005 if they select assets according to ethical, ecological and/or social criteria (Article 25a para. 1 no. 6 of the *Pensionskassen Act – PKG; Pensionskassengesetz*).

All multi-employer *Pensionskassen* in Austria consider ESG factors when investing. This is a trend that has been driven by demand too: 80% of *Pensionskassen* state that they have had ESG enquiries from employers and beneficiaries. Nearly all of them are using internal approaches as well as external ratings and indices for their sustainable investments. With external asset managers, ESG factors are included in their contracts.

### CORPORATE PROVISION FUNDS

All of the eight corporate provision funds, which together managed entitlements of nearly € 13 billion as at 30 September 2019, have voluntarily incorporated sustainability or ESG criteria into their investment rules. The Austrian Society for Environment and Technology (OEGUT) certifies their compliance with sustainability criteria.<sup>25</sup>

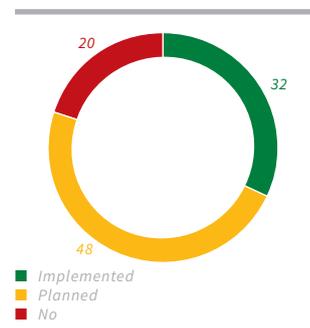
## SUSTAINABILITY AND SALE OF FINANCIAL PRODUCTS

With public debate on climate change and its impact intensifying, providers will be significantly expanding their offer of sustainable financial instruments, and customers will increasingly be asking for this type of finance and investment. Banks and investment firms will therefore also be called upon to focus more strongly on sustainability aspects when selling these financial instruments.

In July 2018 the European Commission asked ESMA to prepare technical advice and submit proposals on how to improve the legal framework in terms of sustainability. ESMA submitted its proposals in April 2019<sup>26</sup>, recommending changes to MiFID II as well as other delegated acts and ESMA guidelines based on it.

In keeping with general organisational requirements, credit institutions and investment firms will in future also have to consider sustainability criteria, in addition to existing criteria, where they are relevant to the provision of investment services.

Chart 12: Does your company consider sustainability risks in its investment guideline (or does it plan to do so within the next three years)? (survey, in %; 16 September 2019)



<sup>24</sup> ESG exclusion criteria are the most frequently used investment strategy, with Austrian insurers predominately using the ESG definitions of external service providers such as the Austrian Ecolabel, Sustainalytics, MSCI and the WWF.

<sup>25</sup> See the OEGUT website: <https://www.oegut.at/en/projects/green-investment/sustainability-certification.php>.

<sup>26</sup> See <https://www.esma.europa.eu/press-news/esma-news/esma-submits-technical-advice-sustainable-finance-european-commission>.

**Customers must not be advised to acquire a provider's own or a more expensive product just because it is regarded as being more sustainable. Additionally, products should not be presented as sustainable if they do not comply with the relevant requirements (greenwashing).**

Conflicts of interest will also take on new significance in that any potential conflicts arising in relation to the sustainability of a financial instrument will also need to be identified and taken into account. Companies will need to take appropriate action to ensure that sustainability aspects considered during the advisory process and in asset management do not lead to mis-selling. For instance, customers must not be advised to acquire a provider's own or a more expensive product just because it is regarded as being more sustainable. Additionally, products should not be presented as sustainable if they do not comply with the relevant requirements (greenwashing).

The product governance rules in MiFID II require providers to state the type of investor at which a particular financial instrument is being aimed. In future, financial instruments should also be classified according to whether they promote sustainability. And a product's sustainability preferences will also need to be checked in future, together with the regular mandatory verification of whether a financial instrument corresponds to the target market.

Current laws already stipulate that investment firms and credit institutions have to take their customers' needs into account when assessing investments for recommendation. In future they will be expressly required to consider their customers' sustainability preferences when providing financial advice or individual asset management services. Specifically, when determining their customers' investment objectives, they will also need to ask them about their sustainability preferences. These preferences are then to be considered during the mandatory assessment of whether a product is suitable for that customer.

The identification of the target market and the suitability assessment should ensure that the customer invests in a product that is appropriate for them. Sustainability is just one aspect in an investment decision, and other factors such as risk, investment horizon and similar aspects also need to be considered. All of these preferences and criteria should be weighed against one another and then considered before a recommendation is made. Transparency is another key aspect for customers. The creation of uniform terminology and transparent, standardised quality labels will enable customers to pick sustainable investments to match their preferences.

## **SUSTAINABLE AND GREEN FINANCE IN NON-FINANCIAL REPORTING**

The Corporate Social Responsibility Directive<sup>27</sup> aims at raising the transparency of the social and environmental information provided by undertakings within the EU. It was transposed into Austrian law through the Sustainability and Diversity Improvement Act (NaDiVeG; *Nachhaltigkeits- und Diversitätsverbesserungsgesetz*) in 2017 and applies to public-interest entities<sup>28</sup>. It obliges large, publicly listed companies to include in their management report a non-financial statement containing information to the extent necessary for an understanding of the undertaking's development, performance, position and impact of its activity. The information should include details about environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters.

The FMA, as part of its financial reporting enforcement remit, is responsible for super-

<sup>27</sup> Directive 2014/95/EU amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups.

<sup>28</sup> Article 189a of the Corporate Code (UGB; Unternehmensgesetzbuch).

vising companies' compliance with the statutory provisions related to non-financial reporting. The importance of transparency around sustainability, and around environmental issues in particular, in today's world is not least reflected in the fact that both ESMA and the FMA have named this as one of their 2019 priorities for supervision and inspections in financial reporting enforcement.<sup>29</sup>

## SUSTAINABLE FINANCE AND THE CHALLENGES FOR SUPERVISION

The FMA is involved in various transnational working groups of the European supervisory authorities (EBA, ESMA and EIOPA) and in the European System of Financial Supervision (ESFS) led by the ECB, as well as in the European Systemic Risk Board (ESRB), working to develop and guarantee transparent markets for sustainable investments and financial products. The FMA is also supporting financial market participants in their efforts to integrate sustainability risks into their risk management practices. To this end, it is adapting existing regulatory frameworks and developing new ones. It is also consistently contributing the specific Austrian point of view to the debate and ardently representing Austrian interests. As in all other areas, the FMA's policy of engaging in an open dialogue with all stakeholders applies here too.

To be able to provide supervised entities with more information relating to the integration of sustainability risks and to promote a common understanding of those risks, the FMA will prepare a guide on handling sustainability risks, with a round of public consultation scheduled to start in the first quarter of 2020. This FMA guide should aid supervised companies across all sectors in integrating sustainability and, particularly, climate risks into their classic risk management processes, as well as into their strategy and governance considerations. Additionally, examples of good practice in relation to methods and courses of action taken to identify, measure and manage risks will also be given.

The way forward: the Disclosure Regulation should be applied throughout Europe and agreement reached on the Taxonomy Regulation in order to lower the cost of obtaining information in the market, to ensure comparability of that information and to thereby limit the danger of market failure. Stricter disclosure requirements will enable investors to follow sustainable investment strategies of their own in an informed and independent manner. New rules on advice should be aligned with the market intermediaries' role of reducing information asymmetries in relation to sustainability aspects.

With all these initiatives, the FMA is advocating global, or at least Europe-wide, standards and regulations that guarantee a level playing field for all. We must make every effort to ensure that the use of shoddy environmental or social standards is not distorting the market; and this not only to protect businesses and investors, but first and foremost to protect our climate, environment and ecosystems.

As supervisors we are critical of any development in which regulation is remodelled as a steering tool for investments, e.g. when purportedly sustainable investments are automatically treated preferentially in the regulation of own funds requirements without basing this on sufficient data. Financial market supervision and regulation should continue to focus on risk management and transparency, and keep fair compe-

**The FMA guide should aid supervised companies across all sectors in integrating sustainability and, particularly, climate risks into their classic risk management processes, as well as into their strategy and governance considerations. Additionally, examples of good practice in relation to methods and courses of action taken to identify, measure and manage risks will also be given.**

<sup>29</sup> See <https://www.fma.gv.at/en/cross-sectoral-topics/checking-of-financial-reporting-enforcement/>.

tition for all in mind; economic regulation and investment incentives, meanwhile, are the responsibility of the fiscal and economic policymakers.

We have taken the first steps towards greater sustainability in the financial market, but many more steps must follow.

# IT SECURITY

## Preparing for and responding to cyber attacks

**A**ttacks from cyberspace have emerged as a direct threat to our security and to the proper functioning of government and society. They can have a major impact on our daily lives. The virtual world is open to abuse by hackers, and by organised crime and terrorist organisations, but is also vulnerable to exploitation by state bodies such as the intelligence agencies or the military. The threats emanating from the virtual world are practically unlimited. Consequently, the Austrian government's "Austrian Cyber Security Strategy" is one of the government and industry's top priorities as they work to shore up their virtual assets.<sup>1</sup>

### CURRENT THREAT LEVEL

The rapid pace of technological advances provides potential attackers with new lines of attack. At the same time, the ways and means of launching a cyber attack are readily available on the dark web (for example in the form of cybercrime as-a-service models<sup>2</sup>). While attacks were once being perpetrated by individuals with relatively simple technology at their disposal, many crimes nowadays are being carried out by insiders, if not by states, hackers and cyber terrorists. Organised crime in particular has grown. Yet the motives for these attacks and their targets vary greatly. The financial backing increasingly available to attackers enables them to deploy sophisticated, long-term and highly customised methods, for which conventional security concepts are no match. The question today is no longer if but when the next attack will occur, and whether it will even be identifiable as such.<sup>3</sup>

<sup>1</sup> Federal Ministry of the Interior, Austrian Cyber Security Strategy, [https://www.bmi.gv.at/504/files/130415\\_strategie\\_cybersicherheit\\_en\\_web.pdf](https://www.bmi.gv.at/504/files/130415_strategie_cybersicherheit_en_web.pdf).

<sup>2</sup> Federal Ministry of the Interior, cybercrime cases and investigations, <https://bundeskriminalamt.at/306/start.aspx> (in German).

<sup>3</sup> PWC, Cybersecurity – A challenge for financial service providers (in German), <https://www.pwc.de/de/finanzdienstleistungen/digital/cyber-security-herausforderung-fuer-finanzdienstleister.html>.

**Cyber attacks can cause a great deal of damage to institutions' data systems and thus to their operations. Attacks targeting the IT systems of financial companies jeopardise the availability, integrity, confidentiality and authenticity of their data.**

The attacks are often broken down into the following types of threat:

- Standard attacks (no complicated technical expertise or tools needed, freely available hacking tools, exploiting known vulnerabilities)
- Highly complex attacks (generally launched by experienced hackers and targeting complex, in some cases unknown, vulnerabilities, use of state-of-the-art tools and processes)
- Innovative attacks (focusing on new attack vectors and security weaknesses created by new technologies).

Computer hackers possess excellent IT skills and are always working to discover and exploit new vulnerabilities.<sup>4</sup>

### IMPACT OF CYBER ATTACKS ON COMPANIES IN THE BANKING SECTOR

Cyber attacks can cause a great deal of damage to institutions' data systems and thus to their operations. Attacks targeting the IT systems of financial companies jeopardise the availability, integrity, confidentiality and authenticity of their data. Nearly all banking processes are now automated. For all attackers, regardless of their motive, data and the functionality of the applications used to process that data are attractive targets. System outages and attacks from the outside or from within can have serious repercussions. Austria has not experienced any large-scale attacks in the form of a major incident to date, yet it is critical that financial service providers take action against the growing threat.

One key issue for banks associated with cyber and IT risks is the risk of reputational damage and a loss of confidence among customers and on the market more generally. There could also be financial losses or a need for payments to be made to contractual partners, and any incident could result in the supervisory authority imposing measures or sanctions. Activities based on criminal acts, wilful intent or gross negligence, particularly if carried out by insiders, also pose a risk of confidential business and customer data being leaked.

Attacks on payment transaction systems could result in money being transferred incorrectly or restrict the solvency of an institution or its customers.

### THE ROLE OF INTEGRATED SUPERVISION BY THE FMA

IT risks and risks from cyberspace are a form of operational risk. Credit institutions must earmark funds to tackle them. However, in its capacity as an integrated supervisory authority, the FMA published its own guides on IT security for *Pensionskassen*, insurance undertakings, investment service providers and investment firms, as well as for credit institutions in 2018.<sup>5</sup>

In doing so, the FMA is not just pursuing an integrated approach to regulation and supervision but is also applying the principles of risk-based supervision and proportionality. The higher the level of risk, the more penetrating the regulation and the more intensive the supervisory activity. And the simpler a business model and the smaller the business volume, the simpler the regulatory requirements, with less

<sup>4</sup> E&Y, *Cybersecurity: are you prepared for an attack? (in German)*, [https://www.ey.com/Publication/vwLUAssets/ey-giss-2018-executive-summary-de-thumbnail/\\$FILE/ey-giss-2018-executive-summary-de.pdf](https://www.ey.com/Publication/vwLUAssets/ey-giss-2018-executive-summary-de-thumbnail/$FILE/ey-giss-2018-executive-summary-de.pdf).

<sup>5</sup> FMA, <https://www.fma.gv.at/en/fma/fma-guides/>.

intense supervisory activity as a result. Nevertheless, the same goal, namely an appropriate degree of cybersecurity, must be achieved.

The rapid advances in technology are, however, creating an ongoing stream of new challenges for regulators and supervisors. The days of fixed quantitative rules are long gone, with the focus shifting towards qualitative requirements. Alongside capital resources, it is the assessment of risk management and compliance structures that is growing in importance. In this regard the FMA is committed to the principle of technology neutrality in its regulation and supervision of the financial market. It does not favour any particular technological solution over another. An appropriate risk management system must always be guaranteed, even under dynamic conditions. How this is achieved however does not matter, provided that the solution is based on state-of-the-art technology.

## **HOW CAN COMPANIES PROTECT THEMSELVES AGAINST CYBER ATTACKS?**

When they think of protection against cyber attacks, many people will automatically imagine a highly specialised IT expert working on a virtual defence against risks from cyberspace. And, indeed, these experts are vital for protecting IT systems.

IT governance must start with a company's leadership. Managers must make IT risks a sufficiently high priority in order to have a governance structure within a company that will optimally address IT risks.

## **THE FMA'S FIRST CYBER STRESS TEST OF BANKS**

In order to obtain a better insight into the financial sector's ability to withstand cyber attacks, the FMA and OeNB jointly carried out the first cyber stress test for the Austrian financial market in 2019. The test was supported by Kuratorium Sicheres Österreich (KSÖ), which was able to contribute its expertise gained from organising and conducting stress tests in other sectors. Participants in the stress test, implemented by the FMA and OeNB, included ten credit institutions and their IT providers, the Computer Emergency Response Team Austria (CERT.at)<sup>6</sup> and the Federal Agency for State Protection and Counter Terrorism (BVT). According to international studies, around two thirds of the damage caused by cybercrime can be attributed to employee behaviour, or is at least aided by the actions of employees. Consequently, this stress test focused on the human factor and was staged in the form of a cyber war game. The cooperation between the banks and the supervisory authorities, and also the other institutions involved in the event of a cyber attack, was the subject of particularly close scrutiny.

The cyber stress test shows that the Austrian financial sector is essentially well prepared for cyber attacks, although the degree of readiness varies from one area to another. The results of the test are being analysed in detail, with the findings being incorporated into regulatory and supervisory activity. What is clear, however, is that when it comes to defending against cyber attacks, a joint approach to safeguarding the stability of the financial sector is key, and a sector-specific CERT for the banking sector could make an important contribution.

<sup>6</sup> The Computer Emergency Response Team Austria (CERT.at) is the Austrian national CERT and is operated by the company nic.at GmbH. CERT.at is the primary contact point for IT security at a national level and will inform the network providers and responsible local security teams in the event of IT systems being attacked on a national scale.

The results of an IBM study conducted in 2019 (Ponemon study) show that many companies have still not prepared for how they would respond to an attack. These deficits in contingency planning have remained constant over the past four years. As Ted Julian, co-founder of IBM Resilient puts it: “Failing to plan is a plan to fail when it comes to responding to a cybersecurity incident. These plans need to be stress tested regularly and need full support from the board to invest in the necessary people, processes and technologies to sustain such a program.”<sup>7</sup>

Companies know that it is only a matter of time before a cyber attack takes place and should therefore have a company-wide response plan in place. An awareness of the potential threat is an important first step, but does not go nearly far enough. In order to be properly prepared for a cyber attack and respond accordingly, companies need to have developed a sophisticated, proactive and specially tailored strategy that extends well beyond an incident response plan. An effective security plan should combine the implementation of company-wide procedural guidelines, data security measures (also) including technical data protection measures, and the introduction of a response plan for the worst-case scenario. It is also important to remember that it is the employees who usually find themselves on the front line, which is why they should know exactly what is expected of them.

In addition to standard training sessions, the IT experts and managers who are responsible for cybersecurity should also be given practical training with realistic simulations so that they know what to do in the event of a cyber attack. Unless they have practised what to do and know how to take quick, focused action when needed, security teams, managers and employees will often end up being unprepared and disorganised.

It is the role of management to implement a company IT strategy that matches the more general corporate strategy and can also be made part of everyday activities. Organisational aspects such as a clear separation of IT operations and the controlling or managing functions (risk management, compliance and internal audit) are also the responsibility of executive staff. Another key aspect is the appointment of an appropriate IT security officer.

Figure 3 shows the tasks that need to be covered and the allocation of roles when implementing a comprehensive IT strategy.

Provided that managers carefully devise and implement basic parameters to tackle IT

Figure 3: IT governance, management and operational implementation (source: FMA Guides<sup>8</sup>)

<b>GOVERNANCE</b>	<i>Role of management board IT strategy IT governance</i>
<b>CONTROLLING</b>	<i>IT risk management Information security management IT incident management</i>
<b>OPERATIONAL IMPLEMENTATION</b>	<i>IT operations User authorisation management IT projects, application development, purchased software</i>

<sup>7</sup> IBM Ponemon Report on The Cyber Resilient Organization: more than half of German companies never test their incident response plans, <https://www-03.ibm.com/press/de/de/pressrelease/54907.wss> (in German).

<sup>8</sup> FMA Guide on ICT Security in Credit Institutions, FMA Guide on IT Security in Insurance and Reinsurance Undertakings, FMA Guide on IT Security in Investment Service Providers and Investment Firms and FMA Guide on IT Security in Management Companies (the latter two are only available in German).

risk and IT risk management, the relevant departments and individuals can cooperate in the best possible way in order to successfully prevent cyber attacks.

The information security officer has a key role to play in this regard, not just being responsible for the existence and practical implementation of an information security policy, but also reporting directly to management, both regularly and on an ad hoc basis when, for example, a vulnerability is detected.

On the basis of organisational measures to tackle IT risks, these risks must be detected within the company and made the subject of risk-reduction measures. An appropriate risk management process must therefore be established in order to be able to control any risks that are identified.

Compliance with relevant international standards (e.g. ISO 27001, ITIL, BSI, COBIT) is also recommended in order to prevent any weaknesses.

IT security concepts can take many different forms. Some of the key aspects are highlighted in Figure 4.

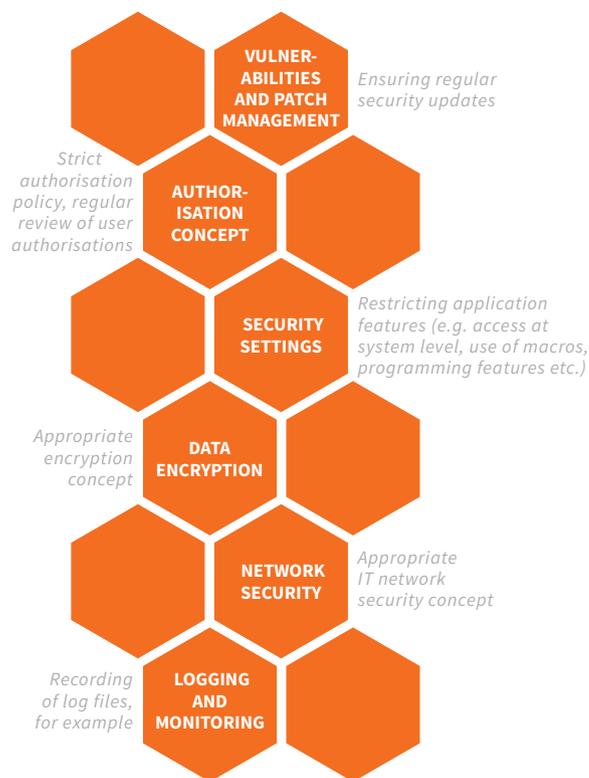


Figure 4: Elements of an IT cybersecurity concept

## HOW SHOULD COMPANIES RESPOND TO A CYBER ATTACK?

It is not possible to completely prevent cyber attacks. It is therefore essential that companies are sufficiently well prepared. Preparations should be made in the context of continuity management, with specific plans in place for the restoration of critical functions, information and processes should these be compromised (following an attack in the form of malicious or extortion software that encrypts the company’s key data, for example). Such a plan should include measures to enable any information that is stolen or compromised to be restored as quickly as possible, and it should also make provision for alternatives should it not be possible to restore the data. Companies should ideally also have implemented processes for the identification, investigation and documentation of incidents. Continuity plans must be regularly tested to ensure their effectiveness in a real-life situation.

Plans also need to be in place regarding the flow of information in the event of a cyber attack, not just within the company itself but also the provision of information to customers affected by the breach and other stakeholders. From a regulatory perspective, it should be noted that banks are required under the Payment Services Act 2018 (ZaDiG 2018; *Zahlungsdienstegesetz*)<sup>9</sup> to report any serious operational or security incident to the FMA immediately.

Ultimately, for companies that operate in the financial sector and are therefore frequently the target of hackers, the key message is that good preparation will help to limit any damage and cushion the negative impact of an attack.

<sup>9</sup> Article 86 of ZaDiG 2018, Federal Law Gazette I No. 17/2018, as last amended.

# IORP II

## The introduction of Europe's new supervisory regime for pension companies

**W**ith effect from 1 January 2019 the regulation and supervision of institutions for occupational retirement provision (IORPs), essentially the *Pensionskassen*, has been fundamentally overhauled in Austria. This was the date on which the revised Occupational Pension Funds Directive (IORP II Directive)<sup>1</sup> entered into force, transposed into Austrian law through the amended *Pensionskassen Act* (PKG; *Pensionskassengesetz*). The aims of the new supervisory regime are to drive forward and improve the principles of good corporate governance, to facilitate employee mobility between Member States, and to deepen and extend the information that must be provided to beneficiaries. IORP II imposes a minimum level of harmonisation in the regulation and supervision of occupational pension provision institutions across the entire European Economic Area.

### STRENGTHENING THE GOVERNANCE SYSTEM

The governance systems for *Pensionskassen* are being harmonised and strengthened. Under the new legislation, IORPs are obliged to set up new key functions, to adopt a more comprehensive approach to risk management, and to comply with extended information requirements. Every *Pensionskasse* must also carry out an own-risk assessment incorporating its investment and risk sharing groups. Many quantitative caps previously applicable to investment have been abolished and replaced with binding internal investment guidelines. The prudent person principle, already in place, has also been consistently extended. Consequently, occupational retirement provision institutions may only invest in assets and instruments where the risks can

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<sup>1</sup> Directive (EU) 2016/2341 on the activities and supervision of institutions for occupational retirement provision (IORPs), OJ L 354, 23.12.2016, p. 37-85. It replaced Directive 2003/41/EC, the old Pension Funds Directive.

be appropriately detected, measured, monitored, managed and controlled by the company concerned, and appropriately incorporated into its risk management. This means that the company is required to set its own rules within a given framework in order to guarantee that the funds under its management are invested in a way that benefits the security, quality, liquidity and profitability of the entire portfolio.

#### **KEY FUNCTIONS**

The required key functions encompass risk management, internal audit and the actuarial function. Internal policies must also be drawn up and approved by management, and reviewed at least every three years. The material findings and recommendations of the key function must be reported to management. If no appropriate measures are taken, the lack of action will trigger an obligation to report directly to the FMA.

Risk management now relates to the institution as a whole and not just investment by the respective investment and risk sharing group (as was previously the case). The internal audit function is now also responsible for reviewing the suitability and effectiveness of the internal control system. An actuarial function is obligatory if the IORP also provides cover against biometric risks and assumes guarantees. This function's remit includes coordinating and monitoring technical provision calculations. While key functions or activities may generally be outsourced in full or in part, complete responsibility for these remains with the *Pensionskasse* at all times.

#### **FIT AND PROPER REQUIREMENTS AND REMUNERATION**

Clearly defined and function-based fit and proper requirements are made of persons who actually manage the company, persons who hold key functions, and persons to whom or institutions to which key functions have been outsourced. Another new element of the legislation is that a remuneration policy must be in place for persons who effectively run the IORP or carry out key functions and for other categories of staff whose professional activities have a material impact on the company's risk profile. The main content of that policy must be published regularly and reviewed at least every three years.

#### **SUSTAINABILITY STRATEGY**

Investments must be made in accordance with the prudent person rule. One of the small number of quantitative limits relates to investment in equities, which is capped at 70% under IORP II. Member States may, however, opt to reduce this limit to as low as 35%. With regard to the prudent person rule, environmental, social and governance (ESG) factors will, however, also have to be taken into account when making investment decisions in future, ensuring that the environmental impact, social sustainability criteria, and corporate social responsibility are all considered.

On this basis, companies are required to establish the principles of their own remuneration policy, which should be published and reviewed at least every three years. This policy should also demonstrate how ESG factors have been and continue to be incorporated into investment decision-making.

#### **OWN-RISK ASSESSMENT**

*Pensionskassen* are required to analyse, evaluate and assess their risk position at least every three years. The results of this own-risk assessment must then be reported

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to the FMA and include a description of how the risk assessment is factored in to the management and decision-making process, an assessment of the effectiveness of the risk management system, and an assessment of the risks for beneficiaries currently drawing their pension (e.g. with regard to pension cuts).

#### **EQUITABLE SPREAD OF RISKS AND BENEFITS BETWEEN GENERATIONS**

The principle of guaranteeing an equitable spread of risks and benefits between generations is also enshrined in law for the first time. Where relevant, IORPs must work to ensure that risks and benefits are distributed equitably among different generations.

#### **PROMOTION OF MOBILITY AND CROSS-BORDER TRANSACTIONS**

**One of the key aims in reforming the Pension Funds Directive was to promote cross-border mobility for workers in the European Economic Area, as well as making it easier for occupational retirement provision institutions to access the single market. To achieve this, the responsibilities of the national and European authorities have been clearly defined, with more specific dividing lines.**

One of the key aims in reforming the Pension Funds Directive was to promote cross-border mobility for workers in the European Economic Area, as well as making it easier for occupational retirement provision institutions to access the single market. To achieve this, the responsibilities of the national and European authorities have been clearly defined, with more specific dividing lines. The applicable processes and rules regarding the cross-border transfer of portfolios have also been clarified.

For cross-border activities, the authority in the home Member State is as a general rule responsible for compliance with the supervisory regulations. Otherwise, it is the employment and social law of the host Member State, as well as its information rules, that apply. Consequently, it is the authority of the host Member State that is responsible for monitoring such compliance. Given that it is the authority in the home Member State that is generally responsible for supervision, the host authority is required to report to the former any misconduct that occurs in its area of responsibility. Should the home authority fail to take any appropriate action, the host authority may however introduce measures (after informing the home authority) and, in an extreme case, also prohibit the cross-border activity.

For the first time, the new Directive defines rules on the cross-border transfer of occupational pension schemes. The approval of the majority of beneficiaries or of the majority of their representatives is required before such a transfer can take place. The *Pensionskasse* must provide timely information on the applicable terms and conditions for and resulting from the transfer. Transfers must be approved by the authority responsible for the institution that is taking on the portfolio, and must also have been approved in advance by the authority responsible for the transferring institution. Both authorities are required to carry out in-depth checks, including with regard to whether the occupational retirement provision institution is in fact in a position to operate the type of business concerned or whether the assets are appropriate and sufficient to meet the obligations involved. Checks must also be made to ensure that the transfer will not result in any claims being reduced. The European Insurance and Occupational Pensions Authority (EIOPA) has the role of mediator in the event of any disagreement between Member States on a potential cross-border transaction.

#### **GREATER TRANSPARENCY AND INFORMATION**

The information that *Pensionskassen* are required to provide must be regularly updated, as well as being clear, precise and easy to understand. It must also be pro-

vided at no additional charge. IORPs are also required to provide their members with an annual Pension Benefit Statement (PBS). As well as personal data, the PBS must include details of any guarantees, forecasts, and the contributions and costs recorded during the past year. The supervisory authorities should base their rules on best practices regarding format and content.

If the FMA needs to sanction an IORP it must publish details of the sanction, along with a description of the type of breach and the name of the person responsible. Exceptions are only permitted in justified cases.

## AMENDMENTS TO THE FMA'S REGULATIONS AND MINIMUM STANDARDS

The IORP II Directive and its transposition into national law through an amendment to the PKG also resulted in the need for changes to be made to some of the FMA's regulations, circulars and minimum standards.

### **Risk Management Regulation for *Pensionskassen* 2019 (PK-RiMaV 2019)**

The Risk Management Regulation for *Pensionskassen* 2019 (PK-RiMaV 2019; *Pensionskassen-Risikomanagementverordnung*) was published by the FMA on 17 December 2018<sup>2</sup> and entered into force on 1 January 2019. As in the case of insurance undertakings, risk management is now considered to be a key function at *Pensionskassen*, encompassing the risks of the investment and risk sharing groups as well as the risks of the *Pensionskasse* as a whole, on both the assets and the liabilities side. The Regulation was also streamlined at the same time, while retaining the core elements of the previous version:

- It is the board of management that is responsible for setting up risk management systems and processes, ensuring that the required expertise and IT resources are made available.
- The risk management function is primarily tasked with monitoring and reporting duties, and is involved in material strategic decision-making. Conflicts of interest are to be avoided, particularly with regard to investment. Clear deputising arrangements must be in place to ensure that the function is always guaranteed within a company.
- The risk management system includes a risk management strategy tailored to the strategic and operational management of the *Pensionskasse* (business plan/strategy, investment guidelines and principles, risk-bearing capacity, own-risk assessment), internal risk management guidelines, IT systems, processes, documentation and reporting.
- Risk analysis must distinguish between material and immaterial risks. Similarly, the risk-bearing capacity must be determined taking account of asset/liability management, with consideration of the different investment risks.
- Environmental and social risks, as well as risks relating to corporate governance, must also now be taken into account.
- All material risks should be measured using risk models, alongside scenario analysis and stress testing.

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<sup>2</sup> Federal Law Gazette II No. 331/2018.

- Limits should be set as part of the risk management remit. These are then monitored using early warning mechanisms, with appropriate processes being put in place in advance to tackle any instances of limits being exceeded.
- A compulsory financial market data information system must also now be implemented.

### **Information Requirements Regulation for *Pensionskassen* (PK-InfoV)**

The amendment to the Information Requirements Regulation for *Pensionskassen* (PK-InfoV; *Pensionskassen Informationspflichtenverordnung*) was published on 17 December 2018<sup>3</sup>, in which the FMA lays down the content and the structure of information that *Pensionskassen* must make available to their beneficiaries (entitled and recipients). In addition to numerous detailed amendments, one of the main changes is a list of compulsory information that must be given to members. The information in the annual statement of account will also have to be structured in a specific manner, with the Regulation also prescribing the order in which the data should be presented. The annual information for the attention of beneficiaries must be arranged in categories, with the categories themselves following a specific order. Within each category there is, however, flexibility.

The FMA Minimum Standards for Informing the Beneficiaries of *Pensionskassen*, published in December 2013, only required some minor adjustments. These Standards cover the information that *Pensionskassen* are required to give their members upon joining a pension scheme and whenever members leave the company before having drawn any benefits. No changes were made to the content but some references to provisions that no longer apply have been deleted.

### **Regulation on the Auditing Actuary's Audit Report 2013 (PaktPBV)**

The main changes resulting from the amendment of 17 December 2018 to the Regulation on the Auditing Actuary's Audit Report 2013 (PaktPBV; *Prüfaktuar-Prüfberichtverordnung*)<sup>4</sup> are the inclusion in the audit report of new disclosures on the suitability of the underwriting policy, on the assessment of the reliability and appropriateness of the calculation of technical provisions, and also disclosures on whether the assumptions on which the calculation of the technical provisions was based are consistent with previous values. The changes are to be applied for the first time to all audit reports for the 2019 financial year.

## **THE NEW SUPERVISORY REGIME**

Europe's new supervisory regime in the area of occupational pensions, implemented in the form of IORP II, resolves outstanding issues in the cross-border provision of services and supervision. It strengthens the governance of *Pensionskassen*, improving their risk management in particular, and ensures that greater priority will be given to sustainability criteria in future. It also adds to the supervisory toolbox, creating tools that can be used to detect problems with individual providers and to introduce efficient, effective measures in response. What it also does, however, is make a major

<sup>3</sup> Federal Law Gazette II No. 337/2018.

<sup>4</sup> Federal Law Gazette II No. 334/2018.

contribution to greater stability in the pension company sector, at both national and European level.

The new tools give the FMA a more comprehensive and in-depth view of the business activity of *Pensionskassen*. Additional key functions, the obligation to prepare and apply guidelines, the additional information and reporting obligations vis-à-vis the supervisory authority, and the widening of the group of people for whom compliance with fit and proper requirements needs to be reviewed all help to improve the FMA's information base. It will thus be able to take its analysis even further, develop meaningful risk profiles, push for effective risk management and review implementation of all of these improvements regularly on the ground. Regular stress tests are used to detect vulnerabilities and problems at *Pensionskassen* at an early stage so that appropriate countermeasures can be introduced in good time.

In performing its supervisory activity, the FMA is committed to maximum transparency and therefore proactively communicates its expectations to the supervised entities. It therefore also discloses how challenges created by the new supervisory regime are incorporated into the FMA's priorities for supervision and inspections in 2020. The focus lies on the sustainability of business models and good corporate governance.

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# SOLVENCY II REVIEW

Revision of the regulatory and supervisory regime for insurance undertakings

**T**he Solvency II Directive<sup>1</sup> entered into force on 1 January 2016, introducing fundamental changes to the regulatory and supervisory regime for insurance undertakings. It includes new risk-based solvency requirements governing own funds of insurance undertakings and insurance groups, quality-based requirements for risk management and revised disclosure obligations covering a much wider scope. Considering the fundamental nature of the revision, even prior to enactment EU legislators planned an evaluation and review based on practical experience within the first five years. The aim here is to determine whether the original objectives have been achieved and whether any approaches are available to realise them more efficiently and effectively.

By the end of 2020, the European Commission will present a report with proposals for revising the Solvency II regime to the European Parliament and the Council. Meanwhile, the review and evaluation of experience with the regime is already taking place under the European Insurance and Occupational Pensions Authority (EIOPA) and the various national supervisory authorities. The evaluation is centred on the methods, assumptions and standard parameters serving as the basis for calculating solvency capital requirements using the standard formula.

Issuing several specific calls for advice<sup>2</sup>, the Commission has requested EIOPA to provide proposals for revision. In response, EIOPA has been working with the national competent authorities to gather data and facts, discussing the material in working groups and preparing appropriate proposals for changes.

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<sup>1</sup> Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II).

<sup>2</sup> <https://eiopa.europa.eu/publications/requests-for-advice>.

## FIRST PHASE OF THE SOLVENCY II REVIEW

A detailed response to the first call for advice has been prepared. The main item requested was to simplify the standard formula used to calculate regulatory solvency capital requirements (solvency capital ratio, SCR). Based on the EIOPA recommendation, the Commission revised the Delegated Regulation<sup>3</sup> on the Solvency II Directive, subsequently publishing it on 18 June 2019. To simplify SCR calculation, adaptations were made to items including non-life risk, the loss-absorbing capacity of deferred taxes, and the capital requirements for loans or equity associated with a lower risk and for which no ratings are provided.

## SECOND PHASE OF THE SOLVENCY II REVIEW

The European Commission issued a renewed request in February 2019, asking for technical advice<sup>4</sup> on specified items of the Solvency II Directive. Additionally, an impact assessment covering all relevant qualitative and quantitative impacts expected from each individual proposal as well as the combined impact of all proposed changes (holistic assessment) was requested. This was to entail numerous quantitative market analyses by the national supervisory authorities, assisted by the insurance sector.

As a result, the FMA was mandated to carry out a vast number of surveys and market studies of Austria's insurance sector as part of the SCR review: compilation of best estimate data on EPIFPs (expected profits in future premiums), contract boundaries, expenses, future management actions, unbundling, and valuation of options and guarantees; 2019 liquidity test; 2019 LTG (long term guarantee) review; 2019 FMA stress test of insurance undertakings; 2019 EIOPA stress test: 2019 cyber reach out exercise; compilation of data for the non-life underwriting risk comparative study on internal models; compilation of data on non-life cross-border insurance business of a long-term nature; 2019 FMA assessment of cyber maturity levels; ESG (environmental, social and governance) factors in 2019; and the 2019 survey on potential drivers for short-termism in the insurance sector.

EIOPA is currently evaluating the data, market studies and impact studies from each of the Member States, and plans to submit the resulting revision proposals to the Commission by mid-2020. One of main tasks here is to evaluate the valuation methods used in the various Member States to ensure that no cross-border competitive advantages arise from applying differing standards or from varied application of the same standards. This is in keeping with the notion of a level playing field, i.e. fair terms of competition for all. The object here is to identify any deviations in valuation methods, while also developing proposals to meet the challenge of ensuring more consistent and uniform implementation of Solvency II requirements within the European Economic Area (EEA).

Another focus in the evaluations relates to applying measures for long-term guarantees (LTG). Such measures are planned to provide for a smoother transition to the new funds requirements and to dampen procyclical behaviour in crisis situations.

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<sup>3</sup> Commission Delegated Regulation (EU) 2019/981 amending Delegated Regulation (EU) 2015/35 supplementing Directive 2009/138/EC.

<sup>4</sup> [https://ec.europa.eu/info/sites/info/files/business\\_economy\\_euro/banking\\_and\\_finance/documents/190211-request-eiopa-technical-advice-review-solvency-2.pdf](https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/190211-request-eiopa-technical-advice-review-solvency-2.pdf).

Certain LTG measures can be applied individually:

- Matching adjustment to the relevant risk-free interest rate term structure (Article 77b and 77c of the Framework Directive)
- Volatility adjustment to the relevant risk-free interest rate term structure (Article 77d of the Framework Directive)
- Duration-based equity risk sub-module (Article 304 of the Framework Directive)
- Transitional measure on the risk-free interest rates (Article 308c of the Framework Directive).

Other LTG measures are applied automatically:

- Extrapolation of the relevant risk-free interest rate term structure (Article 77a of the Framework Directive)
- Calculation of the equity risk sub-module: symmetric adjustment mechanism (Article 106 of the Framework Directive)
- Extension to recovery period (Article 138(4) of the Framework Directive).

### IMPACT OF THE LTG MEASURES ON AUSTRIAN INSURANCE UNDERTAKINGS

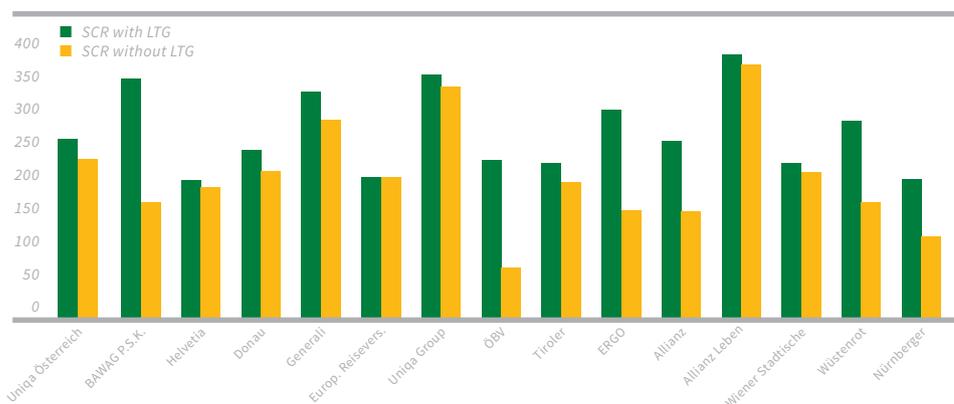
As at the balance sheet date of 31 December 2018, these LTG measures reduced the total solvency requirements needing to be met by Austrian insurance undertakings under Solvency II from € 12.4 billion to € 11.7 billion. Without these LTG measures, the average SCR would drop, from roughly 299% to 268%. Yet the insurance sector would still have a good solvency level overall (minimum requirement of over 100%). Nonetheless, the impact on specific insurance undertakings varies strongly, as can be seen in Chart 13.

For details on solvency in specific cases, refer to the reports on solvency and financial situation published by the various insurance undertakings.

#### MATCHING ADJUSTMENT TO THE RELEVANT RISK-FREE INTEREST RATE TERM STRUCTURE

When valuing technical provisions as part of calculating solvency capital requirements using the standard formula, a risk-free interest rate term structure specified by EIOPA is to be used. To determine this, a matching adjustment (MA) may be applied to the risk-free interest rate term structure under certain circumstances. The assets must

Chart 13: Solvency ratios in Austria with/without LTG measures (in %, as at 31 December 2018)



be maintained strictly separate from other obligations, while the cash flows of assets and obligations have to be replicated. When calculating SCR using the standard formula, no diversification effects between portfolios to which MA is applied and those without MA may be taken into account. This restriction is now under review.

Due to the requirements involved<sup>5</sup>, currently only undertakings based in Spain and the United Kingdom are applying the MA to the risk-free interest rate term structure. After Brexit, only companies from one single country would still use this method. For this reason, one of the items under evaluation is whether the current scope of application, arising in particular from the requirements for assets, should not be adjusted.

#### **VOLATILITY ADJUSTMENT TO THE RELEVANT RISK-FREE INTEREST RATE TERM STRUCTURE**

The volatility adjustment (VA) to the relevant risk-free interest rate term structure is intended as a means of avoiding any influence of increased market volatility on the valuation of long-term guarantees. The VA is currently based on a typical reference portfolio from which the mean interest spread is derived. As a second step, the risk-corrected portion of the spread is determined, with the amount used to adjust for volatility being 65% of that risk-corrected currency spread. The liquid component of the interest rate term structure is then increased by the VA, with this increased interest rate term structure subsequently having to be used in assessing solvency.

Unlike in Germany, volatility adjustment in Austria is not subject to approval by the supervisory authority. No volatility adjustment may be applied to obligations for which the interest rate term structure includes a matching adjustment. Volatility adjustment is presently based on a portfolio for each currency or country and not on individual portfolios of insurance undertakings.

One of the potential improvements currently under discussion is whether portfolio data from specific undertakings should be used in determining VA.

Another topic under discussion is whether to allow dynamic volatility adjustment (DVA) even when calculating the spread risk based on the SCR standard formula. DVA means that, when determining VA, the impact of stressed credit spreads is taken into account in each individual assessment scenario. Several undertakings that apply an approved internal model instead of the standard SCR formula use DVA in this case, which does, however, materially impact solvency requirements. Allowing DVA in the standard formula as well would reduce any unjustified advantages arising from the application of internal models but also add to the complexity of the spread risk module in the standard formula. The converse notion is also being discussed, that is whether it might not be more helpful to simply exclude the use of DVA with internal models as well.

#### **TRANSITIONAL MEASURES ON RISK-FREE INTEREST RATES AND TECHNICAL PROVISIONS**

Only a single undertaking in Europe currently applies the transitional measure on the risk-free interest rates. The transitional measure on technical provisions, in contrast, was used by five of Austria's 35 insurance undertakings as of the balance sheet date at

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<sup>5</sup> Article 77b of the Framework Directive.

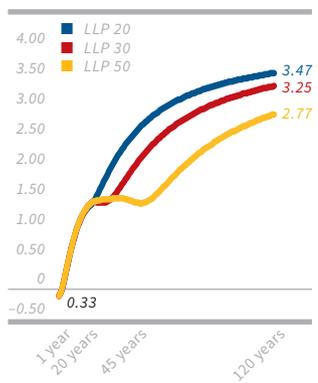
the end of 2018. In simple terms, these undertakings use an interpolated provision figure that combines the level of provision as based on the Corporate Code (UGB; *Unternehmensgesetzbuch*) and of technical provision as calculated on the basis of Solvency II, resulting in reduced own fund requirements. A point under discussion here is whether initial application of this transitional measure should still be allowed in future.

**EXTRAPOLATION OF THE RELEVANT RISK-FREE INTEREST RATE TERM STRUCTURE**

When determining the risk-free interest rate term structure to be specified by EIOPA, market data extending back to the last liquid point (LLP) are consulted. In addition, the future interest rate term structure is extrapolated based on certain parameter assumptions. Extrapolation of the relevant risk-free interest rate term structure (Article 77a of the Framework Directive) obviously has a material impact on the calculation of the technical provision in the case of products with a long term; this is particularly the case with life insurance products having annuity options. Current evaluations are looking at the potential impact of changing the extrapolation method and the LLP. Setting the last liquid point has an implicit effect on the interest level within the extrapolated part of the interest structure.

Any impact resulting from the LLP always needs to be considered together with setting and calibrating the pace of convergence and the ultimate forward rate (UFR).<sup>6</sup> Impact studies in recent years have evaluated the possible effects of adjusting the parameters of LLP and UFR for the purpose of calibration. One of the findings emerging is that an LLP of 20 years is possibly too low for the euro. An investigation in 2019 looked into the possible effects of increasing the LLP (> Chart 14).

Chart 14: Risk-free interest curves as a function of LLP (in %)



**DURATION-BASED EQUITY RISK SUB-MODULE**

At the moment, the equity risk may be calculated using a duration-based approach (Article 304 of the Framework Directive) under certain conditions.

The EIOPA working group recommends refraining from this approach in future. One of the considerations underlying the recommendation is the introduction of a reduced 22% stress factor for a specific equity category, referred to as long-term equity investments, as a result of the revised Delegated Regulation; this is contingent on certain conditions being met in relation to duration and to the relationship between equity and obligations. Both valuation approaches are directed at equity investments with a long investment period.

Austrian insurance undertakings are currently not using the duration-based approach, as conventional insurance products do not satisfy the criteria to qualify at present.

As part of analysing the LTG measures, issues are being discussed that relate to the sensitivity tests required when the MA and the VA are applied. The FMA has reservations about these transitional measures, since no serious impairment of insurance coverage must result from applying LTG measures and an adequate level of own funds must be ensured to cover risk. Supervisory authorities are accordingly assessing the impact of all transitional measures on an ongoing basis.

<sup>6</sup> The ultimate forward rate represents the assumed interest rate at which the risk-free interest term structure converges over the long term. For the euro, the applicable UFR amounted to 3.9% in 2019.

## TECHNICAL PROVISIONS

The amount of technical provisions is highly relevant for the solvency ratio. Even minor changes in this amount can have a material impact on the ratio.

EIOPA is to identify any divergence within the supervisory practices of Member States when calculating the “best estimate” of technical provisions, examining these discrepancies in detail and calculating the resulting quantitative impact. The following items need to be considered here:

- Use of scenario generators to calculate the best estimate of life insurance obligations
- Definition of contract boundaries
- Future management measures, within the context both of highly profitable scenarios and defaulting on obligations
- Cost-related assumptions
- Valuation of options and guarantees.

Proposals for the definition of contract boundaries and future profits resulting from future premiums are currently being detailed.

The Solvency II Directive calls for assessments to be carried out in conformance with market conditions, seeking in this regard harmonisation with developments in International Financial Reporting Standards (IFRS).

EIOPA is accordingly evaluating whether to adapt the approach for calculating technical provisions to correspond to the method set out in IFRS 17. The FMA currently considers such an adaptation only possible to a limited extent, for the following reasons:

- The two frameworks pursue differing aims, leading to justified differences. An example here is the contractual service margin, a component of the technical provisions as specified in IFRS 17, allowing profits to be spread over varying periods. Based on Solvency II, however, all profits falling within the contract boundaries from the balance sheet date onwards are covered by own funds, so that no equivalent to the notion of a contractual service margin exists.
- Article 76(2) of the Solvency II Directive requires technical provisions to be valued with the amount corresponding to the transfer value. In contrast, the governing principle in IFRS 17 is fulfilment cash flow.

## STRUCTURE OF OWN FUNDS

Own funds are currently classified in three categories (tiers). A reduction to two categories is now being discussed, along with whether the limits for recognising inclusion in individual categories should be adjusted. As part of the discussion, the own funds structures of banks are being evaluated and compared with those in the insurance sector.

## INTEREST RATE RISK SUB-MODULE

Calibration of the interest rate risk sub-module remained unaffected by the amendments introduced through the 2019 Delegated Regulation. The Commission has announced the corrections to current calibration methods, which are considered necessary, for the next phase of the Solvency II review in 2020. EIOPA is correspondingly repeating its analysis of how well calibration of the interest rate risk sub-module in the standard formula is suited to taking into account the low interest rate environment. These evaluations build on earlier surveys in 2017 and 2018. The findings sug-

**The amount of technical provisions is highly relevant for the solvency ratio. Even minor changes in this amount can have a material impact on the ratio.**

gest that the standard formula significantly underestimates the interest rate risk, with reasons for this including:

- The interest rate changes observed empirically were of a greater magnitude than the values used to calibrate stress.
- No stress is defined for interest rates that have already fallen below zero, even though rates could fall even further, as has been shown.
- The methods applied by internal model users to measure interest rate risk in some cases differ substantially from the current standard formula.
- The impact assessment of the proposals shows that a significant risk exists, with current capital requirements inadequate for ensuring the level of security sought.

The conclusions reached through previous analysis remain basically unchanged, so that EIOPA will again propose that interest rate risk stress be modified. Field studies also reveal significant material impact on the own funds situation as a result of raising the level of interest rate shock. Consequently, allowing a transitional phase prior to the increased stress factors is considered helpful.

EIOPA is also evaluating the stress factor for property risk, currently set at a total of 25% in the standard formula.<sup>7</sup> The discussion here centres on whether to split the factor according to geographic regions. In the case of the default risk in the standard formula, work is being carried out to simplify the calculations of the risk-reducing effect of derivatives, reinsurance agreements, special purpose vehicles and securitisations held by insurance undertakings.

The Solvency II review is far from being completed. Both for national supervisory authorities as well as insurance undertakings, it is critical to evaluate early on the concrete impact emanating from any legislative amendments. Only in this way can undesired effects be avoided, such as distortions in competition resulting from market structures or applications that differ from one region to another. We therefore welcome the European Commission's request to analyse the impact of any proposed changes and to reflect such impact in quantitative terms in market studies. To achieve this goal, national supervisory authorities will need to carry out additional surveys for the SCR review until mid-2020.

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<sup>7</sup> Article 174 L2: The capital requirement for property risk referred to in point (c) of the second subparagraph of Article 105(5) of Directive 2009/138/EC shall be equal to the loss in the basic own funds that would result from an instantaneous decrease of 25 % in the value of immovable property.





# HOW DIGITAL IS AUSTRIA'S FINANCIAL MARKET?

A review of the current situation

**A**ustria's financial market and many of the participants in that market are currently experiencing sweeping changes across a range of areas as a result of the digital revolution. Digitalisation is presenting new opportunities but also throwing up serious risks. The Austrian Financial Market Authority (FMA) has been engaged in this process since the outset, analysing the impact of digitalisation on the business models of existing providers, monitoring the emergence of new players, and considering the regulatory and supervisory challenges that these changes bring. Ultimately, analysis of the consequences of greater digitalisation on the financial market, and of the associated risks, opportunities, legal barriers and unanswered questions, lays the foundation for a future form of supervision that remains every bit as forward-looking, efficient and risk-oriented. With this in mind, the FMA has also made digitalisation one of its medium-term priorities for supervision and inspections. In this regard the FMA has access to a wide body of information and data, not least as a result of its active involvement in many national and international bodies and working groups as it collaborates with partner authorities, transnational expert groups and global standard-setting bodies to discuss current trends and initiatives and share practical experiences. The FMA has also carried out a comprehensive survey into the state of digitalisation in the Austrian financial market, covering all sectors and based on almost complete market coverage in many of them. The interim findings from this analysis, reflecting companies' current situation, medium-term plans and expectations around digitalisation on the Austrian financial market, have now been published on the FMA website.<sup>1</sup> Based on the results of this interim report, the FMA has also

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<sup>1</sup> FMA, *Digitalisation in the Austrian Financial Market – Status Quo, Outlook and Call for Input*.

issued a Call for Input to all stakeholders. The resulting contributions to the debate will be incorporated into the final report, due for publication in 2020.

What general picture is drawn by the FMA study in terms of the digital status of supervised entities? What kind of strategies are companies adopting in this rapidly changing environment? How are the product landscape, technologies and customer interfaces changing, and what conclusions does the FMA draw from these developments?

**DIGITALISATION EXPECTATIONS AND STRATEGIES**

From a medium-term perspective, the companies in Austria's financial sector expect to see existing business models continue to evolve. The probability of disruptive change, and thus of the basic principle of core business being superseded, is generally dismissed as inconceivable over the next three years.

Consequently, most companies assume that they still have enough time to introduce the internal process optimisation measures, with these currently being viewed by *Pensionskassen* and insurance undertakings in particular as their most pressing task. The need for IT tools and software, as well as digital skills, is a further challenge facing the supervised entities. Expertise in data structures and analysis is the most urgently needed type of knowledge, with one quarter of the financial market expressing a need to catch up in this area. Aspects relating to corporate culture also have a major role to play in the case of credit institutions in particular (> *Chart 16*).

The impetus for technological innovation mainly originates in IT departments, where the necessary technical knowledge is concentrated. Efficiency gains, meanwhile, are viewed as the greatest opportunity presented by digitalisation, as well as an improved understanding of customers and their needs. Yet the customer's wishes are generally not (yet) being placed at the heart of digital development.

At a strategic level, most of the supervised companies in Austria have at least made some progress towards going digital, although digitalisation is barely included, if at all, in the strategy of around one fifth of companies (> *Chart 15*).

Although the FMA does not expect any specific digitalisation strategy, the potential impact of technological advances should at least be taken into account when designing the company's strategy if future challenges are to be tackled appropriately. The impact in terms of risk management should also be examined.

There is a general risk that companies will rely too heavily on their own view that the digital revolution will be evolutionary in character. This means there is a risk of potentially disruptive changes being overlooked or identified too late, a shortcoming that

Chart 15: Digitalisation rooted in organisation

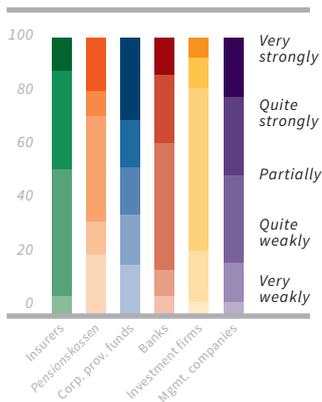
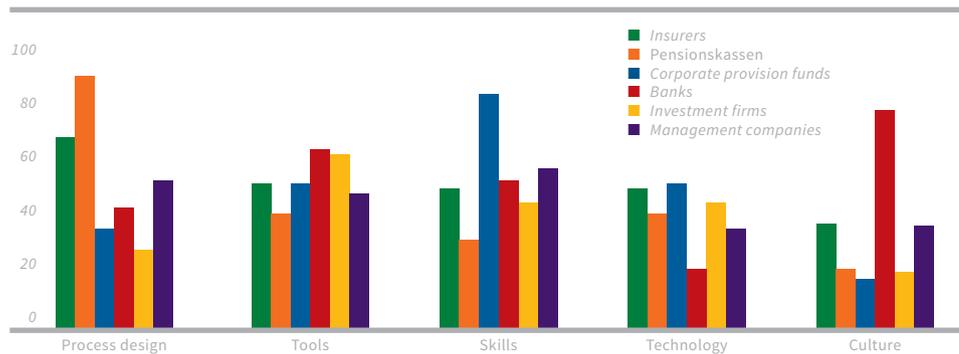


Chart 16: Digitalisation challenges



could pose a greater threat to a company’s continued survival than insufficient capital or improper business practices. There is a risk, for example that supervised companies could increasingly be cut out of direct customer relationships as customers make ever greater use of online comparison sites. Similarly, new forms of risk transfer could increasingly replace traditional products.

## MARKET PARTICIPANTS

Opinions on which players are set to become the biggest competitors on the digital financial market in the medium term vary greatly according to financial sector. Half of banks, for examples, view globally dominant technology groups as their biggest rival whenever such groups enter the financial market laterally as new players. In addition to these BigTechs, it is financial service providers that insurance undertakings regard as their biggest threat (> *Chart 17*)

The digital transformation is opening up scope for new competitors on the financial market. New start-ups, for example, which are embracing state-of-the-art technology and are free of old IT architecture, are only partly covered by regulation and do not require as much physical infrastructure, if any at all. From the outset FinTechs have been focusing on payment transactions, an area that features a huge volume of similar transactions and lower entry barriers compared with business governed by the Austrian Banking Act (BWG; *Bankwesengesetz*). In short, technology-oriented start-ups are offering new financial services or are able to offer existing services at a more favourable cost and/or in a more customer-friendly way. Such developments may fundamentally change the business relationship between financial service providers and their customers. In terms of banking, there is an obvious trend away from relationship banking, and its business model focused on long-term customer relationships, towards transaction banking with a business model that focuses on individual financial transactions. This development is looked at more closely in a separate article.<sup>2</sup> The strategy most commonly pursued by established players in response to FinTechs is one of cooperation – an approach pursued by Austria’s major banks in particular (> *Chart 18*).

A few years ago the FMA set up its own FinTech Point of Contact, a one-stop shop where FinTechs can clarify any regulatory or supervisory issues before entering the market. Such issues might include the potential need for a licence or checking whether unauthorised business is being carried out. Another area could be whether the rules on outsourcing during cooperation between FinTechs and supervised companies are being observed. Plans are also in place for a sandbox to be set up at the FMA, enabling companies to test how a business model that is under development could be realised in accordance with the regulatory conditions.<sup>3</sup> The required legal basis for this scheme has already been the subject of review but is still to be adopted by the Austrian parliament.

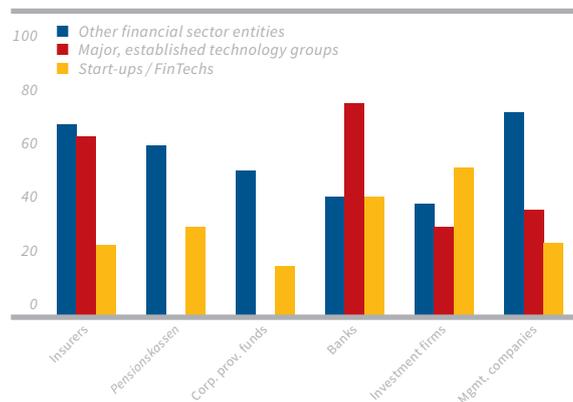
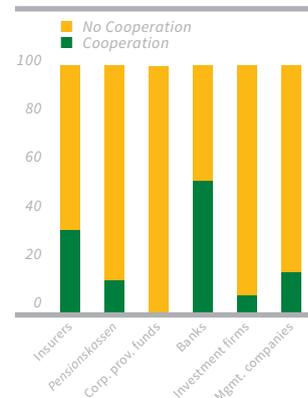


Chart 17: Expected competition on digital market

Chart 18: Cooperation with FinTechs / InsurTechs



<sup>2</sup> See also FTS article “The shift from relationship to transaction banking”.

<sup>3</sup> See Article 23a of the draft amendment to the FMABG.

## PRODUCT DESIGN

Digitalisation is also creating a need for new types of product. Customers increasingly expect to have access to financial products via a variety of channels regardless of their location. Meanwhile, ongoing advances in connectivity, linking up devices, homes and infrastructures, are making new demands of products and services.

Examples of new bank product features:

- **Facility to open accounts online** (from the comfort of your own home): In cooperation with external providers, new customers can be identified via a video chat.
- **Bank transfers using photographs:** Payments are carried out by taking a photograph of the relevant details.
- **Personalised platform services:** Machine learning is used in customer service in order to provide a tailored response.
- **New product types:** Examples of new products include account information services, providing a full and consolidated breakdown of all payment accounts, and payment initiation services, used to trigger payments through a third party.

Examples of new insurance product features:

- **Smart homes:** Using chips installed inside them, smart homes can recognise the contents of the house and automatically adjust the home contents cover accordingly, report claims and use specially developed systems (e.g. fire detectors connected to the system) as an effective way of avoiding damage.<sup>4</sup>
- **On-demand insurance:** Customers can use an app on their smartphone to activate and deactivate insurance cover for particular risks to suit their needs, and can therefore tailor how long the cover lasts.
- **Parametric insurance:** The sum assured is paid out as soon as a triggering event, such as a defined amount of rainfall, occurs.
- **New product types:** Examples include cyber insurance or cryptoassets policies that cover specialist cases.

Examples of new securities product features:

- **Robo advice:** Automated investment advice and the automated sale of financial instruments.

The FMA adopts a generally neutral approach to innovation and technological development, identifying and eliminating legal uncertainties relating to their handling under supervisory law while accepting the opportunities presented by the digital revolution in terms of product design. It works hard to ensure the availability of fair and comparable consumer information that is easy to understand on what can be highly complex products. Moreover, in some areas there is also the question of a legal and social debate with certain population groups and/or risk groups at threat of being excluded from some insurance services. The fact that premiums are increasingly being calculated on an individual basis could, in extreme cases, mean that bad risks lead to prohibitively high premiums.

<sup>4</sup> These systems are already being used by some German insurance undertakings in their products. See <https://www.versicherungsmagazin.de/rubriken/branche/assekuranz-sammelt-erfahrungen-mit-smart-home-losungen-2235272.html> (in German).

## IN-HOUSE USE OF TECHNOLOGY

Product innovations are being supported in particular by the use of improved technologies for data analysis. The concept on everyone's lips is "big data", with huge quantities of data from a variety of sources already available for use in the industry. This data can be linked up and analysed within manageable periods of time in order to generate individually tailored products or customised offers. It can also be used, however, to filter out cases of fraud or to zoom in on risk probabilities in each individual case, to name just two relevant examples.

Banks and insurance undertakings' use of big data is currently focused in the areas of customer relationship management, sales, risk management and fraud detection, reporting and IT security (> Chart 19).

Robotic process automation (RPA) is another growing area. RPA is the collective term for bot software, which is used, for example, to perform repetitive tasks in software applications by means of predefined key strokes and mouse movements.

RPA, which is cheap and simple to implement, is already being used by 18% of supervised entities, with a further 29% planning its introduction (> Chart 20).

Machine learning, where the software itself looks for the best approach to a problem, is currently being used by 17% of insurance undertakings and 20% of banks. Detecting (attempted) fraud and the automated categorisation of e-mails are just two of the applications in use.

A small number of companies are also already turning to artificial intelligence, harnessing the capacity of machines to imitate intelligent behaviour in such areas as automatic text processing.

In contrast, blockchain – a cryptographic ledger of transactions that is resistant to manipulation and stored across a large number of distributed machines – is currently still only playing a minor role on the Austrian financial market, with most players simply monitoring developments in this area for now.

## IT INFRASTRUCTURE

The IT infrastructure within the Austrian financial market in general and within groups and companies in particular is far from uniform. The deployment of solutions from major providers means that the overall software landscape for standard processes is becoming more harmonised, a trend that is reflected in the increased use of cloud services. The latter are IT services that are made available via the Internet, for example, and generally relate to storage space, processing power or application software.

Around a half of all companies in the financial sector use the cloud, a figure set to increase to almost two thirds by 2021. Some companies also use several different cloud solutions, generally in order to fulfil different functionalities within the company (> Chart 21).

Relatively old systems that are reaching the end of their useful life are still being deployed in some companies. In the insurance sector, for example, IT systems are used for an average of ten years, with some variation according to particular area of use. On average, the plan is to continue using them for a further ten to twenty years. The costs for maintaining, developing and possibly replacing a system rise steeply over time.

Chart 19: Scope of big data analytics (BDA)

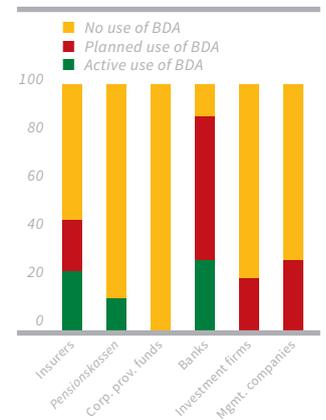


Chart 20: Use of robotic process automation

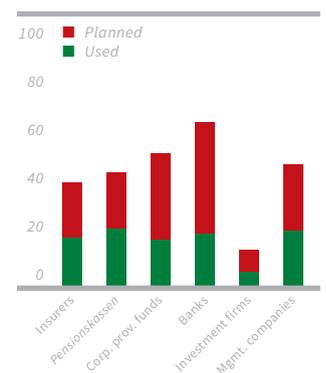


Chart 21: Use of cloud services (in %)

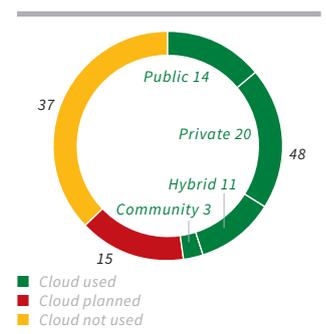
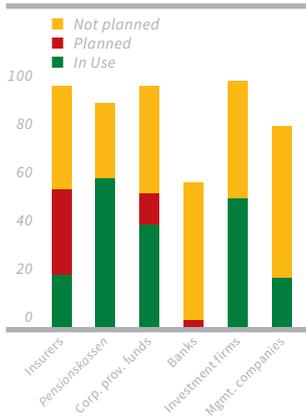


Chart 22: Use of DevOps (continuous integration)



As far as current IT projects are concerned, there is a trend in some sectors away from traditional management methods towards agile approaches, for which no fixed schedule is agreed in advance and with no defined milestones. DevOps (development and operations) refers to a process improvement approach from the field of software development and system administration (> Chart 22).

**CUSTOMER INTERFACES – COMMUNICATION CHANNELS**

With regard to the various communication channels used by supervised companies, there is a strong trend in evidence towards the use of online portals, which provide customisable access to a selection of integrated functionalities.

Just under half of the supervised companies use customer portals. This applies to banks in particular, with a figure of 80% – the portal functionality is generally integrated into the banks’ e-banking systems (> Chart 23).

Insurance undertakings are the most likely to use social media (70%), with almost half of banks also doing so (45%). Nearly all banks not currently active on social media are planning to make use of this tool within the next three years. In other sectors, social media only have a minor role to play (> Chart 24).

As far as the banking sector is concerned, apps are now standard, being used by 83% of credit institutions. By expanding the functionality of these apps and creating more secure designs, banks expect to grow customer loyalty. Currently used by 44% of insurance undertakings, apps are becoming increasingly common in the insurance sector too (> Chart 25).

Comparison websites are sites that enable consumers to directly compare different providers’ prices for similar products and services. Given that many customers get their information from a comparison site before signing a deal, it is difficult to assess their actual impact on the Austrian financial market.

Half of insurance undertakings are currently using comparison sites, primarily to sell their motor vehicle and home insurance policies but also for legal expense insurance. 35% of banks also use them (> Chart 26).

Chat bots and robo advisors are used for direct communication. Chat bots are software programs developed to communicate with people and interact in as human a manner as possible. Robo advisors offer greater functionality than chat bots and can

Chart 23: Online portals

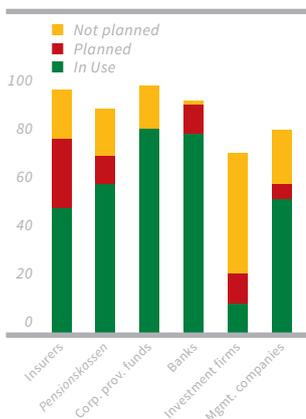


Chart 24: Social media

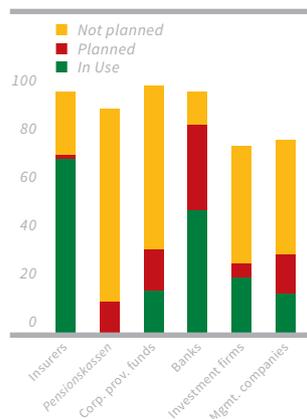


Chart 25: Apps for mobile devices

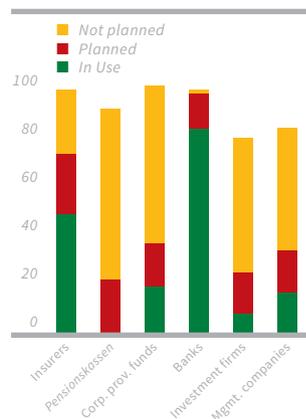
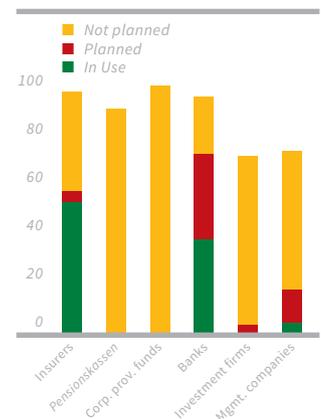


Chart 26: Comparison websites



## THE FMA'S NEW BENCHMARK FOR COMPANIES' APPROACH TO CYBERSECURITY

How sophisticated an approach are Austrian insurance undertakings adopting towards the ever growing issue of cyber risks? To answer this question, the FMA has developed its Cyber Maturity Level Assessment 1.0, carried out for the first time to determine insurance undertakings' cyber risk maturity ranking.

This tool, which has been designed for the insurance sector in the first instance and takes account of its particular characteristics, is based on international IT security standards such as COBIT5, CIS Controls v7 and ISO 27001. Strategic, organisational and process-based measures on handling cyber risks, as well as technical aspects of implementation, are set out in the 12 subject areas listed in Figure 5.



Figure 5: The 12 subject areas of the FMA Cyber Maturity Level Assessment 1.0

The assessment is based on the 5-level maturity ranking, where a high score is associated with a higher level of compliance with the criteria (> Figure 7).

The average maturity ranking for Austrian insurance undertakings is calculated as 3.1, where a score of 1 is the lowest ranking and equates to “Not available/not implemented” and a score of 5 is the maximum ranking, i.e. “Reviews and updates implemented”. This means that, on average, insurers are already applying key measures to guarantee cybersecurity but that the documentation on the related procedures and considerations with regard to process improvements do not yet provide a basis for future development.

However, detailed consideration of the results is needed to assess the respective maturity ranking of individual subject areas and individual companies:

- The average rankings achieved by companies vary greatly, ranging from 2.0 to 4.7.
- The average maturity rankings by subject area also vary, ranging from 2.6 (Test methods and practices) to 3.8 (IT assets) (> Figure 6).
- Overall, the average maturity ranking for specific technical projects around cybersecurity themes is a comparatively high 3.3. In contrast, potential for improvements in relation to governance and controlling is clearly in evidence, with an average maturity ranking of 2.9.

Further findings gained from the assessment and the background to its implementation have been published in the FMA's 2019 report on the state of the Austrian insurance industry.



Figure 6: Maturity ranking by subject area

Figure 7: FMA maturity level basic principle



be used in more versatile applications. Six insurance undertakings are, for example, already giving their customers the option of putting their questions to a simple chat bot on their website. These bots can help customers make a claim and can also calculate premiums. Automated customer advice, extending beyond chat bots, is currently only being used by insurance groups in individual cases.

With regard to established means of communication, the use of e-mail is set to decline in future, on data security and data protection grounds. Similarly, insurers are making less and less use of telephone communications. Banks, meanwhile, have plans to use voice identification in future as a means of customer identification.

In terms of supervisory law, there will be implications for the FMA primarily in relation to eliminating the legal uncertainties associated with the use of new digital technologies. Relevant issues include the need for consent when contracts are concluded electronically and during electronic communication, or adherence to the regulations on pre-contractual and ongoing information obligations in relation to digital financial services.

### THE FMA'S DIGITALISATION STRATEGY

The FMA developed its own Digital Roadmap back in 2017, which aims at defining how innovation in general and the digital revolution in particular can best be utilised to the benefit of the Austrian financial market from the perspective of a regulator and supervisor.

- A **Call for Input** addresses supervised entities and the bodies representing their interests, along with stakeholders in general, inviting them to identify and jointly analyse with the Authority existing regulatory obstacles and impediments and to devise appropriate solutions.
- The **FinTech Point of Contact** established at the FMA in 2016 provides a single point of contact for technology-reliant start-up companies active in the financial market (FinTechs) to clarify all regulatory issues in a non-bureaucratic way.
- As a rule, the digital world favours (Internet-based) cross-border activities. The FMA correspondingly concentrates on international cooperation in this area too, participating in transnational working groups of specialists representing regulators and supervisors.
- As part of the ongoing supervision of companies licensed by the FMA, the latter evaluates the regulatory challenges raised by technological change, responding in particular to the potential risks posed by the use of new technologies. The current buzzwords include cyber risk, IT and data security, outsourcing and interfaces, and operational risks.

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

On this basis, when devising its medium-term strategy (2018-2023), the FMA identified digitalisation as one of the major challenges facing the Austrian financial market and made this area one of its priorities for supervision and inspections.

The FMA's 2019 study "Digitalisation in the Austrian Financial Market", the interim

findings of which are presented and discussed here, represents the most comprehensive, representative and in-depth study of the current situation to date, while also setting out the market's expectations for the next three years in relation to the digitalisation of Austria's financial market.

This FMA study provides market participants with a reliable overview of the state of digitalisation on the Austrian financial market and of their comparative position. At the same time, it provides the FMA itself with a good basis from which to develop its supervisory strategy on digitalisation and to set appropriate and targeted priorities for its supervision and inspection activities.

# CRYPTOASSETS: BITCOIN, LIBRA AND CO

Where we are now

**I**t all began in October 2008. At that time, a group or individual using the pseudonym Satoshi Nakamoto – even now nobody knows who was really behind it – published a white paper that conceived of a decentrally administered currency, completely outside the control of states and banks. “What is needed is an electronic payment system based on cryptographic proof instead of trust, allowing any two willing parties to transact directly with each other without the need for a trusted third party,” wrote the unknown Nakamoto. Programmers and other enthusiasts embraced the vision and, together with Nakamoto, released the first version of the reference implementation as Bitcoin Core in January 2009. Soon, the first trading platform was launched, where digital coins could be exchanged for real currency: Mt. Gox – and, as the German business journal Handelsblatt so aptly put it: “digital salvation and virtual disaster took their course.”

## FROM BITCOIN TO LIBRA

The most salient feature of Bitcoin is the use of the underlying technology, the blockchain. A blockchain is a kind of database, the storage of which is usually decentralised and redundant. This means that a huge number of identical copies are held worldwide on an equally large number of unrelated individual computers (nodes). The system is separate from all state structures, from central banks and the established financial service providers of the analogue world – it ultimately manages itself. Initially, Bitcoin and its blockchain technology captivated a relatively small, tech-savvy group, but a speculative hype developed around it over the years and, currently, a complete universe of cryptoassets has emerged, in which billions of dollars,

euros and Bitcoins are traded. Moreover, the technology behind it (blockchain and technologies based on it) has increasingly been penetrating the conventional financial industry as well as the real economy.

For example, social media giant Facebook has caused a sensation because, together with a consortium of other BigTechs and global financial service providers, it has announced plans to issue Libra: its own blockchain-based global, digital currency. The People's Republic of China announced that its central bank is also preparing its own digital currency, partly based on the blockchain. What these two projects have in common is that the blockchain technology being used is no longer decentralised. These currencies are instead built on a "private" blockchain, meaning that all read and write permissions are bundled in a central hub. A variant of this is the "permissioned" blockchain, in which some members have all rights and can grant permissions to other participants.

Today, blockchain technology is no longer used only for payment services, it has a wide range of applications, including: supply chain management, land register management, insurance claims management, clearing and settlement of securities transactions and the complete dematerialisation of securities.

In other words, much has happened since the famous Nakamoto white paper.

## **BIGGER, FASTER, MORE GLOBAL: THE MURKY ROLE OF ICOS**

According to a frequently cited study by US-based consulting firm Satis Group, the global market for initial coin offerings (ICOs) reached as high as 20% of the total volume of all US IPOs in 2018 – a remarkable figure for such a new phenomenon. The list of cryptocurrencies published by data service CoinMarketCap now numbers 2 646<sup>1</sup>.

An ICO is an issuance in which customers receive a virtual store of value, also called a "token" or "coin", in exchange for real currency or a cryptocurrency. These coins or tokens are connected to the company or project of the ICO organiser. For example, they can represent a participation in a company, often a start-up, or a claim to future profits, but they can also represent services or the right to a product that will exist in the future but is still in development. Often, these coins or tokens can also be bought and sold on trading or exchange platforms and are therefore also referred to as cryptoassets.

Some ICOs generate gigantic sums of money. Among them, however, are also numerous spectacular cases of investor fraud: for example, the Pincoin ICO is said to have garnered \$ 660 million worldwide, all of which was embezzled. Criminal cases also involve crypto exchanges, i.e. trading and exchange platforms; mining pools, in which investments are made jointly in the mining of alleged virtual currencies; brokers or trading bots, automated trading software for cryptoassets. Many of these cases of fraud were advertised intensively in advance via social networks and via private networks in Telegram groups.

There is no shortage of people, however, who view ICOs as a revolutionary advancement of what began with crowdfunding. They see ICOs as the digitalisation of alternative financing. But there is a certain reputation gap between crowdfunding and ICOs: crowdfunding and crowdinvesting were perceived quite positively right from the start;

**“Libra’s mission is to create a simple global financial infrastructure that empowers billions of people around the world. It’s powered by blockchain technology and the plan is to launch it in 2020.”**

*Mark Zuckerberg,  
18 June 2019*

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<sup>1</sup> <https://coinmarketcap.com/>, as at 11 September 2019.

many countries have now created their own regulatory regimes to facilitate crowd-funding. By contrast, ICOs are increasingly associated with investment fraud and scams; unintelligible white papers; illiquid cryptoassets; wildly fluctuating price movements. Accordingly, uncertainty persists about the best possible political approach. A total ban of ICOs – like in China? New laws with strong investor protections – as in France<sup>2</sup> (already in force) or Liechtenstein<sup>3</sup> (planned)?

## ICOS IN AUSTRIA

Austrian supervisory law already covers ICOs in cases where de facto regulated financial market instruments are issued. It is not unusual for a cryptoasset, by virtue of its specific rights, obligations and functions, to be classifiable as a financial instrument such as a bond, e-money or other payment instrument.

The first three ICOs were launched in Austria in 2017. In the meantime, the FMA has performed legal assessments of many such issues and derived legally unambiguous criteria relating to the treatment of ICOs. Immediately after the first transactions, key legal interpretations were published in the FinTech Navigator on the FMA website (<https://www.fma.gv.at/en/cross-sectoral-topics/fintech-navigator/>). In line with the FMA's integrated approach, all information relevant to FinTechs is compiled there and addressed from the perspective of all supervisory areas and regulatory perspectives.

The most important message first: cryptoassets and ICOs are not unregulated across the board – but, at the same time, not everything is subject to supervision. A number of supervisory laws may apply, such as the Securities Supervision Act 2018 (WAG 2018; *Wertpapieraufsichtsgesetz*), the Austrian Banking Act (BWG; *Bankwesengesetz*), the Alternative Investment Fund Managers Act (AIFMG; *Alternatives Investmentfonds Manager-Gesetz*), the Payment Services Act 2018 (ZaDiG 2018; *Zahlungsdienstegesetz*), the Capital Market Act 2019 (KMG 2019; *Kapitalmarktgesetz*) or the Alternative Financing Act (AltFG; *Alternativfinanzierungsgesetz*).

For example, the rules for alternative financing instruments offered digitally have already been updated by the AltFG in the light of developments in crowdfunding. A cryptoasset that is qualified as a security or investment can be issued under the AltFG if all requirements are met; in this case, it does not require a capital market prospectus. In the case of a security, services such as the receipt and transmission of orders (brokerage) or third-party securities issue underwriting (placement) are also subject to a licence pursuant to the WAG 2018 or BWG.

## IEOS, STABLECOINS & CO

The aim of digitalising assets is to make transactions easier, faster and cheaper. Now that the initial ICO hype is fading, many providers are moving further in the direction of typical financial products. A new phenomenon is the initial exchange offering: an IEO is very similar to an ICO; the difference is that the asset has already been issued via a crypto exchange. Operators of several crypto exchanges developed their own

<sup>2</sup> In April 2019 a new regulation was adopted in France within the framework of PACTE (*Plan d'Action pour la Croissance et la Transformation – Action Plan for Business Growth and Transformation*).

<sup>3</sup> In Liechtenstein, a draft for a Token and Trustworthy Technologies Service Provider Act (TVTGA) is in the legislative process.

IEOs in 2019, which promised customers the ability to both redeem the issued crypto-assets for services on their respective platforms in the future and to trade them on the crypto exchange. As a vision for the future, they announced that they would also offer IEOs from other companies on their platforms. Some experts already see in the IEO the next trend for 2020.

In addition to IEOs, there is also growing interest in stablecoins and security tokens. The term stablecoin describes a cryptoasset whose value – measured, for example, in euros or US dollars – is not meant to fluctuate significantly. To achieve this objective, the value of stablecoins is linked to fiat currencies (i.e. money issued by central banks), commodities, other assets such as gold and oil or to a basket of cryptoassets (in particular Bitcoin and Ether), or determined via algorithms.<sup>4</sup> The FMA is already dealing with several cases of cryptoassets whose value is based on currencies or gold, or which represent the value of a share 1:1.

There is seemingly no limit to the assets that can be tokenised. In addition to tokenised precious metals and shares, this year saw the first examples in Europe of real estate STOs (security token offerings), in which the cryptoasset represents a security and is supposed to be collateralised with real estate assets. In addition, this year there were also examples in Europe of bank bond financing processed using a blockchain.

The question arises as to the regulatory limits on IEOs, stablecoins and security tokens, and whether these models are subject to supervision by the FMA. As with past examples, the answer depends on the concrete design of the respective cryptoassets and the associated rights. Practical experience demonstrates that it is often difficult to classify cryptoassets according to their function as utility, security or payment tokens because cryptoassets can have multiple functions at once (e.g. payment func-

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<sup>4</sup> See <https://www.fca.org.uk/publication/consultation/cp19-03.pdf>, no. 4.12, as at 11 September 2019.

## TYPES OF TOKENS

### SECURITY TOKENS

Security tokens embody claims to payments (future cash flow) from the issuer, which may be structured according to company law or contract law. Furthermore, security tokens may confer rights under company law, such as voting rights at a general meeting. The design of such security tokens is therefore similar to that of traditional securities, in particular shares and bonds.

### PAYMENT TOKENS

A payment token is a type of token, the primary purpose of which is a payment function. Payment tokens therefore represent a specific value with which goods or services can also be purchased from persons other than the issuer.

### UTILITY TOKENS

Utility tokens are primarily intended to provide the holder with a benefit in relation to a particular product or service. Frequently, they permit access to a digital platform operated by the issuer, which can be used in a specific fashion by the holder of the utility token. In particular, utility tokens may be associated with the right to participate in the design of a product or service, to use a product or service or to redeem the token for a product or service.

tion but also tradability similar to a security). Therefore, only the concrete legal structure of the attached rights and obligations can be used as the starting point for supervisory purposes.

If all criteria are fulfilled, the issue of IEO tokens or stablecoins leads to a registration or licensing obligation. The simultaneous fulfilment of several circumstances requiring a licence is possible as a result of multiple functionalities. Three laws address relevant licensing requirements with regard to the payment function:

- the Payment Services Act 2018 (ZaDiG 2018; *Zahlungsdienstegesetz*) in Article 1 para. 2 no. 5,
- the E-Money Act 2010 (E-GeldG 2010; *E-Geldgesetz*) in Article 1 para. 1,
- the Austrian Banking Act (BWG; *Bankwesengesetz*) in Article 1 para. 1 no. 6.

The applicability of these laws depends in particular on the scope of the network within which the payment function is fulfilled. Open networks do not fall under the exemption from the licensing obligation, as they are generally intended for a constantly growing network of subscribers. In the case of limited networks, however, there may be an exception to the licensing obligation. Although the legislature has not specified unequivocal criteria with respect to how networks must be limited, quantitative as well as qualitative criteria do apply as limitation parameters: the geographical range of the system, the number of accepting entities, the type of available products and services, the term of validity and any limits on coin/token value.

Beginning in 2020, however, providers wishing to make use of the exemption for limited networks must submit a notification to the FMA pursuant to the ZaDiG 2018<sup>5</sup>.

In addition to their status as payment instruments, means of payment or electronic money, cryptoassets may also constitute financial instruments<sup>6</sup>, in particular securities<sup>7</sup>, especially if they confer a right vis-à-vis the issuer, are tradable on the capital market and are comparable to transferable securities such as a certificate.

Finally, cryptoassets, like financial instruments, may constitute public offerings subject to an obligation to publish a prospectus pursuant to the KMG 2019 or the EU Prospectus Regulation<sup>8</sup>. The FMA will therefore continue to be heavily involved in this topic.

## FACEBOOK'S LIBRA

Facebook has published a white paper<sup>9</sup> on the plan for its digital currency, Libra, and set up the website [libra.org](https://libra.org), where the ambitious mission statement can be found. It sets out objectives such as: empowering billions of people, reducing poverty, lowering costs and cash disruption.

When it comes to a BigTech giant like Facebook, such utopian visions no longer seem so far fetched.

The Libra Association in Geneva is already beginning to involve credit card companies, BigTechs, platforms and exchanges, as well as technology and telecommunications providers, to contribute to Libra's success. Here, an immediate difference from

<sup>5</sup> Article 3 para. 4 ZaDiG 2018.

<sup>6</sup> Article 1 no. 7 WAG 2018.

<sup>7</sup> Article 1 no. 5 WAG 2018.

<sup>8</sup> Regulation (EU) 2017/1129 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market.

<sup>9</sup> The information in the following paragraphs is taken from the white paper: <https://libra.org/en-US/white-paper/>, as at 11 September 2019.

most cryptoassets is apparent: although Libra is new, it is also deeply embedded in the financial market and tech industry. And there are other significant differences:

- The Libra Association is to have a central function in the control of the system, and is the only party able to create (mint) and destroy (burn) Libra<sup>10</sup>. With Bitcoin, there is no entity in a central position and no point of contact for problems.
- Transactions are confirmed and executed by the network of validator nodes formed from the Association's membership. In contrast to Bitcoin, where trust is based on computational power consuming vast amounts of energy (proof of work), Libra's consensus protocol is designed as a proof-of-stake system (LibraBFT).
- Libra is to be fully backed by a reserve of real assets in order to keep the value stable. For each coin issued, assets, in particular bank deposits and stable (fiat) currencies, are acquired and held in reserve. Whether, based on this, Libra is to be considered a type of "stablecoin" depends on terminology. In any case, Libra is not pegged to a single currency.
- Users may use pseudonyms, but they are identifiable.

However, important points have yet to be settled, such as whether customers will have a right to return coins. It will therefore depend on the concrete design whether Libra has to be issued and/or distributed in Europe via a regulated company. For the issuance of Libra, it remains to be discussed, in particular, whether existing e-money, payment instrument and fund regulations, as well as the PRIIPs Regulation<sup>11</sup>, are applicable. However, it may also be necessary to discuss whether it has the characteristics of a security and should be classed as a certificate.<sup>12</sup>

From a regulatory standpoint, the special features of Libra are certainly of interest: with a central intermediary, a completely different regulatory approach is possible than with Bitcoin. Furthermore, the planned "digital identity", i.e. the purely digital manifestation, is an interesting feature both in terms of money laundering prevention and for criminal justice authorities: easily traceable transactions are on the wish list of every investigator on the blockchain. However, precisely this aspect has also aroused the attention of data protection activists, who already see Facebook as one of the largest data collection factories of our time, whose careful and correct handling of data – especially the protection of personal rights – is often seen as doubtful.

As a final note, Libra is highly interesting from a monetary policy perspective: first comes the question of whether value and price stability can actually succeed. Second, there is the socio-political question as to whether a global means of payment that is not issued by a central bank is even conceivable and politically desirable without an active monetary policy.<sup>13</sup>

## CRYPTOASSETS AND VIRTUAL CURRENCIES – THE FIGHT AGAINST MONEY LAUNDERING

The booming world of cryptoassets and virtual currencies has created a parallel uni-

**“Libra raises many serious concerns regarding privacy, money laundering, consumer protection and financial stability.”**

*Federal Reserve Chair  
Jerome H. Powell*

<sup>10</sup> Terminology based on the Libra white paper.

<sup>11</sup> Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs).

<sup>12</sup> Tomanek/Rirsch. Libra – Facebooks „Kryptowährung“ – ein Fall für die Finanzmarktaufsicht? [Libra – Facebook's "cryptocurrency" – A case for financial market supervision?]. ZFR 8/2019, Article no. 2019/174, page 392 et seq.

<sup>13</sup> See also the warnings of Yves Mersch, Member of the ECB's Executive Board, during a speech in Frankfurt, [www.ecb.europa.eu/press/key/date/2019/html/ecb.sp190902-aadedd9219.en.html](http://www.ecb.europa.eu/press/key/date/2019/html/ecb.sp190902-aadedd9219.en.html), as at 11 September 2019.

**The booming world of cryptoassets and virtual currencies has created a parallel universe to the largely analogue, established financial sector. However, while market participants in the traditional financial sector are subject to strict AML/CFT obligations, these regulations are not yet applicable to the world of cryptoassets.**

verse to the largely analogue, established financial sector. However, while market participants in the traditional financial sector are subject to strict obligations to prevent money laundering and terrorist financing (AML/CFT), these regulations are not yet applicable to the world of cryptoassets. This has led, on the one hand, to a distortion of the conditions of competition between these two financial worlds and, on the other, to dubious and criminal market participants – in particular organised crime surrounding drug, human and arms trafficking and investment fraud – increasingly shifting their activities to the parallel universe of cryptoassets in order to circumvent supervision and elude criminal prosecution.

The risk of cryptoassets being misused for money laundering and terrorist financing starts at the interface between regulated financial systems and the currently unregulated virtual currency space, where fiat money is exchanged for virtual currencies without prior identification and tracing of where the funds originated. It continues on from there, particularly where certain blockchain or cryptographic technologies are applied (e.g. zero-knowledge proof, ring signatures) which conceal or facilitate concealment of the payment flows and/or the identity of the users. Certain types of virtual currencies, such as anonymity-enhanced cryptocurrencies or privacy coins, also have precisely this aim. Zcash and Monero are two examples.

With the increasing prevalence of virtual currencies, political pressure has therefore increased to include the world of cryptoassets within regulatory regimes and, in particular, to subject them to the due diligence obligations for the prevention of money laundering and terrorist financing.

At international level, the Financial Action Task Force (FATF)<sup>14</sup> took initial steps as early as 2014 with a number of discussion papers, such as the discussion paper “Virtual Currencies – Key Definitions and Potential AML/CTF Risks” and, building on this, the first “Guidance for a Risk-Based Approach to Virtual Currencies”. The aim of the guidance was to provide national supervisory authorities with initial assistance in dealing with virtual currencies in the context of preventing money laundering and terrorist financing. Ultimately, in October 2018, the FATF decided to revise its standards and, in particular, included virtual currencies and virtual currency service providers within the scope of its recommendations. For the first time, a definition was formulated of what is meant by a “virtual currency”. In addition, comprehensive guidance on risk-based implementation of these recommendations was published in June 2019<sup>15</sup>.

Against this backdrop, the European legislator also decided to include virtual currencies in its regulations for the prevention of money laundering and terrorist financing.

## REGULATION AND SUPERVISION IN AUSTRIA

The EU’s Fifth Anti-Money Laundering Directive<sup>16</sup>, which entered into force on 19 June 2018 and is to be transposed into national law by 10 January 2020, for the first time includes measures to combat money laundering and terrorist financing in virtual cur-

<sup>14</sup> The FATF is a global standard setter for combating money laundering and the financing of terrorism and proliferation of weapons of mass destruction. For further detail, see <http://www.fatf-gafi.org/>.

<sup>15</sup> FATF paper “Guidance for a Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers”.

<sup>16</sup> Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU.

rencies. It defines what legally falls under the term “virtual currency” and subjects selected virtual currency service providers to due diligence obligations aimed at preventing money laundering and terrorist financing.

In the national implementation of the Fifth Anti-Money Laundering Directive via the Austrian Financial Markets Anti-Money Laundering Act (FM-GwG; *Finanzmarkt-Geldwäschegesetz*), the group subject to these obligations was expanded even further, in accordance with the FATF recommendation: in addition to exchange platforms (virtual currencies against fiat currencies) and wallet providers, the Austrian law also includes market participants who exchange one or more virtual currencies with each other, anyone who provides transfers of virtual currencies and those who provide financial services for the issue and sale of virtual currencies. This means that these service providers will (in the future) – just as credit and financial institutions are obliged today – have to comply with the due diligence and reporting obligations in relation to AML/CFT and will also have to register with the FMA from 10 January 2020 before offering their services in Austria or from Austria.

Further information can be found on the FMA website. Registration applications are being accepted from 1 October 2019, and a fine of up to € 200 000 may be imposed for failure to register.

With the introduction of regulation and supervision of virtual currencies and relevant service providers in the context of preventing money laundering and terrorist financing, the corresponding powers have been transferred to the FMA and another important step has been taken towards regulation and supervision in the world of crypto-assets.

As outlined here, however, the FMA has already been involved as regulator and supervisor of cryptoassets at some points. Accordingly, the FMA is working to create supervisory transparency, for example, through integrated answers to supervisory questions on crypto business models via the FinTech Point of Contact, its one-stop shop for regulatory issues. Where cryptoassets are already violating the limits of supervisory law, the FMA intervenes consistently, for example by combating unauthorised business operations or sanctioning prospectus violations. In addition, the FMA actively participates in national and international committees in the further development of regulation and supervision in the crypto universe.

БАНК



# HETA, KA-FINANZ, IMMIGON – ARE THE NEW RESOLUTION TOOLS ACTUALLY ANY GOOD?

A brief overview

**T**he global financial crisis of 2007/2008 shook the financial markets all around the world, triggered a global recession and left a great many banks fearing for their future existence. Many governments had to step in and support banks with taxpayers' money or even shore them up altogether, with sovereign debt crises consequently following in some countries.

In Austria, parliament adopted a € 100 billion financial market stability package at the height of the crisis in October 2008, only a few weeks after the US investment bank Lehman Bros. had collapsed. It was only later that this was referred to as a bank rescue package. The objective was not only to give out financial aid as a preventive measure. The package also included numerous, extensive statutory and regulatory measures to help address the systemic weaknesses uncovered by the crisis, as well as other issues and challenges that individual institutions were facing. In addition, it gave the FMA additional tools to cushion the impact on the financial market and to maintain investors' confidence in the financial market in Austria. The whole package was implemented through the Financial Market Stability Act (FinStaG; *Finanzmarktstabilitätsgesetz*)<sup>1</sup>; the objective being, according to the Act's statement of reasons, to avoid serious disruptions in Austria's economy, to ensure an overall economic balance and to protect the national economy in Austria.

A couple of years later, when the mist of the crisis had lifted, the lessons had been understood – particularly in Europe – and much thought was given to how to avoid such crises in future, or at least how to manage the potential consequences better, without plunging the whole financial market into turmoil. One of the most important

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<sup>1</sup> Published in Federal Law Gazette I No. 136/2008.

**The crisis had also shown that regulatory and institutional frameworks needed to be set up to enable the removal from the market of banks that are no longer competitive, all the while preserving as many of their assets as possible.**

Lessons learned was the realisation that a separate European resolution regime was needed for banks in order to ensure that taxpayers no longer have to pick up the bill when institutions fail, with the added threat of triggering a sovereign debt crisis. The crisis had also shown that regulatory and institutional frameworks needed to be set up to enable the removal from the market of banks that are no longer competitive, all the while preserving as many of their assets as possible.

The Austrian Financial Market Authority (FMA) was given new rights and obligations, tasks and responsibilities as a result of both packages, namely the Austrian financial market stability package dedicated to immediate crisis management and the new resolution regime for banks. It has already made good use of the new tools in three cases: Hypo Alpe Adria Group, Österreichische Volksbanken AG Group and Kommunalkredit AG. And these new tools have definitely proven their worth in practice!

### THE FINANCIAL MARKET STABILITY PACKAGE AND BANK BAIL-OUTS

The financial crisis rapidly spilled over into the real economy, plunged the global economy into recession and of course also impacted on the Austrian economy. The Austrian financial sector, and banks in particular, felt the pressure most keenly in 2008/2009. The financial market stability package provided the Government with several tools to support those struggling banks at the time:

- Assumption of liability (specifically guarantees, suretyships, collateral promises) for an institution's liabilities or liabilities owed to such an institution
- Granting of loans and allocation of own funds to credit institutions
- Acquisition of shares
- Assumption of ownership rights held by institutions, in exceptional cases.

Nearly all of the major banks seized the opportunity and had the Republic of Austria subscribe to participation capital, thus raising capital with a loss-absorbing capacity, for a limited period, as a precautionary measure. However, in the case of Hypo Alpe Adria, Volksbanken AG and Kommunalkredit, this did not go far enough.

#### **HYPO ALPE-ADRIA-BANK INTERNATIONAL AG (HYPO)**

In December 2008 the Federal Government had acquired participation capital worth € 900 million in Hypo Alpe-Adria-Bank International AG (Hypo), in accordance with the FinStaG. By the end of 2009, however, the situation had deteriorated to such a massive extent that it had to fully nationalise the bank. The state had to continue subsidising the failed institution for many more years.

#### **ÖSTERREICHISCHE VOLKSBANKEN AG (ÖVAG)**

In 2009 Österreichische Volksbanken AG (ÖVAG) received € 1 billion in participation capital from the Republic of Austria within the scope of the banking package (FinStaG). As early as in 2008, Kommunalkredit AG, a subsidiary of ÖVAG and the Dexia Group, had to be nationalised. However, state participation capital was not enough to stabilise ÖVAG. In 2012 another package of measures had to be put together, in the course of which the Republic of Austria became a minority shareholder in ÖVAG with a 43% stake. In 2015 the ECB's stress testing yielded a negative result for ÖVAG, meaning that another restructuring plan had to be prepared and approved by the European Commission. ÖVAG was split up: into a wind-down entity, immigon portfolioabbau AG,

which was made up of all companies and assets not needed for the Volksbank co-operatives' future strategy, while the remainder of the institution, comprising all essential functions, was transferred to Volksbank Wien-Baden AG. This institution functions as the central organisation in the form of Volksbank Wien AG, with the Republic of Austria only holding shares in the latter (25% + 1 share).

#### **KOMMUNALKREDIT AUSTRIA AG**

Kommunalkredit Austria AG, which – as mentioned – used to be owned by ÖVAG and the Dexia Group, was transferred to the Republic of Austria in 2008 by way of a sales contract and thus nationalised. In the autumn of 2009, KA Finanz AG, the resolution institution for all problematic assets and liabilities, was spun off from Kommunalkredit Austria; it is fully owned by the Republic of Austria. This helped to sell the healthy part of the banking business as Kommunalkredit AG, thus in effect reprivatizing it, which was accomplished in 2015.

### **FROM BAIL OUT TO BAIL IN – PRIVATISING THE COSTS OF A BANK FAILURE**

At the height of the crisis in 2008 and 2009, the only support available for a systemically important Austrian credit institution requiring substantial support was from the existing legal framework and public funding – ultimately paid by the taxpayer. Insolvency law was in practice only applied to smaller banks since with financial service providers it would have eaten up their entire assets and it might also have led to massive, life-threatening collateral damage at other banks, given the degree to which so many financial players on the market are interlinked. These contagion channels are hard to identify, and were even harder to ward off under the former laws. Falling back on public funding to save a bank is a classic example of a bail out, privatising profits and socialising losses by having the state intervene in the event of a crisis.

When the financial crisis started to evolve into a sovereign debt crisis, it became more and more evident that alternative, new solutions needed to be found. A paradigm shift followed, with “bail outs” out and “bail ins” in. The thinking behind this was that it should not be the public sector that was forced to pick up the bill during the bad times. Rather, those who had enjoyed the profits during the good times should be required to bear the losses too (risk materialisation).

In 2011 the Financial Stability Board (FSB), which is based at the Bank for International Settlements (BIS), published a discussion paper<sup>2</sup> to develop a specific resolution regime for banks. Based on the paper's key attributes, the European Union (EU) developed its own resolution regime for banks, with the Bank Recovery and Resolution Directive (BRRD)<sup>3</sup>, adopted in 2014, forming the legal basis. The Directive was transposed into Austrian law by way of the Bank Recovery and Resolution Act (BaSAG; *Bankensanierungs- und Abwicklungsgesetz*)<sup>3</sup>, which entered into force on 1 January 2015.

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<sup>2</sup> *Key Attributes of Effective Resolution Regimes for Financial Institutions.*

<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 was published on 12 June 2014.*

<sup>4</sup> *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.*

This created a whole new set of tools to resolve banks, which could also expressly be used for those institutions that had already been nationalised during the financial crisis. These institutions had previously been required to continue operating under the provisions set forth in the Austrian Banking Act (BWG; *Bankwesengesetz*) – relating to, for example, own funds and regulatory capital – while at the same time having to change their business strategy to partially or fully wind down their portfolio according to a resolution or restructuring plan approved by the European Commission. This became more and more difficult as the BWG was written with going concerns in mind. When a wind-down is the institution's foremost purpose, the BWG is not flexible enough.

This is where the BaSAG comes in. It has proved to form a suitable legal basis for resolution cases, with its tools working well in practice. While it stipulates that a wind-down unit must still apply the BWG, albeit to a limited extent, the BaSAG does not, for example, require institutions to comply with the own funds requirements according to the European capital regime for active banks, the Capital Requirements Regulation (CRR)<sup>5</sup>.

## BRRD AND BASAG IN PRACTICE

HETA Asset Resolution AG (HETA) as the wind-down entity of the Hypo Alpe Adria Group was the first institution to be subjected to the BaSAG regime when resolution measures were imposed on it in March 2015, and has since been under the supervision of the FMA in its capacity as the national resolution authority.

In July 2015 immigon portfolioabbau ag (IMMIGON) emerged from a spin-off of Österreichische Volksbanken-AG (ÖVAG), which had been part-nationalised in 2012, and commenced activities with the sole purpose of realising its assets in the best possible way, followed by liquidation on the basis of a strategy and risk profile approved by the FMA, the competent resolution authority.

Following progress made in the resolution of HETA and the successful resolution of IMMIGON under private law, the final phase in the orderly resolution of the third Austrian bank, KA Finanz, was initiated in September 2017. KA Finanz is a spin-off from Kommunalkredit and was taken over by the Republic of Austria after falling into serious difficulties threatening its existence during the global financial crisis. The FMA approved the transformation of KA Finanz AG, which had previously been licensed as a bank, into a wind-down entity pursuant to the BaSAG<sup>6</sup>.

When evaluating the current status of these three wind-down entities, which are (wholly) owned by the Republic of Austria, the outcome is highly positive.

### HETA

HETA has been in the process of being successfully wound down under the BaSAG regime since 1 March 2015. Within a period of five years, € 6.0 billion of the € 7.1 billion in assets (excluding money holdings) on hand in March 2015 had been realised. By the end of 2018 the remaining assets totalled just € 1.1 billion, meaning that around 84% of all assets have been realised since the start of the resolution process.

<sup>5</sup> Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms.

<sup>6</sup> Article 162 para. 1 BaSAG.

It is expected that all assets will be sold by the end of 2020. The better than expected progress made in realising the assets is mostly due to transactions that were carried out on the market when the time was right, and not when time was pressing in insolvency proceedings. The transactions included the sale of individual properties and real estate, as well as the sale of portfolios and subsidiaries.

The effective performance in relation to the wind-down of the HETA portfolio is apparent from the cash balance at Österreichische Nationalbank (OeNB): it jumped from € 2.5 billion on 1 March 2015 to € 6.2 billion at the end of 2016, before increasing further to € 8.5 billion by 31 May 2017. Had it not been for the interim distributions made at the end of 2018, it would amount to well over € 10 billion. Owing to this favourable liquidity position, which had been achieved with the portfolio's rapid and successful wind-down, HETA was able to distribute € 8.2 billion of its realisation revenues to the creditors of eligible non-subordinated liabilities before these fell due. This means that creditors received nearly 98% of their claims prematurely, which the FMA had cut to 64.40% by administrative decision in 2017, and 73% of the claims that the FMA had cut to 86.32% in September 2019 by issuing an administrative decision in relation to the challenge procedure.

#### **IMMIGON**

IMMIGON emerged on 4 July 2015 from Österreichische Volksbanken-AG (ÖVAG), which had been part-nationalised in 2012, being split up on the basis of its closing balance sheet for 2014 along pre-defined non-core business areas. Volksbank Wien AG took over the role of central institution of the Volksbank cooperative sector while IMMIGON started operating as the wind-down entity with the sole purpose of realising the assets on the best possible terms with subsequent liquidation.

IMMIGON acted as a wind-down entity pursuant to the BaSAG<sup>7</sup>, meaning that its strategy and risk profile required approval by the FMA in the capacity of resolution authority. The whole process was supervised by the FMA and effected on the basis of a wind-down plan approved by the supervisory board and submitted to the resolution authority. Additionally, the wind-down entity had to draw up an annual liquidation report detailing the liquidation progress made compared against the wind-down plan.

Over the years IMMIGON took several steps to achieve its statutory task of winding down its portfolio. Apart from selling interests and the premature repayment of loans, this also included selling properties that were mainly located in Eastern Europe. Additionally, extensive redemption programmes were conducted for securitised liabilities issued by IMMIGON. During the wind-down period the volume of securitised liabilities was reduced from € 2.9 billion to just below € 200 million (31 December 2018).

In early 2019, IMMIGON notified the FMA in its capacity as resolution authority that it had completed its portfolio wind-down, enclosing a relevant confirmation from its auditor. The annual general meeting of IMMIGON adopted the dissolution resolution under company law on 15 May 2019.

With IMMIGON having resolved all banking activities and investment services and the liquid funds being sufficient to satisfy existing and projected future liabilities, the resolution authority issued an administrative decision<sup>8</sup> terminating IMMIGON's oper-

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<sup>7</sup> Article 162 and Article 84 para. 1 BaSAG.

<sup>8</sup> Article 84 para. 12 BaSAG.

ations as of 28 June 2019. IMMIGON ceased to be a wind-down unit pursuant to the BaSAG with this decision, and the FMA's competence also ended there. The company's liquidation is being exclusively carried out on the relevant terms in company law. IMMIGON's wind-down was much more successful than originally expected: the entity had made use of all legal means stipulated in the BaSAG and had been closely supervised throughout by the FMA, acting in the capacity of resolution authority. Its own funds and liquidity, almost exclusively invested at Oesterreichische Nationalbank, have gone up considerably. In figures: it held € 775 million in own funds, € 906 million in cash reserves and total assets of € 1.07 billion as of 31 December 2018.

#### **KA FINANZ AG**

In September 2017 the final phase in the orderly resolution of KA Finanz AG, which was a spin-off from Kommunalkredit to resolve its problematic assets, was initiated. The FMA approved the transformation of KA Finanz AG, which had previously been licensed as a bank, into a wind-down entity pursuant to the BaSAG<sup>9</sup>.

Similar to IMMIGON, the process of winding down KA Finanz AG was based on the wind-down strategy and risk profile as approved by the FMA in its capacity as the resolution authority. According to the current strategy, the wind-down process is focused on active portfolio reductions over a period of ten years (up until 31 December 2026).

Total assets of KA Finanz AG made up € 9.8 billion on 31 December 2017 and were reduced by some € 2.6 billion within the first full business year as a wind-down entity pursuant to the BaSAG. The total assets of KA Finanz AG thus came to € 7.2 billion on 31 December 2018.

On 31 December 2017 the nominal value of the portfolio (securities, loans and CDS/liabilities) of KA Finanz AG amounted to € 7.4 billion, including loans worth € 4.2 billion and securities worth € 3.1 billion.

In the period between 31 December 2017 and 31 December 2018, the nominal value of the portfolio dropped by € 1.6 billion, of which € 1.3 billion related to active reductions and € 412 million to scheduled and unscheduled repayments. At the same time, currency effects led to a small increase in the nominal values of some assets.

The FMA continues to support and supervise KA Finanz and its wind-down activities in accordance with the legal wind-down objectives.

**As has been shown with HETA, IMMIGON and KA Finanz, the new resolution regime created with the European BRRD and the Austrian BaSAG has proven to provide an effective set of tools to resolve special purpose vehicles that emerged from bank nationalisations caused by the financial crisis.**

#### **THE NEW RESOLUTION TOOLS HAVE PROVEN THEIR WORTH**

As has been shown with HETA, IMMIGON and KA Finanz, the new resolution regime created with the European BRRD and the Austrian BaSAG has proven to provide an effective set of tools to resolve special purpose vehicles that emerged from bank nationalisations caused by the financial crisis. Whilst the BWG is suitable for going concerns, many of its provisions are difficult to implement in institutions that are in the process of being liquidated or resolved, and some are even unduly excessive or not necessary. Apart from taking account of the importance of financial market stability, following the BaSAG rules allows assets to be realised without time pressure when the time is right and without the added cost of insolvency proceedings. When the

<sup>9</sup> Article 162 para. 1 BaSAG.

market presents opportunities, these can be used in a much more favourable and efficient way to the benefit of creditors. Meanwhile, the supervisory work of the FMA, acting in the capacity of resolution authority, also has a calming effect on the market.

# IMPLEMENTATION OF RESOLUTION TOOLS

based on the minimum requirement for own funds and eligible liabilities (MREL)

**One of the most important lessons learned from the financial crisis has been the need to find ways and means to remove failed banks from the market in a manner that does not undermine financial stability, and to ensure that the owners and creditors are presented with the bill, rather than the taxpayer.**

**T**he financial crisis of 2007/2008 demonstrated that insolvency is out of the question for certain credit institutions, as their sudden withdrawal from the market in the context of insolvency proceedings would jeopardise financial market stability, shake the confidence of market participants and disrupt essential functions for the real economy. Moreover, the crisis dramatically showed that rescuing banks through tax revenues can in turn trigger a sovereign debt crisis, which endangers other financial market participants and sets in motion a vicious cycle of mutually reinforcing banking and sovereign debt crises, pulling downwards in a veritable death spiral.

One of the most important lessons learned from the financial crisis has therefore been the need to find ways and means to remove failed banks from the market in a manner that does not undermine financial stability, and to ensure that the owners and creditors are presented with the bill, rather than the taxpayer.

## THE NEW EUROPEAN RESOLUTION REGIME

A separate European resolution regime for banks has been created for this purpose. Institutionally, this Single Resolution Mechanism (SRM) is formed by the Single Resolution Board (SRB) based in Brussels and the network of national resolution authorities – the FMA being the national authority for Austria. If necessary, the SRB is able to use funds from the Single Resolution Fund (SRF) for the resolution of a bank. The SRF is funded by annual contributions from banks, depending on their size and risk. While the SRB is the competent resolution authority for systemically important credit institutions with cross-border activities, the FMA is responsible for all other banks that

operate based on a licence granted by the FMA<sup>1</sup>. As the national resolution authority, the FMA has a seat and a vote in the SRB Plenary Session and cooperates actively and closely with the SRB at all levels.

The regulatory constitution of this new resolution regime consists of the Single Resolution Mechanism Regulation (SRMR), which was enacted in June 2014 as directly applicable EU law and has been in force since 1 January 2016, and the Bank Recovery and Resolution Directive (BRRD). The latter Directive was enacted in May 2014. It was implemented in Austria by the Bank Recovery and Resolution Act (BaSAG; *Bankensanierungs- und Abwicklungsgesetz*), which entered into force on 1 January 2015.

One of the premises of the resolution regime for banks is that the Austrian Insolvency Act (IO; *Insolvenzordnung*) should continue to apply for the resolution of credit institutions. Only if certain preconditions are met may the FMA, in its capacity as the national resolution authority (NRA), conduct the resolution. These requirements are laid out in Article 49 para. 1 BaSAG. The most important are:

- The default or at least the probable default of the credit institution (fail or likely to fail or FOLTF) must be established beyond reasonable doubt.
- It may not be preventable by other means within a reasonable time period.
- The resolution must be in the public interest.

Such a public interest<sup>2</sup> exists when resolution measures are necessary to achieve legally defined objectives<sup>3</sup>. These include, in particular, ensuring the continuity of critical functions or avoiding significant adverse effects on financial stability. Moreover, it must not be possible to achieve the objectives to the same extent through insolvency.

As the national resolution authority, the FMA has the following resolution tools at its disposal:

- the sale of business tool
- the bridge institution tool
- the asset separation tool
- the bail-in tool.

## **MREL – MINIMUM REQUIREMENT FOR OWN FUNDS AND ELIGIBLE LIABILITIES**

### **THE PURPOSE OF THE MREL**

In order to be able to guarantee the financing of the selected resolution tools in the event of resolution, the BRRD and SRMR stipulate that each credit institution must maintain a minimum amount of own funds and eligible liabilities (MREL) at all times at the request of the competent resolution authority.

The purpose of this MREL requirement is to ensure that sufficient own funds and bail-inable liabilities are available at all times in a potential case of resolution in order to enable implementation of the selected resolution tool. This ensures that the credit institution can absorb losses at any time by writing down own funds and bail-inable

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<sup>1</sup> The SRB is responsible for a total of eleven groups of credit institutions. For eight of those groups, the parent credit institution is domiciled in Austria: Erste, RBI, RLB OÖ, BAWAG, Volksbanken, Addiko, Sberbank (ultimate parent domiciled in a third country), Bausparkasse Wüstenrot AG. Three groups of credit institutions have subsidiaries in Austria: UniCredit Bank Austria, Crédit Agricole (FCA Bank) and Santander Consumer Bank.

<sup>2</sup> Article 49 para. 2 BaSAG.

<sup>3</sup> Enumerated in Article 48 BaSAG.

liabilities, and is able to restore its capital position by converting bail-inable liabilities into equity. In this way, the bank can continue to fulfil its critical economic functions during and after the crisis.

The MREL requirement is therefore one of the most important instruments used by the resolution authorities to improve the resolvability of credit institutions and to make recovery actually possible in crisis situations.

#### **WHICH FINANCIAL RESOURCES CAN BE INCLUDED IN THE MREL?**

The minimum amount of own funds and eligible liabilities prescribed as MREL by the resolution authority can be met by own funds or by liabilities that can be collected through the process of a bail-in<sup>4</sup>, i.e. creditor participation in the event of a resolution. The bail-inable liabilities must, however, meet additional requirements for MREL eligibility, which are set forth in Article 100 paras. 2 and 3 BaSAG.

The criteria under Article 86 para. 2 BaSAG qualifying a liability as bail-inable are exclusion criteria. In principle, all liabilities of an institution are bail-inable unless they are:

- Secured deposits
- Secured liabilities (secured by the institution; no collateral provided by third parties)
- Liabilities from holding client funds and client assets in custody (e.g. through undertakings for collective investment in transferable securities – UCITS, alternative investment funds – AIFs), but only where there is a preferential right or right of separation
- Liabilities from trusts
- Liabilities to credit institutions, central securities depositories, securities settlement systems with a maturity of less than seven days
- Liabilities to employees (bonuses excluded), trade payables, liabilities from contributions payable to deposit guarantee schemes.

However, such bail-inable liabilities are only eligible as MREL if they also meet the following criteria (Article 100 para. 2 BaSAG):

- The liability is fully paid in
- The liability does not relate to the institution itself, nor is it secured by the institution
- The liability was neither directly nor indirectly financed by the institution
- The liability has a remaining term of at least one year
- The liability does not relate to derivatives
- The liability does not arise from deposits with a preferential position in insolvency proceedings (unsecured deposits of natural persons and small and medium-sized enterprises).

Since the requirements for the eligibility of a liability for MREL are higher than those for bail-in eligibility alone, credit institutions generally have more bail-inable liabilities than MREL-eligible liabilities.

#### **DETERMINATION OF MREL**

As a new regulatory indicator, all credit institutions are required to comply with the

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<sup>4</sup> Pursuant to Article 86 BaSAG.

MREL. Each must have an MREL at individual level<sup>5</sup>, and parent institutions<sup>6</sup> must have an MREL at consolidated level.

The European resolution authority SRB determines the MREL for systemically important and cross-border credit institutions. At present, eleven Austrian groups of credit institutions fall within its area of responsibility. In its capacity as the national resolution authority, the FMA determines the MREL for the other credit institutions holding a licence to operate in Austria. In 2019, 432 credit institutions were under the direct responsibility of the FMA.

The MREL is expressed as a percentage of the total liabilities and own funds of the credit institution.

The national resolution authority may also require the credit institution to hold parts of the MREL in subordinated liabilities (subordination requirement).<sup>7</sup> The structure of the MREL subject to the subordination requirement depends on whether the composition of senior unsecured liabilities creates a risk that a creditor will exit the resolution in a worse position than under the alternative of insolvency (“no creditor worse off” principle). In such cases, insolvency proceedings would be favoured over bank resolution. This also applies in the event that senior unsecured financial instruments can only be valued with a high expenditure of time and resources (e.g. derivatives).

Subordination is thus an instrument for improving resolvability in order to remove barriers to resolution and ensure effective implementation of the chosen strategy.

The amount of the MREL for a credit institution is fundamentally dependent on the preferred strategy selected in the course of resolution planning.

There are two basic resolution strategies – a financial resolution strategy and a structural reorganisation strategy:

- In the case of **financial resolution**, the loss absorption and subsequent recapitalisation of the institution takes place exclusively through the reduction of liabilities and/or conversion of liabilities into equity (bail-in). If only the bail-in tool is used to restructure the bank, this is referred to as open bank bail-in. This is a possible resolution strategy especially when the future viability of the institution and the sustainability of the bank’s business model is reasonably deemed to be restorable by means of a recapitalisation combined with a subsequent reorganisation plan. Under this strategy, the institution’s legal and operational structures remain unchanged.
- The **structural reorganisation strategy** involves adapting the credit institution’s business model and/or operating model. This is particularly appropriate when the continuation of critical functions cannot be ensured within a bank’s existing structures. The structural reorganisation strategy takes advantage of the bank’s financial, legal and operational set-up by using various resolution tools (bridge bank, sale of business, asset separation) to achieve adequate capitalisation and viability for the restructured (then usually smaller) institution. The resolution measures aimed at structural reorganisation can also be combined with the bail-in tool.

Depending on the resolution strategy chosen, the level of the MREL must in particular ensure<sup>8</sup> that losses can be absorbed and that the credit institution can be recapitalised in such a way that the legal requirements are met and that the measures are

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<sup>5</sup> Pursuant to Article 100 para. 1 BaSAG.

<sup>6</sup> Pursuant to Article 101 BaSAG (for SRB see Article 12 SRMR).

<sup>7</sup> Pursuant to Article 104 BaSAG.

<sup>8</sup> Pursuant to Article 100 para. 4 no. 2 BaSAG.

sufficient to restore market confidence. The MREL is therefore composed of the loss absorption amount (LAA) and the recapitalisation amount (RCA):

- **LAA:** Under current legislation, the loss absorption amount corresponds to the credit institution's own funds requirements (including Pillar 2 and the combined buffer requirement), although the resolution authority may adjust this amount on a case-by-case basis and in close cooperation with the supervisory authority. The post-resolution components of a credit institution's capital requirements are initially equal to the LAA. They relate only to those parts of the business that are expected to continue engaging in banking activities after resolution.
- **RCA:** The recapitalisation amount may be adjusted in accordance with the resolution strategy selected for the credit institution. In addition, the resolution authority must determine an additional amount to ensure that market confidence is maintained post resolution.

For institutions for which the preferred resolution strategy is a structural reorganisation (transfer strategy) in the form of a sale of business or partial transfer to a bridge institution, the MREL requirement will generally be lower since a complete recapitalisation of the institution would not be necessary in most cases.

In addition, the resolution authority must take the following criteria<sup>9</sup> into account when determining the amount of MREL: size, business model, refinancing model and risk profile of the credit institution. This implies, for example, that the credit institution's access to the capital market must also be considered. In all cases, the principle of proportionality must also be applied when determining the MREL.

Moreover, the resolution authority may, if necessary, define individual and appropriate transitional periods for the establishment of the MRELS.

#### IMPOSITION OF THE MREL

The FMA's analyses within the framework of resolution planning have shown that insolvency proceedings appear feasible and credible for the majority of Austrian credit institutions in a default scenario. This means that the use of resolution tools is considered unnecessary for these banks. In the absence of a planned resolution, the MREL for these credit institutions will be set only at the level of existing own funds and buffer requirements as loss absorption amount (LAA). The institutions concerned have already been informed in writing by the FMA about the key content of their current resolution plans and about the amount of MREL to be maintained.

For 16 of the largest credit institutions falling under the competence of the FMA as the national resolution authority, the use of resolution tools is considered probable in a default scenario. In the second quarter of 2019, notifications were issued requiring them for the first time to hold MREL in excess of the LAA. Thus, more than 90% of all credit institutions for which the resolution regime falls under the direct responsibility of the FMA have already been informed of their current MREL requirements.

In the area of responsibility of the SRB at European level, MREL was set for two Austrian groups of credit institutions in 2019 by means of an implementation decision from the FMA, in its capacity as the competent national resolution authority, on the basis of SRB decisions. For the other Austrian banking groups within the SRB's area of responsibility, the MREL requirements will be issued at the beginning of 2020.

**The FMA's analyses within the framework of resolution planning have shown that insolvency proceedings appear feasible and credible for the majority of Austrian credit institutions in a default scenario. This means that the use of resolution tools is considered unnecessary for these banks.**

<sup>9</sup> Article 100 para. 4 BaSAG.

Resolution plans must be reviewed and adjusted on an ongoing basis. Accordingly, the resolution authorities will also continuously adjust the MREL requirements, taking into account the principle of proportionality, to the changing circumstances of the banks and the financial market. In particular, subordination requirements must also be examined in order to ensure the resolvability of the credit institutions concerned. Above all, however, it must be ensured that the banks hold the currently prescribed minimum amount of own funds and eligible liabilities at all times.

## **SUPERVISION OF SALES OF BAIL-INABLE FINANCIAL INSTRUMENTS**

In its capacity as an integrated supervisory authority, the FMA observes, analyses and monitors the development of own funds and bail-inable liabilities from all perspectives of the financial market. In addition to considering the requirements in the event of bank resolution, these perspectives include the prudential supervision of the active bank, where the FMA monitors the effects of MREL on operational business, or the supervision of other sectors such as insurance, *Pensionskassen*, investment firms or investment funds, where it observes cross-institutional holdings of equity instruments and eligible liabilities, analyses linkages and identifies possible contagion channels. The FMA also attaches particular importance to the perspective of consumer protection, where it focuses on ensuring that mis-selling is prevented in the sale of MREL instruments. This refers to the selling of such financial instruments to clients for whom – or for whose needs – they are not suitable.

Mis-selling can occur in different ways:

- By not adequately explaining the product and/or by not presenting the opportunities and risks fairly and transparently at the time of sale
- By not managing and/or disclosing conflicts of interest – in particular in the case of self-placement by the bank
- By not sufficiently ascertaining whether the product is suitable for the investor in general and for the individual investment purpose in particular (suitability and appropriateness assessment)
- By offering such a financial instrument to retail investors although its complexity and/or risk content makes it unsuitable for this target group.

And these are only the most important examples of mis-selling.

In regulatory terms, the risks that may arise for investors from the sale of MREL-eligible financial instruments are addressed, in particular, by the EU's Markets in Financial Instruments Directive (MiFID II). There are also the regulatory requirements on customer information for self-placements of bail-inable financial instruments<sup>10</sup>, on product governance<sup>11</sup> and on managing conflicts of interest<sup>12</sup>.

In 2018 and 2019, the FMA focused on compliance with these regulatory requirements in the sale of bail-inable financial instruments as part of its supervision of the conduct of banks (particularly in the context of self-placement) and their distribution partners (investment firms and other financial service providers).

In its capacity as an integrated supervisory authority over the entire Austrian financial market, the FMA thus contributes in no small way to ensuring that banks facing eco-

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<sup>10</sup> Article 48 of Commission Delegated Regulation (EU) 2017/565.

<sup>11</sup> Articles 30 et seq. of the Securities Supervision Act 2018 – WAG 2018; Wertpapieraufsichtsgesetz.

<sup>12</sup> Article 41 of Commission Delegated Regulation (EU) 2017/565.

conomic difficulties but that are fundamentally viable can be restructured and reorganised, that banks that are no longer competitive can be removed from the market in an orderly manner and that the stability of the financial market and the confidence of market participants are preserved, and savers, investors and consumers are protected to the fullest possible extent.





# THE RESPONSIBILITY OF LEGAL PERSONS IN RECENT COURT RULINGS

**A**

ny person who exercises rights must also fulfil their obligations. And any person who does not fulfil such obligations will be held responsible. This simple rule should apply to both natural and legal persons.

However, based on the principle “only those who act culpably can be punished”, legal persons have long been protected from punishment. This principle is based on the understanding that every criminal offence involves a human act.

Since legal persons are not themselves capable of carrying out a human act, they cannot be held criminally responsible. Legal persons can only guarantee the fulfilment of their obligations through a natural person. Accordingly, Article 9 of the Administrative Penal Act (VStG; *Verwaltungsstrafgesetz*) stipulates that responsibility under penal law for a legal person’s compliance with administrative rules rests with that legal person’s regular representative or special responsible representative appointed by them. The criminal liability of these persons responsible pursuant to Article 9 VStG (also referred to hereinafter as “natural persons responsible”) is based either on the fact that they themselves committed the administrative penal offence or that they have not taken sufficient precautions to prevent the administrative penal offence being committed by persons acting for the legal person.

## A NEW MODEL FOR THE RESPONSIBILITY OF LEGAL PERSONS

To date, the concept of criminal liability in administrative penal law has only applied to natural persons. However, as a result of European Union law<sup>1</sup>, the responsibility of

<sup>1</sup> Compare for example Article 66(2)(c) and Article 67(2)(e) of Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, OJ L 176, 27.6.2013, p. 338; implemented in Austria by way of Article 99d BWG.

**According to Article 99d, a legal person's responsibility is created by making that person accountable for the conduct of certain natural persons. These "attribution persons" are persons who have a specific leading position within the legal person concerned.**

legal persons has been incorporated into some of the material laws to be enforced by the FMA.

Article 9 VStG stipulates that where a legal person fails to comply with an obligation that it is required to meet, this will result in punishment of the natural person responsible for fulfilment of the obligation. This provision does not comply with EU rules. Austrian lawmakers were therefore forced to make provision for the punishment of legal persons in order to implement the relevant provisions of Union law.

This was achieved by the addition of Article 99d to the Austrian Banking Act (BWG; *Bankwesengesetz*). Accordingly, a legal person's responsibility is created by making that person accountable for the conduct of certain natural persons. These "attribution persons" (also referred to as "management persons" by the Administrative Court – VwGH) are persons who have a specific leading position within the legal person concerned. Such persons will either have breached a BWG obligation themselves or, through a lack of monitoring or control, have made possible such breaches by a person acting for the legal person.

Based on European law requirements, provisions similar to those in Article 99d BWG have also been added to other supervisory laws such as the Financial Markets Anti-Money Laundering Act (FM-GwG; *Finanzmarkt-Geldwäschegesetz*)<sup>2</sup>, the Securities Supervision Act 2018 (WAG 2018; *Wertpapieraufsichtsgesetz*)<sup>3</sup> and the Stock Exchange Act (BörseG; *Börsegesetz*)<sup>4</sup>. All of these provisions define hefty fines for legal persons amounting to up to 15% of their total annual (net) turnover or up to three times the amount of the benefit derived from the breach, where the benefit can be quantified.

### THE FMA'S ADMINISTRATIVE PRACTICE

Legal persons can now be held responsible in the same way as natural persons. The above-mentioned supervisory laws authorise the FMA to prosecute legal persons, while not obliging it to do so. Conversely, the FMA may refrain from punishing the natural person responsible when an administrative penalty has been imposed on the legal person for the same breach, provided that there are no particular circumstances that would preclude the option of refraining from punishing the natural person.<sup>5</sup>

This gives the FMA some discretion in prosecuting natural persons responsible, resulting in the principle of legality, already having been softened<sup>6</sup>, being superseded in this area by the principle of opportunity<sup>7</sup>.

The FMA makes regular use of this discretionary power by primarily taking action against the target of the breached obligations, i.e. the legal person. In this way, the FMA prevents companies from flouting supervisory rules to gain a competitive edge over their competitors with illegal conduct, a practice that runs contrary to the aim of achieving a level playing field for all companies supervised by the FMA.

<sup>2</sup> Cf. Article 35 of FM-GwG.

<sup>3</sup> Cf. Article 96 of WAG 2018.

<sup>4</sup> Cf. Articles 108, 142 and 156 of BörseG 2018.

<sup>5</sup> See Article 22 para. 6 no. 2 of the Financial Market Authority Act (FMABG; *Finanzmarktaufsichtsbehörden-gesetz*) (cf. also Article 99d para. 5 of the former version of the BWG).

<sup>6</sup> Pursuant to Article 22 para. 6 no. 1 FMABG, the FMA may refrain from imposing a fine on a natural or legal person or both where the breach is not significant.

<sup>7</sup> Pursuant to Article 25 para. 1 VStG, administrative offences must be prosecuted *ex officio*, except in the cases referred to in Article 56 VStG (matters of private prosecution).

## FIVE YEARS OF LEGAL PERSONS' RESPONSIBILITY

The option of holding legal persons responsible marked the start of a new era in administrative penal law. This new model for the responsibility of legal persons raises a number of legal issues. Five years after Article 99d BWG entered into force and other related provisions in various supervisory laws have been introduced, the supreme courts are still looking into questions related to legal persons' responsibility. Some of these questions are listed here, and the legal interpretations explained in brief.

### **Are administrative authorities actually allowed to impose such high fines?**

Article 99d BWG specifies a sanction to be imposed by the FMA. Given that this sanction is not defined as an administrative penalty, considering the amount of the threatened fine, and that it therefore ought not to have been imposed by an administrative authority, the provision was considered unconstitutional and the Federal Administrative Court (BVwG) initiated a law review procedure with the Constitutional Court (VfGH).

The VfGH did not share the BVwG's assumption. In its decision of 13 December 2017<sup>8</sup>, the VfGH departed from its former rulings and found that the constitution<sup>9</sup> does not oblige the legislator to transfer proceedings against breaches of Article 99d para. 3 BWG to the competence of ordinary (criminal) courts owing to the severe punishment laid down in the Article. The VfGH reasoned that drawing a line between judicial criminal law and administrative criminal law on the basis of the extent of a punishment no longer gives adequate consideration to the variety of possible facts of cases, and explicated as follows:

- First, it does not make sense to base a definition of competence solely on the criterion of the threatened punishment; this applies both within criminal jurisdiction and to making a distinction between judicial criminal law and administrative criminal law.
- Second, basing the allocation to one of the two areas of enforcement solely on the upper limit for the threatened fine, as specified by the legislator for the respective offence, does not consider the different functions of fines in judicial and administrative criminal law, or the consequences of their imposition.
- Third, using the upper limit of a fine threatened for an offence as a schematic way of distinguishing between judicial criminal law and administrative criminal law cannot capture the differences between legal and natural persons or between affluent and less affluent persons, thus only allowing an inadequate verdict on the "severity" of a punishment.
- Fourth, in its previous rulings the VfGH had not sufficiently considered the political objectives connected with the legislator's allocation, particularly the objectives of stigmatisation and decriminalisation.

The VfGH also points out in its statement of reasons that, as a result of first-instance administrative jurisdiction having been introduced, the whole legal structure of the federal constitution had been fundamentally changed, and that judges of first-instance administrative courts enjoy the same judicial safeguards as ordinary judges.

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<sup>8</sup> VfGH, 13 December 2017, G 408/2016, Point IV.

<sup>9</sup> Cf. Article 91 of the Federal Constitutional Act (B-VG; Bundes-Verfassungsgesetz).

The FMA, in its capacity as administrative authority, is therefore allowed to impose such high fines as laid down in Article 99d para. 3 BWG.

**Does the person to whom conduct has been attributed have to be punished with final and binding effect before the legal person can be punished?**

In its decision of 25 June 2018<sup>10</sup>, the BVwG presented its view that sanctioning legal persons pursuant to Article 99d BWG presupposes a two-stage process: the natural person must first be found guilty for the offence with final and binding effect before, in a second stage, a fine may be imposed on the legal person in accordance with Article 99d BWG.

In its decision of 29 March 2019<sup>11</sup>, the VwGH strongly opposed this opinion, explaining that proceedings against the natural person do not have to be conducted and completed first, and also that no guilty verdict is required in order to also punish the legal person. Moreover, the VwGH stated that it was of no consequence whether administrative penal proceedings were – also – conducted against a natural person or, if so, against which natural person.

**What are the legal consequences of prosecuting a legal person?**

In its decision of 29 March 2019<sup>12</sup>, which has already been mentioned above, the VwGH pointed out another aspect that had not been asserted before – neither in proceedings before the FMA conducted against legal persons nor in any of the subsequent appeals brought before the BVwG:

*“Since the legal person cannot act themselves, their criminal liability pursuant to Article 99d BWG can only be the result of illegal and culpable conduct by a management person that constitutes an offence. Accordingly, in order for acts of prosecution against the legal person to be effective, the offence committed by the natural person must be described in detail. An act of prosecution as set forth in Articles 31 and 32 VStG must be founded on a certain administrative offence, which means that it must refer to all facts of the case on which a subsequent punishment is based. When an accusation is directed towards the legal person, this also includes an accusation directed towards the natural person named, since a legal person’s criminal liability is dependent on an infringement committed by the natural person attributed to them.*

*Where a management person who has been mentioned by name, or who can be definitely determined according to otherwise given individual criteria, is accused of one of the mentioned offences in the course of an act of prosecution against the legal person, and where that management person is considered for punishment (which, pursuant to the provisions referred to in Article 99d BWG, [only] applies to persons responsible pursuant to Article 9 VStG), the person responsible pursuant to Article 9 VStG is suspected of that administrative offence, which means that from that time onwards the person is deemed to be a defendant pursuant to Article 32 para. 1 VStG, particularly since the official act does not have to be addressed to the suspect.”*

These VwGH rulings led to the FMA initiating numerous proceedings against natural persons responsible through requests for justification addressed to legal persons. The

<sup>10</sup> See BVwG, 25 June 2018, W210 2138108-1.

<sup>11</sup> See VwGH, 29 March 2019, Ro 2018/02/0023.

<sup>12</sup> See VwGH, 29 March 2019, Ro 2018/02/0023.

FMA is therefore now faced with the question of whether<sup>13</sup>, and possibly at which stage of the proceedings against a legal person<sup>14</sup>, it may refrain from punishing the natural person responsible.

The FMA decided to discontinue proceedings against the natural person responsible, even though proceedings against the legal person were still pending before the BVwG. The BVwG rulings on the admissibility of such discontinuations<sup>15</sup> are inconsistent. Presumably, the VwGH will therefore deal with this question in the near future.

### **Is it mandatory to hear the natural person in proceedings against the legal person?**

According to the mentioned VwGH decision of 29 March 2019<sup>16</sup>, a natural person responsible is deemed a defendant<sup>17</sup> from the time an act of prosecution against the legal person has been carried out. The VwGH states that, for the person responsible, the status as defendant means that they not only have to be treated as a defendant in any cases brought against them but also in proceedings against the legal person; their rights as parties would not be guaranteed otherwise.

Interpretations of this VwGH statement also vary. In the FMA's opinion, it must only hear the natural person responsible in proceedings against the legal person if it considers such a hearing necessary or if the legal person requests it. In this case, the natural person responsible is to be questioned as a defendant, and consequently does not have to answer questions.<sup>18</sup>

This view of the FMA is shared by one BVwG senate<sup>19</sup>. Other BVwG senates argue that where the rights of natural persons are not safeguarded, this also means that the rights of the legal person are not safeguarded; therefore, the natural person's rights as a defendant must also be safeguarded in proceedings against the legal person. In two cases<sup>20</sup> the senate of decision ruled that not hearing the natural person responsible constituted a procedural flaw. However, since the FMA discontinued the proceedings against the natural person responsible later on, this cannot be corrected. In another case<sup>21</sup> the senate of decision ruled that the flaw of not hearing the natural person responsible had been corrected since the Authority questioned them during the oral proceedings.

### **Can the legal person only be attributed the conduct of a person responsible as defined in Article 9 VStG?**

The following passage from the VwGH's decision of 29 March 2019, already cited on page 150, caused diverging views in other respects too:<sup>22</sup>

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<sup>13</sup> Pursuant to Article 22 para. 6 no. 2 FMABG, the FMA may refrain from imposing a fine where "no particular circumstances exist that prevent the possibility of refraining from imposing a fine."

<sup>14</sup> Pursuant to Article 22 para. 6 no. 2 FMABG, the FMA may refrain from imposing a fine "when an administrative penalty has already been imposed on the legal person for the same breach."

<sup>15</sup> For rulings in favour of admissibility, see BVwG, 24 June 2019, W158 2173890-1 and 4 September 2019, W158 2197393-1 and, for those in favour of inadmissibility, see BVwG, 30 July 2019, W210 2162676-1 and 12 August 2019, W210 2138108-1.

<sup>16</sup> See VwGH, 29 March 2019, Ro 2018/02/0023.

<sup>17</sup> Pursuant to Article 32 para. 1 VStG, a person suspected of having committed an administrative offence is a defendant starting from the date of the first act of prosecution by the authority until the criminal case is concluded.

<sup>18</sup> Pursuant to Article 33 para. 2 VStG, the defendant must be instructed about their right to express their opinion or to remain silent.

<sup>19</sup> See BVwG, 5 July 2019, W230 2195157-1.

<sup>20</sup> See BVwG, 24 June 2019, W158 2173890-1 and 4 September 2019, W158 2197393-1.

<sup>21</sup> See BVwG, 30 July 2019, W210 2162676-1.

<sup>22</sup> See VwGH, 29 March 2019, Ro 2018/02/0023.

**The FMA is now faced with the question of whether, and possibly at which stage of the proceedings against a legal person, it may refrain from punishing the natural person responsible. The BVwG rulings on the admissibility of discontinuations are inconsistent. Presumably, the VwGH will deal with this question in the near future.**

*“Where a management person who has been mentioned by name, or who can be definitely determined according to otherwise given individual criteria, is accused of one of the mentioned offences in the course of an act of prosecution against the legal person, and where that management person is considered for punishment (which, pursuant to the provisions referred to in Article 99d BWG, [only] applies to persons responsible pursuant to Article 9 VStG), the person responsible pursuant to Article 9 VStG is suspected of that administrative offence, which means that from that time onwards the person is deemed to be a defendant pursuant to Article 32 para. 1 VStG, particularly since the official act does not have to be addressed to the suspect.”*

Individual BVwG senates<sup>23</sup> concluded from this – in contrast to the views shared by the FMA and another BVwG senate<sup>24</sup> – that attribution of a criminal offence to a legal person can only be effected through persons responsible as referred to in Article 9 VStG. This issue has also been lodged with the VwGH. The court’s decision is still pending.

## OUTLOOK

The issues raised here in relation to the responsibility of the legal person, which could only be partly resolved, make up just a small part of the grey areas found in the relatively new model for the responsibility of legal persons. While the VwGH’s decision of 29 March 2019 shed light on some areas, it has also raised new questions. It will take some time for all of the outstanding issues to be clarified.

The FMA will meanwhile continue to adhere to its strategy of making use of the principle of opportunity in as many cases as possible, i.e. of only prosecuting serious breaches and holding the legal person responsible for them. It will as a rule refrain from punishing the natural person, unless particular circumstances require it.

Upcoming VwGH decisions will show whether the FMA can continue with this approach.

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<sup>23</sup> See BVwG, 24 June 2019, W158 2173890-1 and 4 September 2019, W158 2197393-1 as well as BVwG, 30 July 2019, W210 2162676-1, 12 August 2019, W210 2138108.1, 13 August 2019, W210 2194720.

<sup>24</sup> See BVwG, 5 July 2019, W230 2195157-1.

# LEGAL DEVELOPMENTS

Major changes in national, European and international laws

**E**uropean and national financial market law is constantly evolving, requiring existing laws to be regularly analysed and examined to determine whether their objectives have actually been achieved with implementation and whether this achievement has been efficient and effective too. Then there is the need to keep up with technical innovation in the financial industry, particularly the current challenges posed by the pace of digitalisation. And finally, investor and consumer protection also features highly on the legal agenda, while strict transparency requirements are needed for the development of modern and efficient markets.

In Europe there is a clear trend towards directly applicable EU law in order to avoid any erosion of the intended harmonisation when European regulations are transposed into national law. Another trend is that European lawmakers are increasingly adopting framework directives, which the European supervisory authorities (EBA, ESMA, EIOPA)<sup>1</sup> subsequently convert into regulatory technical standards that are binding on market participants. Yet administrative penal law, criminal law and enforcement continue to be handled nationally to a large extent, albeit with a trend towards a greater alignment of penalties throughout Europe, particularly through the stipulation of low maximum penalties.

As the Austrian economy is predominantly based on small and medium-sized companies, the Austrian Financial Market Authority (FMA) advocates the principles of subsidiarity and proportionality in developing the European framework for regulation and supervision in order to ensure that the proven diversity on the Austrian market, with a structure that has evolved historically and is appropriate to the country's real economy, can be maintained.

**In Europe there is a clear trend towards directly applicable EU law in order to avoid any erosion of the intended harmonisation when European regulations are transposed into national law.**

<sup>1</sup> The European Banking Authority (EBA), the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA).

The following section provides a summary of the major changes to the legislation within the FMA's scope of enforcement.

## NATIONAL LEGISLATION

### AMENDMENTS TO EXISTING LAWS DURING THE REPORTING PERIOD

**Act on the Demerger of Cooperative Societies (GenSpaltG; *Genossenschaftsspaltungsgesetz*) and amendments to the Act on Audits of Cooperative Societies 1997 (GenRevG 1997; *Genossenschaftsrevisionsgesetz*), the Act amending the Law on Audits of Cooperative Societies 1997 (GenRevRÄG 1997; *Genossenschaftsrevisionsrechtsänderungsgesetz*), the Cooperative Societies Act (GenG; *Genossenschaftsgesetz*) and others, Federal Law Gazette I No. 69/2018**

The GenSpaltG enables cooperative societies to transfer their assets or single items of those assets by way of universal legal succession to one or more cooperative societies already in existence. Cooperative societies may also spin off parts of their assets to an existing subsidiary. In terms of content, the GenSpaltG follows the model of the Federal Act on the Demerger of Joint Stock Companies (SpaltG; *Spaltungsgesetz*).

The GenRevG 1997 provides for the transformation of auditing associations that are organised in accordance with the Associations Act (VerG; *Vereinsgesetz*) into cooperative societies whilst preserving their legal identities. If a credit institution leaves an auditing association – for instance if an auditing association is transformed into a cooperative society – the most recently appointed auditor will remain the bank examiner under the new law until a new one is appointed. This ensures a bank examiner is available at all times. The GenSpaltG as well as the amendments to the GenRevG 1997 entered into force on 1 January 2019.

**STS Securitisation Enforcement Act (STS-VVG; *STS-Verbriefungsvollzugsgesetz*) as well as amendments to the Financial Market Authority Act (FMABG; *Finanzmarktaufsichtsbehördengesetz*), the Investment Fund Act 2011 (InvFG 2011; *Investmentfondsgesetz*), the Alternative Investment Fund Managers Act (AIFMG; *Alternatives Investmentfonds Manager-Gesetz*), the Insurance Supervision Act 2016 (VAG 2016; *Versicherungsaufsichtsgesetz*), the Stock Corporation Act (AktG; *Aktiengesetz*), the Real Estate Investment Fund Act (ImmoInvFG; *Immobilien-Investmentfondsgesetz*) and the Banking Act (BWG; *Bankwesengesetz*), Federal Law Gazette I No. 76/2018**

Regulation (EU) 2017/2402, the STS Regulation, is aimed at harmonising the highly fragmented securitisation market. It creates a quality label for simple, transparent and standardised (STS) securitisations. The STS-VVG introduces the provisions that are required to make the STS Regulation effective in Austria. In particular, this includes naming the FMA as the competent authority and specifying its supervisory and monitoring powers in this area. Additionally, the STS-VVG clarifies that corporate provision funds are to be regarded as institutional investors within the meaning of the STS Regulation and are therefore subject to the FMA's supervision. The AktG was amended to expand the potential uses of bearer shares. Bearer shares may in future also be issued through a multilateral trading facility (MTF) or when the articles of association include the intention of trading via an MTF.

The amendments entered into force on 1 January 2019.

**Amendment to the *Pensionskassen Act (PKG; Pensionskassengesetz)*, Federal Law Gazette I No. 81/2018**

This PKG amendment transposes Directive (EU) 2016/2341 on the activities and supervision of institutions for occupational retirement provision (IORP II Directive). The IORP II Directive lays down new governance requirements as well as information obligations and facilitates cross-border activities. The major changes to the PKG concern the following points:

- Rules governing the cross-border transfer of pension schemes
- General governance requirements, remuneration policy and the transfer of duties to third parties
- Designation of key functions, requirements for fit and proper managers and key function holders, as well as rules and obligations to be met by holders of key functions
- Expansion of risk management to also cover the balance sheet of the *Pensionskasse* itself, in addition to the assets allocated to investment and risk sharing groups which had been already included
- Expansion of the custodian bank's area of responsibility to include assets that cannot be held in custody
- Adjustment of the *Pensionskasse's* information requirements towards its beneficiaries in line with the additional provisions contained in the IORP II Directive
- Adjustment of the FMA's rights and obligations in line with the rules in the IORP II Directive.

In addition, further adjustments have been made to accommodate common practice:

- Actuarial requirements in relation to the business plan and the determined interest rates (new business plan structure in line with common practice)
- Transmission of data in connection with the *Pensionskasse's* annual accounts (clarification that the management report needs to be submitted to the FMA too) as well as the quarterly report (new version as of March 2019) of the assets allocated to an investment and risk sharing group
- Adjustments to the investment of assets allocated to the investment and risk sharing group.

The amendments entered into force on 1 January 2019.

**Amendment to the E-Government Act (E-GovG; *E-Government-Gesetz*), the ICT Consolidation Act (IKTKonG; *IKT-Konsolidierungsgesetz*), the Signature and Trust Services Act (SVG; *Signatur- und Vertrauensdienstegesetz*), the Business Service Portal Act (USPG; *Unternehmensserviceportalgesetz*), the Federal Law Gazette Act (BGBlG; *Bundesgesetzblattgesetz*), the Process of Service Act (ZustG; *Zustellgesetz*) and others, Federal Law Gazette I No. 104/2018**

The amendments to the ZustG enable authorities to serve most official letters by electronic means, thereby generating savings.

In 2017, a display module had already been introduced to the ZustG through Federal Law Gazette I No. 40/2017, providing recipients with a uniform overview of all electronic documents kept for them. This module displays documents served by way of delivery systems listed in the ZustG (electronic delivery services, official communication systems of authorities) as well as those from systems used in accordance with other procedural laws (e-justice pursuant to the Court Organisation Act – GOG;

*Gerichtsorganisationsgesetz*, FinanzOnline portal pursuant to the Federal Tax Code – BAO; *Bundesabgabenordnung*). The Federal Ministry for Digital and Economic Affairs is setting up a joint directory (for all systems) which senders may use, irrespective of their delivery system, to address recipients.

The amendment is being introduced on a staggered basis between 28 December 2018 and 1 December 2019.

**Network and Information System Security Act (NISG; *Netz- und Informationssystem-sicherheitsgesetz*) and amendment to the Telecommunications Act 2003 (TKG 2003; *Telekommunikationsgesetz*), Federal Law Gazette I No. 111/2018**

The NISG implements Directive (EU) 2016/1148 concerning measures for a high common level of security of network and information systems across the Union (NIS Directive) in Austria. The NISG obliges operators of essential services from various sectors to take appropriate security measures and to report significant disruptive effects to computer emergency response teams (CERT).

Annex II of the NIS Directive lists banking (credit institutions) and financial market infrastructures (operators of trading venues, central counterparties) as essential services in the financial market context. Article 1(7) specifies that sector-specific Union legal acts take precedence over security requirements or reporting obligations for digital service providers or operators of essential services as defined in the NIS Directive, provided that such requirements are at least equivalent in terms of their effect to the obligations laid down in the Directive. This rule has been implemented in Austria in Article 20 NISG. The FMA is obliged to report any major operational or security incidents in accordance with Article 86 para. 1 of the Payment Services Act 2018 (ZaDiG 2018; *Zahlungsdienstegesetz*) at payment service providers that had been classed as operators of essential services to the Federal Minister of the Interior without delay.

The NISG entered into force on 29 December 2018. The NISG provisions are set forth in greater detail in the Network and Information System Security Regulation (NISV; *Netz- und Informationssystem-sicherheitsverordnung*), published in Federal Law Gazette II No. 162/2019.

**Insurance Mediation Amendment 2018 (*Versicherungsvermittlungsnovelle*), Federal Law Gazette I No. 112/2018**

The Insurance Mediation Amendment changes the Trade Act 1994 (GewO 1994; *Gewerbeordnung*), the BWG, the FMABG, the Brokers' Act (MaklerG; *Maklergesetz*) and the VAG 2016.

The amendment implements Directive (EU) 2016/97 on insurance distribution as well as Directive (EU) 2018/411 and adapts the GewO to Regulation (EU) No 1286/2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs).

These Directives lay down the rules for the distribution of insurance contracts (including PRIIPs), particularly also via the Internet. The amendment introduces changes in relation to insurance distribution via independent insurance intermediaries, specifically insurance agents, insurance brokers, commercial investment advisors, credit institutions and ancillary insurance intermediaries. General provisions contained in the Directives relating to mandatory continuing professional development, international activities, collaboration with authorities and penalties have been added to

the GewO 1994. The new Article 335a GewO 1994 requires the district administration authority to monitor insurance intermediaries' compliance with the PRIIPs Regulation.

The amended Article 21 para. 2 no. 3 FMABG enables mutual cooperation among the Federal Minister for Digital and Economic Affairs, the district administration authority and the FMA, not only with respect to the supervision of insurance intermediaries but also that of credit and securities brokers. Changes in the BWG ensure that the FMA is vested with exclusive responsibility for the overall supervision (introduction of measures, on-site inspections and administrative penalties) of credit institutions' insurance mediation activities. Following these changes, the FMA may now carry out on-site inspections and impose administrative penalties in connection with credit institutions' insurance activities. Rules of conduct, non-compliance with which is subject to administrative penalties, are now no longer laid down in the GewO 1994; instead they are included in specific rules of professional conduct for insurance intermediaries, which are to be issued by regulation.

The amendment entered into force on 29 December 2018.

### **Brexit Supplementary Act 2019 (BreBeG 2019; *Brexit-Begleitgesetz*), Federal Law Gazette I No. 25/2019**

The BreBeG 2019 introduces changes in the regulatory areas of the civil service, labour, education, finances, internal affairs including integration, the judiciary and agriculture. Relevant to the financial market are amendments to the Company Employee and Self-Employment Provisions Act (BMSVG; *Betriebliches Mitarbeiter- und Selbständigenvorsorgegesetz*) and the Federal Act on Choice of Law regarding Companies registered in the United Kingdom of Great Britain and Northern Ireland with head offices in Austria.

To prepare for a no-deal Brexit, the investment limits defined in the BMSVG have been adjusted. In the event of the UK leaving the EU without a deal, UK undertakings for collective investment in transferable securities (UCITS) would become "third-country AIFs" (alternative investment funds), located in a country outside the EU. UK UCITS held by corporate provision funds would then fall under the investment limits applicable to AIFs, pursuant to Article 30 para. 3 no. 7a BMSVG. This would mean that they would then only be allowed to hold 1% of the assets allocated to the investment and risk sharing group in such securities. To ensure that the funds can redeem their positions in UK UCITS without incurring losses, they will be exempt from the investment limits laid down in Article 30 para. 3 no. 7a until 1 January 2021.

The Federal Act on Choice of Law regarding Companies registered in the United Kingdom of Great Britain and Northern Ireland with head offices in Austria specifies that these companies will continue to be treated as if the United Kingdom were a Member State of the European Union until 31 December 2020. Since the freedom of establishment would no longer apply to the UK in the event of a no-deal Brexit, limited liability companies that are registered in the UK and have a head office in Austria would risk no longer being recognised as foreign legal entities. This might lead to shareholders becoming personally liable.

The fiction of law in the federal act, namely that the UK remains an EU Member State until 31 December 2020, will give the companies concerned sufficient time to make the necessary legal arrangements.

The Act will only enter into force in the event of a no-deal Brexit. The Austrian Federal Chancellor must proclaim the effective date of the UK's withdrawal from the EU by means of publication in the Federal Law Gazette, in accordance with Article 16 BreBeg 2019.

**Amendment to the Insurance Supervision Act 2016 (VAG 2016; *Versicherungsaufsichtsgesetz*), Federal Law Gazette I No. 26/2019**

The VAG 2016 has been amended in relation to unit-linked life insurance to prepare for a no-deal Brexit. The amendment addresses the underlying problem that only UCITS or special funds defined in Austrian laws may be used as cover for technical provisions pursuant to Article 125 VAG 2016 (cf. explanatory notes on the government bill in annex 354 to the shorthand verbatim records of the National Council, 25th legislative period, p. 32). A no-deal Brexit would mean that UCITS that were authorised in the United Kingdom would become AIFs from a third country. If the UK leaves the EU without a withdrawal agreement, such non-EU AIFs would no longer be permitted as cover for technical provisions under Austrian law.

The amendment provides legal certainty, stipulating that, in the event of a no-deal Brexit, UCITS authorised in the UK would continue to be considered as units in a UCITS until 31 December 2020 and could therefore be used as cover for technical provisions.

The Act will only enter into force in the event of a no-deal Brexit.

**Anti-Gold Plating Act 2019 (*Anti-Gold-Plating-Gesetz*), Federal Law Gazette I No. 46/2019**

The Anti-Gold Plating Act 2019 is a cumulative amendment of several laws aimed at abolishing additional regulations that go beyond EU minimum requirements, a practice referred to as gold plating. Current protection rules will remain unaffected by the abolition. Mere editorial changes in the Anti-Gold Plating Act 2019 or regulations with no bearing on the financial market are not dealt with here.

Amendments to the AIFMG bring forward the effective date of provisions relating to the marketing of AIFs to retail investors. In 2017, Federal Law Gazette I No. 106/2017 dedicated to SME finance companies had already eased the requirements relating to retail AIFs. These changes have yet to be implemented; Austrian lawmakers are waiting for the EU's ruling on whether Federal Law Gazette I No. 106/2017 complies with EU state aid rules. Since the state aid ruling has no bearing on retail marketing, the AIFMG amendments entered into force on 29 May 2019.

Amendments to the BWG are aimed at minimising the administrative burden triggered by Article 35 BWG and at adapting the corresponding penal provisions set forth in Article 98 BWG:

- The information that banks must provide in their lobbies on the interest rates paid on savings deposits, fees, general terms and conditions of business, as well as information about deposit protection (there will also be amendments to Articles 38 para. 2 and Article 52 of the Deposit Guarantee Schemes and Investor Compensation Act – ESAEG; *Einlagensicherungs- und Anlegerentschädigungsgesetz* in this respect) may in future be published on their websites instead.
- The exchange rate information that previously needed to be updated daily and displayed within and outside the bank branch is no longer required.

The changes to the InvFG 2011 and the ImmoInvFG relate to the currently applicable requirement of having the supervisory board approve the fund rules. The underlying Directive 2009/65/EC does not specify any such requirement, which means that this provision extends beyond EU legislation. Instead of requiring approval for changes beforehand, the supervisory board must now only be informed of the rules after the fact.

In the VAG 2016, provisions pertaining to deputising arrangements for governance and other key functions are abolished. The general governance requirements applying to insurance and reinsurance undertakings already include the obligation to maintain these functions at all times; no additional requirements are set forth in Directive 2009/138/EC (Solvency II).

The amendments to the Auditing, Tax Advising and Related Professions Act 2017 (WTBG 2017; *Wirtschaftstreuhandberufsgesetz*) and the Senior Accountant Act 2014 (BiBuG 2014; *Bilanzbuchhaltungsgesetz*) establish equivalence between auditors, tax consultants and senior accountants and other professions (e.g. notaries public and lawyers) in relation to the due diligence obligations they are required to fulfil in their capacity of obliged entities within the meaning of Directive (EU) 2015/849, the Fourth Anti-Money Laundering Directive.

The amendments to the Corporate Code (UGB; *Unternehmensgesetzbuch*) are designed to eliminate difficulties in the application of accounting rules that arose because of gold plating when Directive 2013/34/EU was implemented through the Accounting Amendment Act 2014 (RÄG 2014; *Rechnungslegungs-Änderungsgesetz*).

The Anti-Gold Plating Act 2019 entered into force on 1 July 2019, with the exception of some individual provisions.

### **EU Finance Adaptation Act 2019 (EU-FinAnpG 2019; *EU-Finanz-Anpassungsgesetz*), Federal Law Gazette I No. 62/2019**

The EU-FinAnpG 2019 implements five European Directives, specifies national measures accompanying the implementation of Regulation (EU) 2017/1129, the Prospectus Regulation, and remedies the deficiencies identified by the European Commission regarding insufficient implementation of Directive (EU) 2015/849, the Fourth Anti-Money Laundering Directive. The adaptations were effected by the adoption of an EU Tax Dispute Resolution Act (EU-BStbG; *EU-Besteuerungsstreitbeilegungsgesetz*) and the Capital Market Act 2019 (KMG 2019; *Kapitalmarktgesetz*), as well as by amending 16 federal acts relating to tax and financial market law. This is an enormous legislative package, which is why the FMA is concentrating here on those areas that are relevant to its particular field of work.

#### *Amendments to the FM-GwG, WiEReG and GSpG*

Directive (EU) 2018/843, the Fifth Anti-Money Laundering Directive, is implemented through amendments to the Financial Markets Anti-Money Laundering Act (FM-GwG; *Finanzmarkt-Geldwäschegesetz*), the Beneficial Owners Register Act (WiEReG; *Wirtschaftliche Eigentümer Registergesetz*) and the Gambling Act (GSpG; *Glücksspielgesetz*), as well as compliance packages introduced to the WiEReG. The key points are:

- Registration and AML supervision of providers of virtual currencies by the Financial Market Authority (taking account of the FATF's recommendations)
- Determination of minimum due diligence requirements for transactions and business relationships with high-risk third countries

- Improved cooperation between the FMA and the Federal Ministry of Finance's gambling supervision unit and other national and international authorities for the purposes of preventing money laundering and the financing of terrorism
- Implementation of the measures laid down in the Directive with regard to ensuring accurate information in the beneficial ownership register and the rules on making that information public
- Expiry of the transitional provision exempting prepaid cards worth up to € 250 from the FM-GwG
- Permitting persons professionally authorised to represent legal parties to upload "compliance packages" comprising all documents needed to review beneficial owners to the beneficial ownership register.

#### *Amendments to the VAG 2016*

The VAG 2016 has been adapted:

- to accommodate the Bilateral Agreement between the European Union and the United States of America on prudential measures regarding insurance and reinsurance, and
- to include the required references and clarifications (addition of the Commission's directly applicable implementing acts) in order to guarantee that Directive 2009/138/EC (Solvency II) is being properly implemented.

#### *Amendments to prospectus and fund law*

The KMG 2019 introduces national measures in relation to the public offering of securities accompanying the implementation of the Prospectus Directive, transfers regulations on the (non-harmonised) public offering of investments from the former KMG, and repeals the KMG. Major areas of regulation are:

- Public offering of investments: the existing national regime for the public offering of investments continues to apply. Due to the extensive body of prospectus law, the wording of regulations for the investment regime was mostly kept.
- Public offering of securities: supplementary rules were added to implement the Prospectus Directive. The FMA is named as the competent authority in relation to prospectus law governing securities, and administrative penal provisions are aligned with requirements of the Prospectus Directive.
- Repeal of the KMG originally published in Federal Law Gazette No. 625/1991 in the version of the federal act published in Federal Law Gazette I No. 62/2019 (see Article 30 para. 2 KMG 2019).

The amendments of national laws by way of the EU-FinAnpG 2019 have numerous different effective dates, and are therefore not listed here.

#### **Stock Corporation Law Amendment Act 2019 (AktRÄG 2019; Aktienrechts-Änderungsgesetz), Federal Law Gazette I No. 63/2019**

This federal act transposes the provisions of Directive (EU) 2017/828, the Shareholder Rights Directive (SRD2), as regards votes on the remuneration policy and the remuneration report, transactions with related parties and the transmission of information to shareholders on the vote at the general meeting. Key points: establishment of remuneration policy principles for administrative and supervisory bodies, preparation of a remuneration report and rules regarding transactions with related parties.

Apart from implementing the Directive, the Amendment Act also introduces changes to the committee examining the appropriateness of a proposed conversion ratio pursuant to Articles 225g et seq. AktG.

All amendments became effective retroactively as of 10 June 2019. The remuneration policy must be drawn up for the first time for all business years starting on the day after the effective date. The provisions relating to transactions with related parties entered into force on 31 July 2019, those relating to the conversion ratio committee on 1 August 2019 and the penal provisions on 24 July 2019.

### **Amendment to the Stock Exchange Act 2018 (BörseG 2018; Börsegesetz), Federal Law Gazette I No. 64/2019**

This federal act transposes the provisions of Directive (EU) 2017/828, the Shareholder Rights Directive (SRD2), as regards identification of shareholders and transparency rules in connection with institutional investors, asset managers and proxy advisors. The aim is to improve communication between companies that are admitted to trading on a regulated market and their shareholders, and to encourage shareholder engagement. Key points:

- Companies are granted the right to identify their shareholders if those shareholders hold more than 0.5% of shares or voting rights.
- Intermediaries (credit institutions, investment firms etc.) must communicate the information regarding shareholder identity to the companies, transmit information to shareholders and fulfil a number of other obligations.
- In addition, it sets up transparency requirements for institutional investors (insurance undertakings), asset managers (investment firms, AIFMs, management companies etc.) and proxy advisors. This encompasses information on how companies integrate shareholder engagement in their investment strategy or whether shareholders' equity investment strategy is consistent with the profile and duration of their liabilities.
- Article 189 BörseG 2018 includes new administrative penal provisions (pertaining, for example, to the infringement of information, announcement and publication obligations or the obligation to prepare an engagement policy). Such infringements can be sanctioned with a fine of up to € 25 000, with the FMA being the authority responsible for enforcing any such sanctions.

The amendments became effective retroactively as at 10 June 2019; some of the penal provisions laid down in Article 189 entered into force on the day after the publication date. The provisions on shareholder identification, transmission of information and facilitation of the exercise of shareholder rights and the remaining part of the penal provisions enter into force on 3 September 2020.

### **AMENDMENTS TO REGULATIONS DURING THE REPORTING PERIOD (NON-FMA)**

#### **Rules of professional conduct for insurance intermediaries (*Standesregeln für Versicherungsvermittlung*), Federal Law Gazette II No. 162/2019**

This regulation implements the rules governing independent insurance intermediaries' pursuit of activities (information requirements and conduct of business rules) as defined in Directive (EU) 2016/97 on insurance distribution (IDD), with all other provi-

sions already having been implemented in the GewO 1994. The rules of professional conduct for insurance intermediaries entered into force on 18 June 2019.

**Network and Information System Security Regulation (NISV; Netz- und Informationssystem-sicherheitsverordnung), Federal Law Gazette II No. 215/2019**

This regulation includes:

- Definition of security incidents having a significant disruptive effect (Article 3 no. 6 NISG)
- Definition of operators of essential services in the sectors listed in Article 2 NISG
- Detailed rules on which security precautions (Article 17 NISG) must be maintained by operators of essential services
- Exceptions from the requirements for operators of essential services regarding security precautions and notifications (pursuant to Article 20 NISG) owing to an existing and equivalent level of security of network and information systems.

The regulation entered into force on 18 July 2019.

**Amendment to the Alternative Financing Information Regulation (AltF-InfoV; Alternativfinanzierungs-Informationsverordnung), Federal Law Gazette II No. 264/2018**

This amendment brings the AltF-InfoV into line with the revised Alternative Financing Act (AltFG; *Alternativfinanzierungsgesetz*), Federal Law Gazette I No. 48/2018. The revised AltFG can now be applied generally to securities and investments below certain thresholds, in contrast to the former exhaustive list of alternative financial instruments. The regulation adapts the information sheet, the former version of which was primarily tailored to subordinated loans, according to current laws. The information requirements comprise information about the issuer and the planned project, main features of the offering process and conditions for the capital raising, specific risk factors, information on the offering of securities or investments, investor rights, fees, information and legal redress, as well as the audit opinion. The structure is based on that of the Annex of Commission proposal COM(2018) 113 final on European Crowdfunding Service Providers (ECSP) for Business. The aim is to ensure a minimum level of transparency and to promote investor protection.

The amendment to the AltF-InfoV entered into force on 6 October 2018. The former original version of the AltF-InfoV applied up until 31 December 2018, provided that the offerings were published before 6 October 2018.

**AMENDMENTS TO FMA REGULATIONS DURING THE REPORTING PERIOD**

**Amendment to the FMA Cost Regulation 2016 (FMA-KVO 2016; FMA-Kostenverordnung), Federal Law Gazette II No. 218/2018**

This amendment revises the FMA-KVO 2016 to bring it into line with the ZaDiG 2018, takes account of third-country companies' liability to pay costs when they offer investment services through branches in Austria, and includes general editorial changes and revisions of references. The amendments entered into force on 1 September 2018.

**Amendment to the FMA Regulation on the Incoming Platform (FMA-IPV; FMA-Incoming-Plattformverordnung), Federal Law Gazette II No. 219/2018**

The amendment is due to changes in the ZaDiG 2018 as well as the abolition of notification obligations in the InvFG 2011 and the ImmoInvFG brought about by the amendment published in Federal Law Gazette I No. 67/2018, which revised the AIFMG, ImmoInvFG and InvFG 2011. The FMA exercises its power to issue regulations, which is defined in Article 58 AIFMG, in relation to the obligation of AIFMs to notify any changes of managing director as well as any transfers of head offices (Article 1 para. 5 no. 5a AIFMG). The amendments entered into force on 1 September 2018.

**Amendment to the FMA Fee Regulation (FMA-GebV; FMA-Gebührenverordnung), Federal Law Gazette II No. 220/2018**

Changes concerning fees in the ZaDiG 2018 have been implemented through this amendment. It introduces, for instance, new cases for fees to be charged by the FMA for licensing payment service providers, for approving changes affecting company law in payment institutions, and for handling the registration of account information services pursuant to Article 15 ZaDiG 2018. Within the scope of supervision tasks in accordance with the AIFMG, work in connection with the enforcement of the European regulations on investment funds, Regulation (EU) No 345/2013 on European venture capital funds (EuVECA), Regulation (EU) No 346/2013 on European social entrepreneurship funds (EuSEF) and Regulation (EU) 2015/760 on European long-term investment funds (ELTIF), is now being remunerated. New cases liable for fees are introduced in the area of the supervision of alternative investment fund managers (AIFMs) as well as undertakings for collective investment in transferable securities (UCITS), in order to reflect the enforcement of Regulation (EU) 2017/1131 on money market funds and the authorisation work carried out in relation to UCITS and AIFs. The amendments entered into force on 1 September 2018.

**Life Insurance Information Requirements Regulation 2018 (LV-InfoV 2018; Lebensversicherung Informationspflichtenverordnung), Federal Law Gazette II No. 247/2018**

This regulation revises the LV-InfoV in accordance with the VAG 2016 following the implementation of Directive (EU) 2016/97, the Insurance Distribution Directive (IDD), and reissues it as LV-InfoV 2018. Major changes in the LV-InfoV 2018 relate to better representation of the overall costs in the information sheet for endowment life insurance. In addition, a standardised information sheet is introduced for term insurance, referred to as the Life Insurance Product Information Document (LIPID), which is similar in format and content to the Insurance Product Information Document (IPID). The LV-InfoV 2018 also includes information for policyholders on the risk of a bail-in pursuant to Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms. The amendments entered into force on 1 October 2018.

**Amendment to the Information Requirements Regulation for Health Insurance (KV-InfoV; Krankenversicherung Informationspflichtenverordnung), Federal Law Gazette II No. 248/2018**

The amended KV-InfoV includes revisions of references that have been made neces-

sary by changes to the VAG 2016 resulting from the implementation of the Insurance Distribution Directive. The amendments entered into force on 1 October 2018.

**Amendment to the Regulation on Payment Institution and E-Money Institution Reports (ZEIMV; *Zahlungs- und E-Geld-Institute-Meldeverordnung*), Federal Law Gazette II No. 253/2018**

This amendment to the ZEIMV was introduced in response to changes in the ZaDiG 2018. Reporting items have been introduced in Annexes A1 and A2 for the new payments services. In Annex A3 master data reporting is aligned with that in Annex A1 of the Master Data Reporting Regulation 2016 (StDMV 2016; *Stammdatenmeldungsverordnung*). In addition, some references have been revised. The amendments entered into force on 21 September 2018, with the revised Annexes A1, A2 and A3 to be applied for the first time to reports written as at the reporting date of 1 October 2018.

**Regulation on Forms and Annual Reports 2019 (FJMV 2019; *Formblatt- und Jahresmeldeverordnung*), Federal Law Gazette II No. 333/2018, and amendment to the Regulation on Quarterly Financial Statements 2012 (QMV 2012; *Quartalsmeldeverordnung*), Federal Law Gazette II No. 330/2018**

The FJMV 2019, which replaces the FJMV 2016, and the QMV 2012 detail the structure and form of reports to be submitted by *Pensionskassen* annually and quarterly. Regulation (EU) 2018/231 of the European Central Bank on statistical reporting requirements for pension funds (ECB/2018/2) as well as the Decision of the Board of Supervisors on EIOPA's regular information requests towards NCAs regarding provision of occupational pensions information (EIOPA-BoS/18-114) defined new reporting requirements in relation to occupational retirement provision. These requirements were transposed into national law with this amendment. In addition, various references were revised in the QMV 2012 to reflect changes of the PKG as published in Federal Law Gazette I No. 81/2018, which resulted from implementation of Directive (EU) 2016/2341, the IORP II Directive.

The FJMV 2019 entered into force on 1 January 2019. Its provisions are to be applied for the first time to annual reports as at the reporting date of 31 December 2019. The revised QMV 2012 entered into force on 1 January 2019 and was applied for the first time to reports as at the reporting date of 31 March 2019.

**Risk management regulation for *Pensionskassen* 2019 (PK-RiMaV 2019; *Pensionskassen-Risikomanagementverordnung*), Federal Law Gazette II No. 331/2018**

Directive (EU) 2016/2341, the IORP II Directive, was transposed into Austrian law by revision of the PKG as amended in Federal Law Gazette I No. 81/2018, laying down new requirements in Article 21a PKG in relation to the risk management of *Pensionskassen*. The revised regulation specifies the requirements made of risk management and the risk management function in Article 21a paras. 1 to 4 PKG. These requirements include:

- Allocation of sufficient funds to risk management
- Specification of the tasks to be carried out by the risk management function, how to deal with conflicts of interest and establishing deputising arrangements for holders of risk management functions
- Specification of the scope of the risk management system to be set up, focusing on

the risk strategy to be defined, as well as on the tasks, responsibilities and decision-making and escalation processes. In addition, requirements regarding the IT systems and processes used for risk management purposes are also laid down.

- Further provisions are dedicated to specific details relating to risk analysis, risk evaluation, risk control and risk monitoring.

Mention should be made of the fact that the statutory requirements on risk management in the revised PKG now no longer refer solely to the assets of the investment and risk sharing group but also to its liabilities, and to both assets and liabilities of the *Pensionskasse* itself. The aim of the regulation is to maintain, in keeping with the principle of proportionality, the major provisions of the repealed PK-RIMAV and to take account of the new legal framework which extended the statutory risk management provisions to include the liabilities of the investment and risk sharing groups and the *Pensionskasse* itself.

The PK-RiMaV 2019 entered into force on 1 January 2019.

#### **Amendment to the Trading Transparency Exceptions Regulation 2018 (HTAusV 2018; Handelstransparenzausnahmen-Verordnung), Federal Law Gazette II No. 332/2018**

The FMA is authorised pursuant to Article 90 para. 11 of the Securities Supervision Act 2018 (WAG 2018; *Wertpapieraufsichtsgesetz*) to grant a deferral for post-trade transparency in accordance with Article 21(4) of Regulation (EU) No 600/2014 on markets in financial instruments (MiFIR). With regard to non-equity instruments and deferred post-trade publication arrangements, an additional rule is imposed: in accordance with subparagraph 1 of Article 21(4) MiFIR, the FMA will in future grant legal entities for the same categories such as operators of trading venues a deferral for post-trade transparency in relation to non-equity instruments, provided that no general deferrals have been granted anyway.

The revised HTAusV 2018 entered into force on 1 January 2019.

#### **Amendment to the Regulation on the Auditing Actuary's Audit Report 2013 (PAkt-PBV; *Prüfaktuar-Prüfberichtverordnung*) and the FMA Regulation on the Incoming Platform (FMA-IPV; *FMA-Incoming-Plattformverordnung*), Federal Law Gazette II No. 334/2018**

The PAktPBV was primarily revised to add the following new details to the audit report:

- Appropriateness of underwriting policy
- Evaluation of the reliability and appropriateness of the calculation of the technical provisions
- Explanation as to whether assumptions used in calculating the technical provisions stand up to a comparison using empirical data.

References to the reissued FJMV 2019 have also been revised in the PAktPBV. In addition, references were changed in the PAktPBV and FMA-IPV to reflect changes of the PKG as published in Federal Law Gazette I No. 81/2018, which resulted from implementation of Directive (EU) 2016/2341, the IORP II Directive.

The amendments of the PAktPBV entered into force on 1 January 2019 and are to be applied for the first time to audit reports prepared for the 2019 business year.

The revised FMA-IPV entered into force on 1 January 2019.

**Amendment to the Capital Buffer Regulation (KP-V; *Kapitalpuffer-Verordnung*),  
Federal Law Gazette II No. 335/2018**

This amendment implements the recommendations made on 4 July 2018 by the Financial Market Stability Board, in essence effecting changes regarding the buffer requirement for other systemically important institutions (O-SII buffer). The O-SII buffer must be maintained by numerous institutions, not only at consolidated level but also at the level of individual institutions. The affiliation of Volksbank cooperatives and Erste Bank der oesterreichischen Sparkassen AG are now required to hold a 1% O-SII buffer for the first time.

The amendments of the KP-V entered into force on 1 January 2019; the Volksbank cooperatives and Erste Bank are required to build up their O-SII buffers by 1 January 2020.

**Amendment to the CRR Supplementary Regulation (4th CRR-BV Amendment;  
*CRR-Begleitverordnung*), Federal Law Gazette II No. 336/2018**

This amendment adjusts the materiality threshold for determining obligor default for less significant institutions (LSIs) with related provisions in Commission Delegated Regulation (EU) 2018/171. In future, the obligor will be deemed to have defaulted when the amount past due exceeds € 100 (for retail exposures) or € 500 (for other exposures), equating to at least 1% of the total amount of all exposures to that obligor. The previous threshold was € 250 and 2.5% of all exposures to the obligor. The materiality thresholds are similar to the values set for significant institutions (SIs) by the ECB. The method used for the calculation of materiality thresholds is also being brought in line with Regulation (EU) 2018/1845 of the European Central Bank. Moreover, the pre-authorisation for the redemption of called cooperative shares has been extended by a further year.

The new thresholds for obligor defaults enter into force on 31 December 2020; institutions may notify the FMA of earlier applications.

**Amendment to the Information Requirements Regulation for *Pensionskassen*  
(PK-InfoV; *Pensionskassen Informationspflichtenverordnung*), Federal Law Gazette II  
No. 337/2018**

In the PK-InfoV, the FMA lays down the content and the structure of information to be provided by *Pensionskassen* to beneficiaries (entitled and recipients). In addition, information requirements have been adapted to reflect changes to the PKG as published in Federal Law Gazette I No. 81/2018, which resulted from implementation of Directive (EU) 2016/2341, the IORP II Directive. In future, beneficiaries need to be provided with certain general information. Furthermore, the information in the annual statement of account will have to be structured in a specific manner.

The amendment entered into force on 1 January 2019 and is to be applied for the first time to annual account statements for the 2019 business year.

**Amendment to the Regulation on Asset, Income and Risk Statements (VERA-V;  
*Vermögens-, Erfolgs- und Risikoausweis-Verordnung*), Federal Law Gazette II  
No. 14/2019**

The revised VERA-V introduces reporting for real estate lending. The aim is to collate sufficient data to assess macroprudential risk in residential property financing. CRR

credit institutions will have to report aggregated data on newly granted residential property loans every six months. This data must include the loan-to-value ratio (LTV), debt ratio and debt service-to-income ratio (DTI/DSTI) and the loan term. Credit institutions will be required to collect data on new loans as of 1 January 2020. The amendments enter into force on 1 January 2020.

**Amendment to the Regulation on the Building Society Act (BSpKV; *Bausparkassen-gesetzverordnung*), Federal Law Gazette II No. 52/2019**

This amendment raises the maximum amount of a loan that may be obtained by one building society customer from € 180 000 to € 220 000, the minimum principal amount of large building savings and loan contracts from € 360 000 to € 440 000, and the maximum amount of unsecured loans from € 25 000 to € 30 000. The adjusted amounts are intended to reflect the real estate price hikes in Austria over the last nine years (last adjustment on 1 January 2010). The increase is in the national economic interest to have a functioning system of residential property financing in place, in accordance with Article 11 para. 1 of the Austrian Building Society Act (BSpG; *Bausparkassengesetz*).

The amendments entered into force on 26 February 2019.

**FMA Regulation on Product Intervention Measures (FMA-PIV; *FMA-Produkt-interventionsverordnung*), Federal Law Gazette II No. 118/2019**

The FMA-PIV turns the temporary product intervention measures introduced by the European Securities and Markets Authority (ESMA) in relation to the marketing, distribution or sale of binary options and contracts for difference (CFDs) to retail clients into permanent national measures.

The FMA-PIV entered into force on 15 May 2019 and applies to binary options and CFDs that are marketed, distributed or sold within or from Austria on or after 30 May 2019.

**Repeal of the FMA Depositing Fee Regulation (*Hinterlegungsgebühren-Verordnung*), Federal Law Gazette II No. 212/2019**

In accordance with Article 13 para. 3 KMG 2019, the FMA may delegate tasks in connection with the electronic publication of approved prospectuses and related documents to the OeKB in its capacity as Notification Office. The FMA concluded a delegation agreement with the OeKB, as a result of which securities prospectuses are no longer to be filed with the FMA but the OeKB. Consequently, the FMA does not need to charge any fees for the service and the regulation had to be repealed.

The repeal took effect at the end of 20 July 2019.

**Amendment to the FMA Fee Regulation (FMA-GebV; *FMA-Gebührenverordnung*), Federal Law Gazette II No. 221/2019**

Apart from editorial changes, the following adaptations were introduced:

- Adaptations in accordance with the KMG 2019, specifically in relation to new types of prospectuses and the individual documents to be approved, which result from national accompanying measures to implement Regulation (EU) 2017/1129, the Prospectus Regulation
- Addition of a new charge in connection with the EMIR Refit regime: notification of intention to make use of the new reporting exemption in relation to intragroup

transactions incurring the same amount as for an existing intragroup transaction exemption

- Addition of a new charge in connection with implementation of Regulation (EU) 2017/2402, the STS Regulation (admission of verification of compliance with STS criteria)
- Adjustment of the charges relating to the supervision of managers of collective portfolios to reflect average current costs.

The amendment entered into force on 1 August 2019, with editorial changes having become effective on the day after the publication date. If the transitional provision set forth in Article 46(3) of the Prospectus Regulation applies to prospectuses, the old charges continue to apply to the approval of supplements.

**Minimum Content, Publishing and Language Regulation 2019 (MVSV 2019; Mindestinhalts-, Veröffentlichungs- und Sprachenverordnung), Federal Law Gazette II No. 222/2019**

The Prospectus Regulation and the KMG 2019 have completely overhauled prospectus law. The MVSV was reissued to bring the following bodies of rules in line with current legislation:

- Criteria for publishing investment prospectuses in newspapers
- Minimum content for information documents to replace the securities prospectus as stipulated in the Prospectus Regulation
- Permitted languages for prospectuses.

The provisions of the former MVSV were carried over into MVSV 2019 as far as possible. The regulation entered into force on 24 July 2019.

## EUROPEAN LEGISLATION

### REGULATIONS AND DIRECTIVES

#### ADOPTED DURING THE REPORTING PERIOD

As part of its regular lawmaking procedures, the European Union adopted the following legal acts of particular relevance to the FMA's scope of enforcement during the reporting period:

**Regulation (EU) 2019/518 amending Regulation (EC) No 924/2009 as regards certain charges on cross-border payments in the Union and currency conversion charges (SEPA review)**

This amended Regulation relates to the charges imposed for cross-border transactions in euro that are sent or received in the EU, while also extending the transparency requirements imposed on payment service providers in relation to their currency conversion practices.

- Payment service users (consumers or companies) that carry out a cross-border transaction (credit transfer, card payment, cash withdrawal) in euro should be charged exactly the same price as would be charged for the corresponding domestic transaction in the official currency of the Member State from which the transaction was sent or in which it was received. This principle, applicable throughout the euro area, is now also being extended to include countries outside the euro area. The rules only relate to cross-border transactions in euro.

- Before a payment is made, payment service providers must guarantee transparency and the comparability of currency conversion offers. They are therefore obliged to disclose the exchange rate applied and the foreign exchange reference rate used, as well as the total amount of all charges applicable to the conversion of the payment transaction. These transparency requirements will enter into force following a three-year transitional phase, during which the currency conversion charges are subject to maximum amounts set by the EBA.

Publication in the Official Journal of the European Union: 29 March 2019, applicable with effect from: 15 December 2019 (on a staggered basis up to 2021).

**Regulation (EU) 2019/630 amending Regulation (EU) No 575/2013 as regards minimum loss coverage for non-performing exposures**

This amended Capital Requirements Regulation (CRR) aims to reduce the level of non-performing exposures (NPEs) in bank balance sheets while also guaranteeing banks' ability to cover NPEs in the future. Banks must now hold minimum amounts of cover in order to withstand potential future losses due to NPEs. If this minimum amount is not met, the required cover will be deducted from the bank's own funds. This minimum cover serves as a form of prudential backstop for any NPEs in the future. Another new addition to the legislation is a common definition of exposures at risk of default, in line with the definition used for supervisory reporting purposes.

Publication in the Official Journal of the European Union: 25 April 2019, applicable with effect from 26 April 2019.

**Regulation (EU) 2019/834 amending Regulation (EU) No 648/2012 as regards the clearing obligation, the suspension of the clearing obligation, the reporting requirements, the risk-mitigation techniques for OTC derivatives contracts not cleared by a central counterparty, the registration and supervision of trade repositories and the requirements for trade repositories (EMIR Refit)**

The changes introduced by the new rules on EMIR include:

- Exemption from reporting obligations for intragroup transactions. Transactions involving a central counterparty now only need to be reported by that CCP.
- Stricter quality assurance obligations for trade repositories.
- Extended ESMA mandate for the development of technical standards on reporting.
- Access to clearing services must be provided on the basis of fair, reasonable and non-discriminatory (FRAND) commercial terms.
- Assets and positions held in client accounts do not form part of the insolvency estate of the CCP or clearing member.
- Exemption from the clearing obligation for small financial counterparties that fall below the clearing threshold.
- Extension of the exemption from the clearing obligation for pension scheme arrangements by three years, with the option of extending once.
- Transparency of CCPs: CCPs must provide their clearing members with a detailed description of their models used to calculate initial margins.
- Increase in the fines that ESMA may impose on trade repositories.
- The procedure used by EU authorities to gain access to trade repository data in third countries is simplified.

Publication in the Official Journal of the European Union: 28 May 2019, applicable with effect from: 17 June 2019 (on a staggered basis up to 2021).

**Banking package: Regulation (EU) 2019/876 amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements, and Regulation (EU) No 648/2012 (CRR II); Regulation (EU) 2019/877 amending Regulation (EU) No 806/2014 as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms; Directive (EU) 2019/878 amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures (CRD V); Directive (EU) 2019/879 amending Directive 2014/59/EU as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms and Directive 98/26/EC (BRRD II)**

The banking package first tackled by the Commission in 2016, with far-reaching changes in relation to the CRR, CRD IV, BRRD and SRM, is being implemented through these legal standards adopted in 2019, with two legal acts already having been introduced in 2017. The new laws essentially involve the following changes:

- Inclusion of financial holding companies in the supervisory system: (mixed) financial holding companies have been incorporated into prudential supervision and therefore now require a licence.
- Improving the resilience of EU institutions and promoting financial stability: as part of the implementation of a regulatory framework agreed by the Basel Committee on Banking Supervision, measures to tackle market and counterparty default risk have been introduced, including imposing more risk-sensitive capital requirements on central counterparties (CCPs) and creating a binding borrowing ratio to prevent institutions from excessively increasing their leverage. Additionally, to overcome excessive dependence on short-term sources of funding in the interbank market and to lower long-term financing risk, a binding net stable funding ratio (NSFR) has been introduced while requirements have been imposed on globally systemically important institutions (G-SIIs), which must hold a minimum level of own funds and other instruments that would have loss-absorbing capacity in the event of resolution (total loss-absorbing capacity).
- Strengthening banks' lending capacities to promote the EU economy: tie-in measures are aimed for example at improving banks' capacities to provide loans to SMEs and to fund infrastructure projects, at reducing the disproportionate administrative burden related to remuneration rules for smaller and less complex institutions (e.g. deferral and pay-out in instruments such as equity), and at improving the proportionality of the rules contained in the CRR and the CRD, thus relieving the burden on smaller and less complex institutions.

Publication in the Official Journal of the European Union: 7 June 2019; Regulation (EU) 2019/876 applicable with effect from: 27 June 2019 (on a staggered basis up to 28 June 2023), Regulation (EU) 2019/877 applicable with effect from: 28 December 2020, implementation deadline for directives: 28 December 2020.

**Regulation (EU) 2019/1156 on facilitating cross-border distribution of collective investment undertakings and amending Regulations (EU) No 345/2013, (EU) No 346/2013 and (EU) No 1286/2014; Directive (EU) 2019/1160 amending Directives 2009/65/EC and 2011/61/EU with regard to cross-border distribution of collective investment undertakings**

This legislative package encompassing a regulation and a directive abolishes the legal barriers to the cross-border distribution of investment funds. The aims are to improve transparency, eliminate unnecessarily complex and costly requirements, and harmonise divergent national rules. The changes include:

- The applicable distribution rules and fees are to be published online by the national competent authorities (NCAs) and ESMA in a transparent manner and “in a language customary in the sphere of international finance”.
- It will be possible in future to use the European passport for the cross-border distribution of investment funds without maintaining a local physical presence in the host Member State.
- In the case of AIFs and EuVECA that do not already exist, management companies may approach potential customers in the form of pre-marketing. This means that AIFMs may test an investment concept or strategy with professional investors but may not advertise an existing AIF without having gone through a notification process.
- The requirements around marketing communications have been harmonised across the EU for all investment funds. The marketing communications of funds can only be revoked if a maximum of ten investors who hold up to 1% of the assets managed by the fund have invested in the fund in a certain Member State.

Publication of the Regulation in the Official Journal of the European Union: 12 July 2019, applicable with effect from: 1 August 2019/2 August 2021. Publication of the Directive in the Official Journal of the European Union: 12 July 2019, implementation deadline: 2 August 2021.

**Regulation (EU) 2019/1238 on a pan-European Personal Pension Product (PEPP)**

Pension product providers can now offer one single personal pension product throughout Europe, known as the PEPP. The PEPP system is a voluntary, complementary system that exists alongside national schemes. There are no plans, however, for a harmonisation of national pension law.

The idea is that PEPPs can be offered by all supervised companies, including insurance undertakings, banks, occupational pension funds, investment firms and asset management companies. In order to sell PEPPs, providers must be licensed by EIOPA, which then authorises them to sell their PEPPs anywhere in the EU. Meanwhile, insurance intermediaries will be authorised to sell third-party PEPPs pursuant to the IDD, doing so alongside companies that have been authorised by their national supervisors.

PEPPs are subject to strict information and distribution obligations, which also apply to online selling. Customer information should be made available primarily by electronic means.

PEPPs, given that they are pan-European in character, may be moved to another Member State, with the result that payments can still be made into and out of them after a move abroad. Buyers of PEPPs have the right to switch provider every five years for a capped fee.

Publication in the Official Journal of the European Union: 25 July 2019, applicable with effect from: as yet unclear due to the entire Regulation only being applicable after publication of all seven delegated acts by the Commission. (Only deadline: ESMA must submit proposals for delegated acts by 15 August 2020.)

## INTERNATIONAL STANDARD SETTERS

In addition to European and Austrian legislation, the financial market is also affected by publications from standard-setting bodies. Although these publications are not legally binding as such, they are frequently used as standards, guidelines or benchmarks when binding legislation is being adapted at a national level or by the EU. The aim is to harmonise supervisory practice on a global level. The publications from such international standard-setting bodies during the reporting period that are most relevant to the FMA are outlined below.

### BASEL COMMITTEE ON BANKING SUPERVISION (BCBS) OF THE BANK FOR INTERNATIONAL SETTLEMENTS (BIS)

The Basel Committee produced the following publications in 2019:

#### **Minimum capital requirements for market risk (January 2019)**

This standard updates the minimum capital requirements for credit institutions, addressing issues identified by the Basel Committee when monitoring the implementation and impact of the previous standard. The new standard is due to enter into force on 1 January 2022.

#### **Revisions to leverage ratio disclosure requirements (June 2019)**

This standard adds to the disclosure requirements imposed on credit institutions in relation to their leverage ratios. The aim is to counter “window dressing” in the form of temporary reductions in the transaction volume around a reporting date in order to report an artificially elevated leverage ratio.

#### **Leverage ratio treatment of client cleared derivatives (June 2019)**

Following the consultative document published in October 2018, this standard revises the treatment of derivatives that banks clear on behalf of their clients during calculation of the leverage ratio. Specific changes have been made to the new standardised approach for measuring counterparty credit risk exposures (SA-CCR) within the risk-based capital framework in order to make banks and the derivative market more robust and more secure. The changes apply with effect from 1 January 2022.

#### **Margin requirements for non-centrally cleared derivatives (July 2019)**

The Basel Committee on Banking Supervision and the International Organization of Securities Commissions (IOSCO) have again postponed full implementation of the margin requirements for non-centrally cleared derivatives due to the high number of affected entities (following an initial postponement in 2015). Implementation is now scheduled for completion by early September 2021.

## FINANCIAL ACTION TASK FORCE (FATF)

The FATF produced the following publications in 2019:

### **Guidance for a Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers (June 2019)**

This Guidance is aimed at virtual asset service providers, who are now obliged entities pursuant to the FATF Recommendations.

### **Guidance for a Risk-Based Approach for Trust and Company Service Providers (June 2019)**

This Guidance deals with the application of the risk-based approach by service providers that set up companies or trusts, or that support and accompany the set-up process.

### **Guidance for a Risk-Based Approach for the Accounting Profession (June 2019)**

This Guidance is dedicated to the risk-based approach in relation to tax professionals and auditors.

### **Guidance for a Risk-Based Approach for Legal Professionals (June 2019)**

This Guidance tackles the risk-based approach in relation to lawyers and notaries public.

### **Terrorist Financing Risk Assessment Guidance (July 2019)**

This Guidance describes relevant sources of information, practical examples and tried-and-tested approaches in order to help countries analyse the threat and risks of terrorist financing.

## INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS (IOSCO)

The public reports listed below, which were adopted by IOSCO during 2019, constitute final standards which are non-binding but can be used as benchmarks.

### **FR03/2019 – Commodity Storage and Delivery Infrastructures: Good or Sound Practices, Report of the Board of IOSCO**

This report is a follow-up document to “The Impact of Storage and Delivery Infrastructure on Derivatives Market Pricing (Storage Report)” published in May 2016. It details 49 good practices for relevant storage infrastructures (RSI) (i.e. the structures for the storage/warehousing and transfer of goods in order to perform the physical delivery process related to a commodity derivative contract) and their relevant oversight bodies (ROB), to assist those entities to identify and address issues that could affect commodity derivatives’ pricing and in turn affect market integrity and efficiency. The good practices cover oversight, transparency, fees and incentives, and conflicts of interest.

### **Statement on Disclosure of ESG Matters by Issuers, Statement of the Board of IOSCO**

This statement sets out the importance for issuers of considering the inclusion of environmental, social and governance (ESG) factors when disclosing information

material to investors' decisions. It should be considered in conjunction with IOSCO Principle 16, which states that issuers should provide "full, accurate, and timely disclosure of financial results, risk, and other information which is material to investors' decisions".

#### **FR01/2019 – IOSCO Report on Good Practices for Audit Committees in Supporting Audit Quality, Report of the Board of IOSCO**

This document is aimed at the audit committees of listed companies. Based on an analysis of audit committees, it suggests seven good practices designed to improve the quality of audits of listed companies, covering such areas as the criteria to be applied when selecting or appointing auditors, audit fees, quality improvement and quality assurance, and communications with auditors.

### **INTERNATIONAL ORGANISATION OF PENSION SUPERVISORS (IOPS)**

#### **2018 Update on IOPS work on fees and charges (January 2019)**

The paper reviews fees charged in 88 different pension schemes in 45 different countries, presenting the average values as well as the legal ceilings. For countries for which there was sufficient data (14 countries), the development of costs between 2014 and 2018 is also compared.

#### **Impact of digitalisation of financial services on pension supervisory practices: Case studies (February 2019)**

Using case studies (China, Hong Kong, Kenya, Mexico), the paper describes how new technologies are being used in the pension sector, assessing the current and foreseen impact of digitalisation on pension supervision.

### **FINANCIAL STABILITY BOARD (FSB)**

#### **Regulatory framework for haircuts on non-centrally cleared securities financing transactions – Update (July 2019)**

Originally published in 2015, the annexes to this document have been updated to include the final recommendations regarding haircuts on non-centrally cleared securities financing transactions (SFTs).

