bankenverband

Moving Europe forward – a strong single market for citizens, businesses and banks

The German private banks' EU policy positions
for the 2019-2024 legislative term

Brussels, November 2018

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Single European market for banks – room for more

Europe is our home market – both economically and politically. In the next legislative term we need more and a better Europe, not a relapse into walled-off national markets. Despite all its internal diversity, Europe must demonstrate political unity externally and underline its global commitment to open markets with agreed rules through economic strength.

At the same time, the European Union (EU) faces major challenges. Renationalisation tendencies in the member states are growing. There is the impression that international trade conflicts are being triggered increasingly erratically. Moreover, populist forces appear to be on the rise worldwide. It is often no longer clear to citizens what benefits the EU delivers. Freedom, peace and more prosperity are taken for granted.

The upcoming European Parliament (EP) elections, along with the appointment of lead candidates for the office of future president of the European Commission, provide an excellent opportunity to present new ideas for further developing the EU and to also draw attention to what has already been achieved. Since the financial crisis, the EU has, for example, managed to make banks and other financial institutions more stable and safer. The crisis showed clearly that supervision and regulation at national level are no longer sufficient to control the globally intertwined financial markets. So it is only logical that the EU has over the past ten years forged ahead with uniform financial market standards and established new European financial supervisory structures enabling it to respond better to crises in future.

The European elections and the new legislative term raise the question, however, of whether everything needed has really been achieved. EU regulation has focussed recently on strengthening financial stability and fostering business finance. What should be the focus in the coming legislative term?

- The EU is still a long way off from a single European banking market. Providing business finance and selling retail financial products often still come to a halt at national borders. This is, it is true, changing slowly as a result of the growing digitalisation of the financial sector. The present momentum must, however, be seized to make cross-border financial services more attractive to consumers and businesses. This calls for a uniform legal framework at EU level.

- One of the big challenges that society as a whole faces in the coming years is combatting climate change. Strenuous efforts are required to limit any further global warming and to address the effects that are already being felt today. By funding these efforts, the financial sector can play its part in the fight against climate change. The outgoing Commission has presented initial proposals on what a more sustainable financial sector could look like. These need to be followed up in the forthcoming legislative term.

- The regulation launched in the wake of the financial crisis should be scrutinised. It is not a question of launching a deregulation phase, though. Rather, the forthcoming

reviews of existing EU legislation should be used to make the legal framework more internationally competitive and rid it of unnecessary burdens for banks and customers. That goes, for example, for the upcoming review of the Markets in Financial Instruments Directive (MiFID) and Regulation (MiFIR), and of the Consumer Credit Directive (CCD).

- The debate on the future of Economic and Monetary Union needs to be continued in the forthcoming legislative term as well. Further action is required particularly with regard to the Banking Union and Capital Markets Union now underway. That goes, for example, for the introduction of a backstop for the Single Resolution Fund. Furthermore, cross-border capital and liquidity waivers for banks should be established. What is also needed is implementation of the supervisory rules adopted by the Basel Committee at the end of 2017 that meets international requirements but avoids unnecessarily burdening European banks. In addition, further progress is called for on risk-mitigating measures – for example, on the reduction of non-performing loans currently under discussion – though these should not impose an excessive regulatory burden on banks. In the capital markets sector, a focus of efforts should be on making the equity markets more attractive to consumers.

The EU thus continues to face challenges in many areas of financial regulation. The private banks in Germany stand ready to support the EU in its initiatives. The focus here should always be on tangible added value for consumers and businesses alike. At the same time, however, banks' competitiveness should be kept in mind. A sound economic policy can also help to bring the EU closer to its citizens again.

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The role banks play in the European economy

Banks make available the financial resources to fund investment opportunities, assume risks, improve liquidity and mobilise savings more easily. As intermediaries, they give businesses access to the capital market. The correlation between a well-developed financial sector and a high level of economic growth is backed up by numerous empirical studies. A thriving, competitive financial sector thus strengthens the growth process and plays a major part in increasing prosperity in Europe.

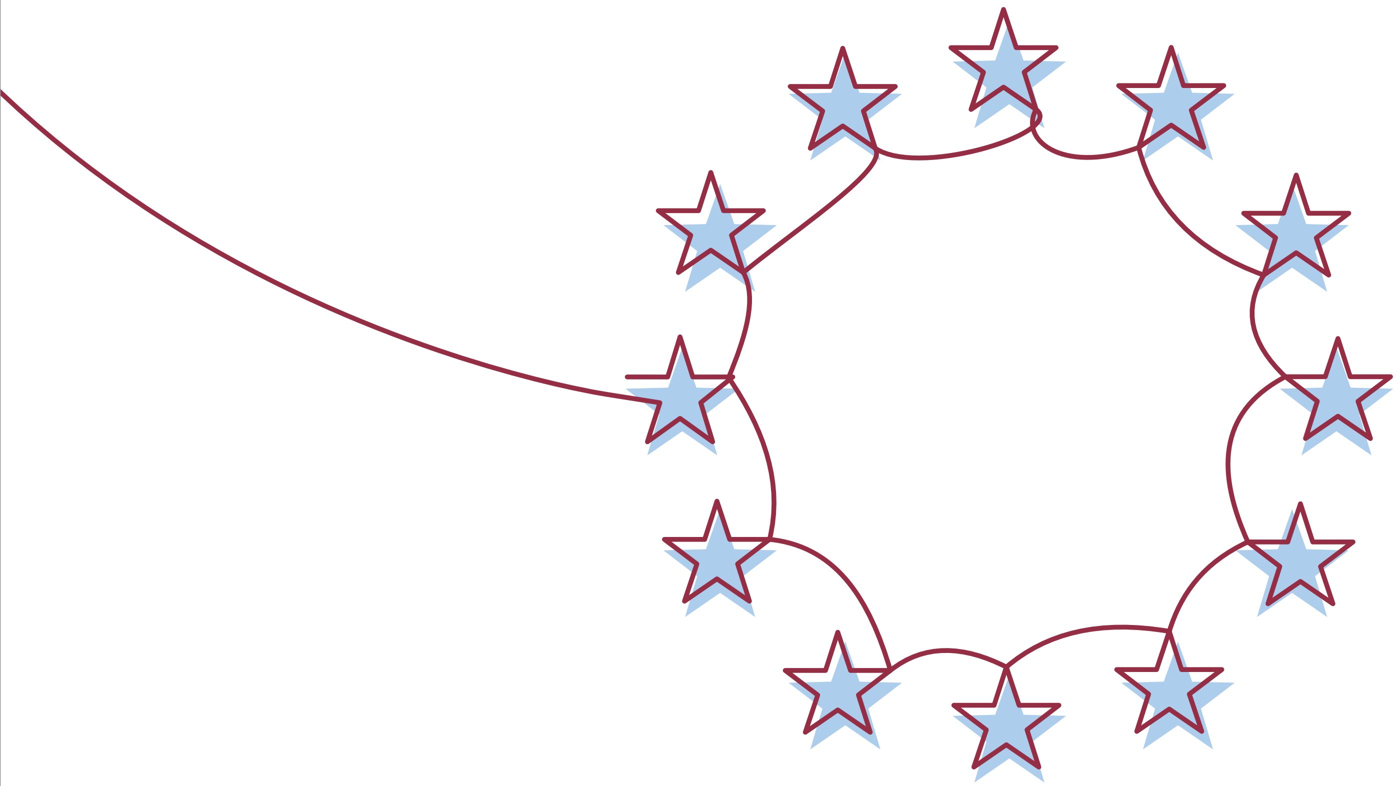
Banks' ability to actually contribute to more prosperity in Europe should not be taken for granted, however. The crucial condition for this is that they can operate profitably. In times of zero and negative interest rates, steadily increasing regulation-related costs and offensively-operating new market players, this is anything but easy.

Especially in Europe, it is noticeable that the financial sector's share of value added has been declining for years – unlike in the US, for example. A marginalisation of the European banking sector cannot be in Europe's interest, however. European banks that are not also-rans but can hold their own against international competitors remain important for the European economy for various reasons. European banks know what their European customers need; they are able to assess risks adequately and provide competent advice. Over the years, stable customer-bank relationships that are geared not to quick contract closure but to long-term partnership have evolved.

On top of this, a set of shared standards links banks and corporate clients. Take data protection, for example: data is handled completely differently in the EU than in Asia or the US. This makes it all the more important that European banks can continue to offer their customers solutions that meet their needs.

So that European banks can operate profitably and compete internationally, they need a single market that is big enough to allow economies of scale. In a bigger market, banks could not only regain their lost profitability but also be the engine of the EU internal market.

Particularly when compared with the US, the EU lacks a single, competitive financial market: the European market is still fragmented into many smaller national markets, so that banks cannot automatically offer and organise their products and services across borders.



A real single market for the financial sector could eliminate the substantial inefficiency caused by many small national markets. The resulting cost-cutting potential would make banks more competitive. Such a market would also improve what is on offer to European citizens, as attractive financial products would be more quickly available in all member states.

A real single financial market also makes sense from a stability perspective. It would enable banks and financial markets to assess risks consistently across the EU and to hedge these as widely as possible, i.e. across borders. With a single market, risks and regional imbalances could also be moderated better and contagion effects thus prevented. Risk transfer through market integration also works much better for Economic and Monetary Union than any public mechanism.

What is clear is: Europe needs a competitive financial market of its own with strong banks that reflects its economic standing and is on a par with other markets. The single European financial market can only remain competitive externally, however, if the EU speaks with one voice when it comes to establishing international rules – for example, at Basel Committee level. It will be much easier for the EU to speak with one voice if it has a single market with a single rulebook. Just as important is that European regulators keep an eye on international competition. “Going it alone”, as in the case of the repeatedly discussed introduction of a financial transaction tax, for example, would be harmful to European competitiveness. —

1. Economic and Monetary Union – carrying on reform

Fundamental reforms are needed to stabilise Economic and Monetary Union (EMU) in the long term. An important starting point in this regard is further developing and strengthening the European Stability Mechanism (ESM) and turning it into a European Monetary Fund. Common eurozone country funds for fostering investment and supporting structural reforms would, in addition, round off the envisaged reform of EMU. At the same time, structural reforms that boost competitiveness and economic growth are in the interest of every member state. Coordination of economic policy through the European Semester should thus be made more transparent, more efficient and more binding.

Fundamental reforms needed

The financial crisis and the sovereign debt crisis exposed basic weaknesses and construction flaws in EMU. The immediate fallout from the crises was fought using emergency measures, with the European Central Bank's monetary policy playing an important role in this respect.

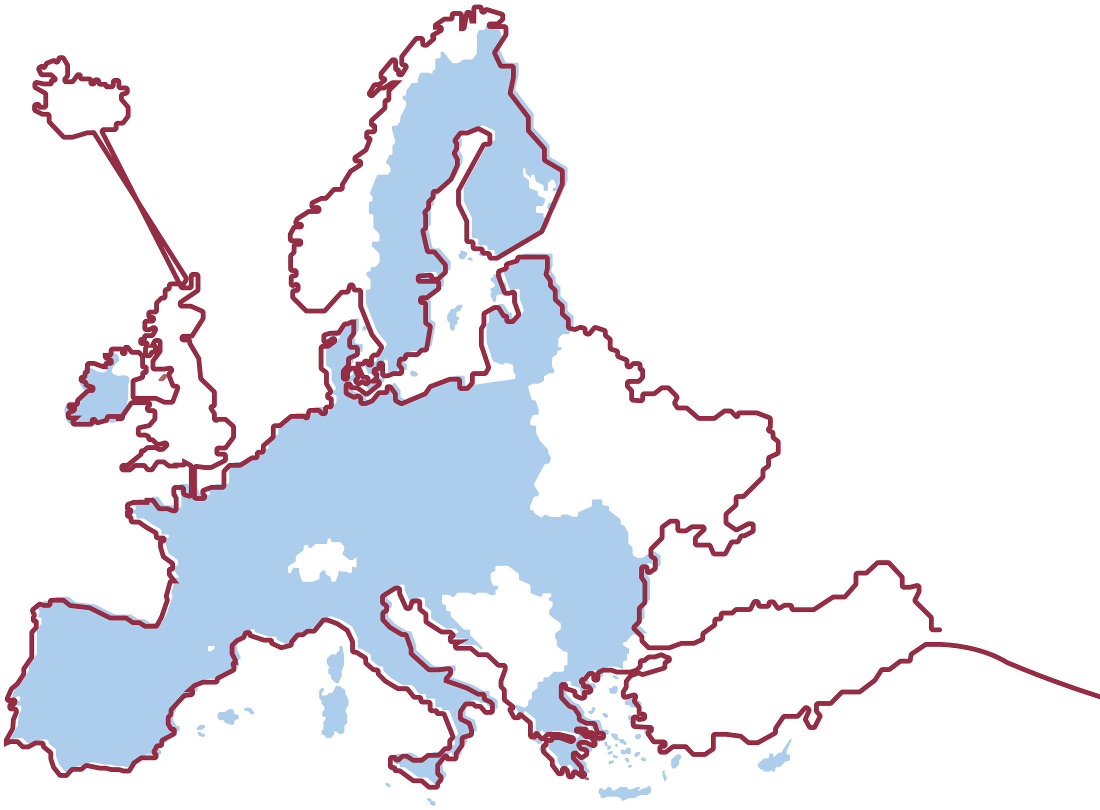
Emergency economic-policy measures managed to put the eurozone back on track again. What is evident, however, is that fundamental reforms in the eurozone and at Union level are vital to achieve a lasting stabilisation.

Doing nothing would be fatal. Any attempts to merely maintain the EMU status quo would heavily weigh on future economic, social and political developments in the eurozone. This would mean passing up income and employment opportunities in Europe along with effective representation of European interests in efforts to shape the global economic and political framework. On top of this, by failing to deepen EMU in economically weaker times, the continued existence of the single currency and thus the centrepiece of European integration will be repeatedly called into question.

Deepening EMU is, in addition, a cornerstone of the EU's large-scale reform agenda. This reform agenda would create preconditions for the continent's success both internally and externally.

Enlarging the eurozone

There is a clear-cut treaty in force that regulates membership of, and entry to, the eurozone. This must be strictly adhered to – also as regards the required level of economic



convergence – and should not be exposed to attempts to influence it through political manoeuvring.

The private banks are convinced that, in the long term, it is economically and politically desirable for all EU member states to join the eurozone provided the underlying contractual conditions for this have been fulfilled. At the same time, we are convinced that the most important task at present is stabilising EMU in the long term and that forcing a member state to join the eurozone against its will does not make sense in any case.

Improving coordination of economic policy

Coordination of economic policy through the European Semester is not transparent, effective or binding enough today. Clearer approaches should be discussed and more use should be made of "best practices" approaches.

Structural reforms that boost competitiveness and economic growth are, of course, in the interest of every member state. Nevertheless, consideration should be given to ways in which initial costs of structural reforms can be cushioned by collective financial assistance. A broad social consensus in each member state on the need for reforms is vital, however.

Further developing the European Stability Mechanism

An important starting point in the reform of EMU is further developing and strengthening the European Stability Mechanism. Besides broader powers for the ESM in implementing, managing and monitoring financial assistance programmes, the ESM could also serve as the backstop for the Single Resolution Fund (SRF) for banks. The backstop should generally enhance the SRF's credibility, particularly if a large-scale payment were to be made from it. To avoid any undesirable effects, however, the ESM backstop should be tied to a further reduction of risks in banks' balance sheets. In addition, it must be ensured that the backstop does not undermine the specified bail-in hierarchies in bank resolution.

On top of this, the ESM should also be given responsibility for continuous budgetary surveillance of member states in the eurozone. This would strengthen the link between competence and responsibility under the ESM. Budgetary surveillance could be designed to introduce a points or “traffic light” system, for example, allowing the ESM to score national budgets. This scoring system could then be used for graduated conditionality for possible ESM assistance.

The improved ESM debt sustainability assessment envisaged by the French and German governments in the Meseberg Declaration must be welcomed. In this context, the effectiveness of debt rescheduling clauses in bond contracts (collective action clauses) should be enhanced. Stipulating a limited automatic maturity extension in bond terms that takes effect when, for example, a country applies for a comprehensive ESM financial assistance programme would also be conceivable. Such a mechanism could set certain incentives for sound fiscal policy in the long term without any fear of an excessively high and thus unacceptable risk premium for problem cases.

Assigning the task of budgetary surveillance to the ESM follows, in general, from the particular importance of fiscal policy for the stability of the eurozone and is thus one of the lessons from the sovereign debt crisis. In addition, the eurozone countries would in this way satisfy the important principle of as much congruence as possible between competence on the one hand and responsibility and liability on the other.

The ESM should, in addition, be equipped with a short-term emergency facility or a precautionary credit line. This funding option should be designed to counter liquidity squeezes at an early stage. If successful, it could prevent recourse to a comprehensive financial assistance programme.

Any financial assistance provided by the ESM should be subject to conditionality, with such conditionality being based on a prior assessment of fiscal policy and on the size of the programmes applied for. This would strengthen the incentives for sustainable fiscal policy in the member states. But it must also be clear that, as the ESM’s owners, the eurozone countries should keep the power to administer the fund in their own hands and not transfer it to the European Commission.

Common eurozone country funds

So that the ESM can focus clearly on longer-term financing problems and longer-term budgetary surveillance of member states in the eurozone, common eurozone country funds for fostering investment and supporting comprehensive national structural reforms should be administered by a “eurozone finance minister”, who would at the same time head the Eurogroup.

Common eurozone country funds for fostering investment and supporting structural reforms would round off the envisaged EMU reform, whereby the eurozone would be given growth and reform-friendlier structures and, in return, the eurozone countries would display a little more solidarity. As a political compromise, these funds should kick off at a moderate volume. This would facilitate the launch of this instrument and its fine-tuning at economic-policy level.

Loosening the sovereign-bank loop

Because of, among other things, numerous liquidity rules and supervisory requirements, commercial banks hold sovereign bonds on their books. To exclude any exchange-rate risk, the bonds they hold are mainly bonds issued by their home country. Yet even within the eurozone, where there is no exchange-rate risk, many commercial banks still prefer bonds issued by their home country. If a eurozone country encounters financing difficulties, the price losses on the sovereign bonds held by banks put a strain on banks’ balance sheets. Conversely, particularly during the financial crisis and the European sovereign debt crisis, the distress experienced by European banks led via public bailout measures to a significant increase in government debt in several eurozone countries. The close ties and mutual dependency between sovereigns and banks – the so-called "sovereign-bank loop" – is a potential threat to financial stability in the eurozone and a serious obstacle to a real single financial market.

As things stand at present, the idea of loosening the sovereign-bank loop by introducing mandatory capital requirements for sovereign bonds at Basel Committee level appears to have been dropped. An "insular approach", i.e. introducing such mandatory capital requirements in individual EU or eurozone countries, must be firmly rejected. It would lead, among other things, to a serious competitive handicap for the financial sector concerned.

Against this backdrop, the European Commission's proposal to put sovereign bond-backed securities (SBBS) to a "market test" through equal regulatory treatment in order to loosen the sovereign-bank loop could be an interesting alternative. However, key preconditions for this would, in our view, be the Commission reliably excluding the risk of any "political readjustment" of the SBBS concept and the introduction of SBBS being accompanied by stricter monitoring of debt levels in the eurozone countries. —

2. Banking Union – initial achievements and further steps

The financial crisis showed that many regulatory issues affecting banks can no longer be addressed solely at national level. This is why it was right and logical to set up a Single Supervisory Mechanism (SSM) and a Single Resolution Mechanism (SRM). The introduction of a backstop for the Single Resolution Fund, as described above, is thus vital to be adequately prepared for any large-scale distress in the banking sector. The idea of a European Deposit Insurance Scheme (EDIS) should, however, only be tackled once a level playing field between individual member state markets is in place. Another project is further harmonisation of the single rulebook for banks. This should be driven forward so that banks can provide their services to customers across borders. To promote cross-border business, it would also be important to establish capital and liquidity waivers for banks. A further priority project will be EU implementation of the supervisory rules for banks adopted recently in Basel.

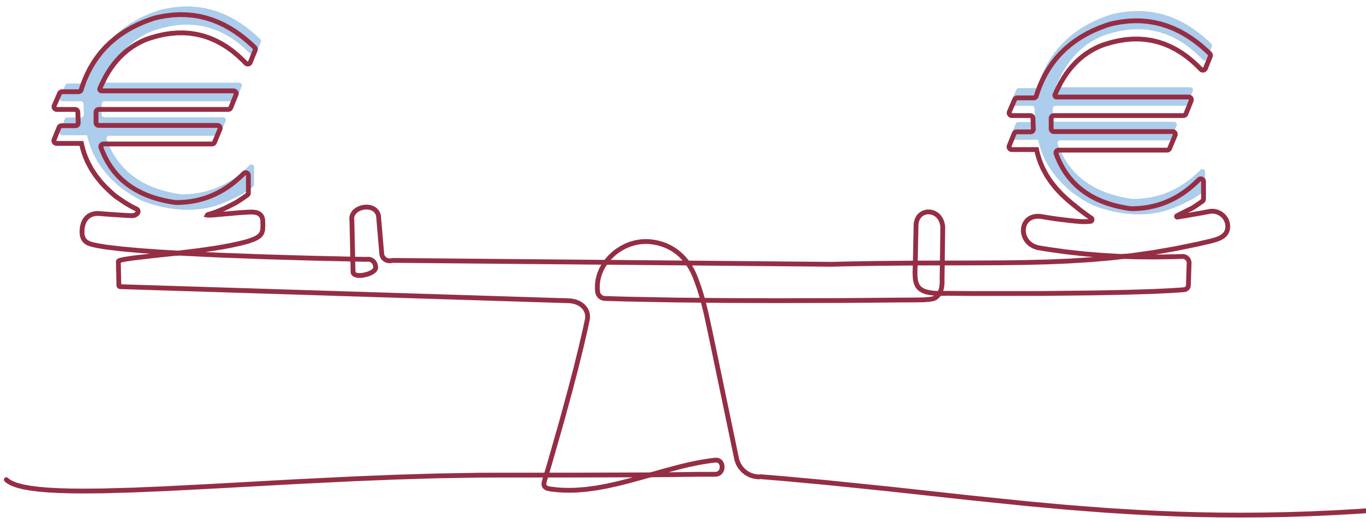
Implementing Basel IV – no unnecessary burdens for European banks

In December 2017, the Basel Committee on Banking Supervision (BCBS) agreed on the Basel IV package. Consistent implementation of the Basel rules by the EU is particularly important. Nevertheless, European specificities justify supplementing these rules accordingly.

Before implementing the Basel package, the EU will carry out a quantitative impact study (QIS). The Association of German Banks believes that, assuming the Basel rules are implemented on an "as is" basis, there will be a significant increase in capital requirements for European banks – something which the European Council rejected in a 2016 resolution. This must therefore absolutely be avoided. In addition, it should be noted that big banks, which mostly use internal models in Europe, will be hit much harder by the Basel reforms than smaller banks.

The European banking market displays specificities in a number of areas: for example, investment finance in Europe is provided mainly through financial intermediation by banks. This means that a significant part of European banks' balance sheets is made up of long-term assets.

A further major factor in European banks' balance sheets is finance provided to small and medium-sized enterprises (SMEs). Real estate finance, another important line of business for European banks, also plays a significant role in this respect.



These European specificities have been accommodated very well so far in risk-based calculation of capital requirements. Internal models have been used to estimate the probability of default separately for borrowers with no external ratings. The national specificities of the real estate markets have been reflected in different loss ratios. The widespread use of internal models by European banks can therefore be regarded as an appropriate response to their market environment.

The planned implementation of Basel IV also includes the general introduction of the output floor. The problems raised by the output floor become evident particularly in its interaction with the standardised approaches: the capital requirements calculated under standardised approaches react less strongly, or do not react at all, to a change in the risk of a position. Internal rating procedures, on the other hand, capture risks better, as banks have built up adequate data histories.

The negative effects of the output floor can be reduced by exempting important portfolios from application of the floor ("carve-out"). In addition, the current credit risk standardised approach (CRSA) arrangements should be supplemented to include more risk-sensitive standardised approaches for some selected portfolios.

The European Commission should carefully examine the findings of the QIS and take these into account when elaborating concrete proposals for action. Any discrimination of the European banking market must be avoided.

European Deposit Insurance Scheme – not at any price

The idea of setting up a European Deposit Insurance Scheme (EDIS) remains a contentious issue and will probably stay on the agenda in the forthcoming legislative term as well. Since the European Commission unveiled its proposal for a Regulation at the end of 2015, neither the Council nor the European Parliament have been able to reach an agreement.

The reasons for this are manifold. It is essentially a question of how deposits can be protected best to strengthen Banking Union. Any form of European deposit insurance should increase deposit protection compared to the national deposit guarantee schemes already in place. At the same time, it should be borne in mind that the national schemes already provide a high level of deposit protection. On top of this, cooperation between the national schemes is prescribed by law. What is more, the deposit guarantee schemes have themselves concluded a multilateral cooperation agreement within the European Forum of Deposit Insurers to which virtually all schemes have subscribed. This means that cross-border depositor compensation is ensured under a European system of national deposit guarantee schemes.

Against this backdrop, the model proposed by the Commission of full mutualisation of deposit guarantee scheme funds clearly overshoots the mark. The draft report presented to the European Parliament by rapporteur de Lange at the end of 2016 acknowledged this and proposed confining any EDIS to a reinsurance model for the time being. The Association of German Banks believes, however, that – if at all necessary – an EDIS should be limited to a purely temporary liquidity shortfall coverage scheme. This does not require fully or partially mutualising funds.

To carry on the deliberations on further Europeanisation of deposit insurance in a constructive manner, a comprehensive QIS, which ought to have accompanied the presentation of the EDIS proposal, should finally be conducted. Furthermore, the Association of German Banks and the German government agree that, in line with the ECOFIN roadmap, a further reduction of risks in the banking sector is called for first.

Various initiatives, such as the proposal for adequate loss absorption buffers to help ensure an orderly and efficient resolution process, are currently undergoing the legislative process. In addition, the Commission has presented a proposal for minimum harmonisation of corporate insolvency law. A further initiative concerns avoiding a build-up of too many non-performing loans in banks' balance sheets in future. All this is important, yet more remains to be done. For example, the most recent Basel Committee decisions still need to be implemented – not only in law but also in practice. Furthermore, the regulatory treatment of sovereign bonds in banks' balance sheets remains an extremely contentious issue. Last but not least, before any mutualisation, a comprehensive asset quality review should be conducted.

The aforementioned preconditions impact deposit guarantee schemes' liquidity requirements and banks themselves. If the right preconditions are fulfilled, the priority status that deposit guarantee schemes enjoy in insolvency proceedings means that they can only have temporary liquidity requirements. Their current priority status ensures that they subsequently recover the funds used in a compensation case. It is therefore also important that national insolvency rules are harmonised where they affect deposit guarantee schemes.

Reducing non-performing loans – differentiation called for

The European Commission's approach aimed at driving forward the reduction of non-performing loans (NPLs) is, in principle, right. While the co-legislators have signalled that they intend to conclude the relevant deliberations before the European elections, this is encountering some – often nationally coloured – resistance.

The Commission proposes, in particular, a "prudential backstop" that will introduce a minimum loss coverage level for newly originated and subsequently defaulting loans.

The proposed measures should, however, focus on banks that have correspondingly large and systemically important holdings of NPLs that they themselves originated. The European Banking Authority has, for example, thus proposed a 5% threshold for NPLs. The advantage of using a threshold would be that only banks with a high NPL ratio would be directly affected. Banks with a low NPL ratio would then be sensitised but not unduly burdened. The proposal would, moreover, reflect the actual risks. However, longer collateral enforcement and loss coverage periods than those called for by the Commission should be accepted to allow mutually agreed restructuring acceptable to both the bank and the customer. —

3. Financial regulation – stability, yes, but not only

In the aftermath of the financial crisis, the EU set itself the target of making the financial markets more stable. Following the installation of the European Commission under Jean-Claude Juncker, it quickly became clear, however, that financial regulation should have further targets – such as, in particular, fostering business finance. So that businesses can tap new – also cross-border – sources of finance, Capital Markets Union was launched.

While individual initiatives, such as revitalising the securitisation market, have already been adopted, they effectively do not go far enough. Other measures still have to be tackled in the first place. In particular, the European equity culture should be strengthened. EU citizens would benefit from improved wealth formation and, at the same time, the provision of finance to businesses would generate growth. To allow this, however, buying securities needs to be uniformly made less complicated and should not be additionally burdened by new levies such as a financial transaction tax.

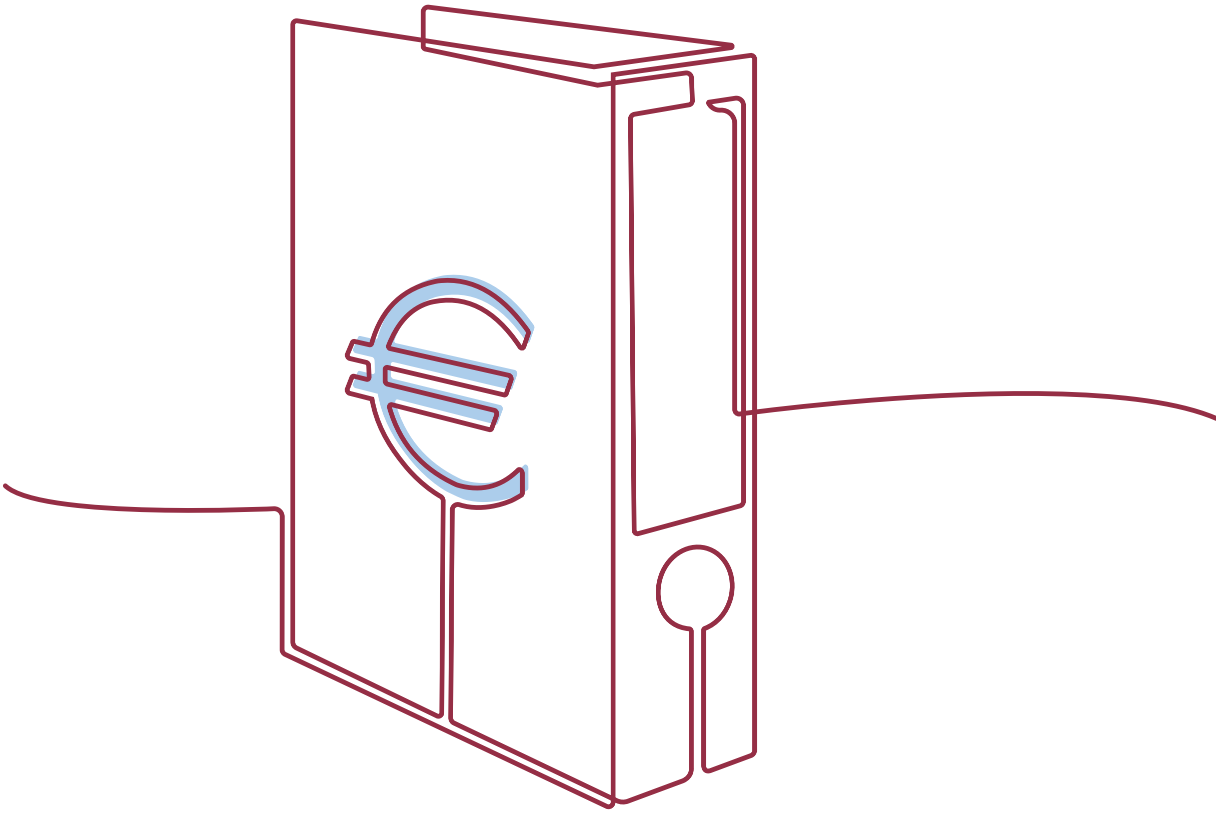
Further initiatives have ground to a halt and therefore need to be driven forward more firmly again in the coming legislative term.

European financial supervision – a work in progress

The European Supervisory Authorities (ESAs) perform major tasks – above all, fleshing out financial regulation. For banks, the European Banking Authority (EBA) and the European Securities and Markets Authority (ESMA) have been important and competent points of contact since their establishment in 2011. The legal framework for the ESAs' work is currently being reviewed; this review will probably not be completed before the European elections.

The Association of German Banks supports the idea of closer convergence of supervision in the different member states. Transferring new tasks and powers to the ESAs, moreover, makes sense provided the respective rules and regulations have already been aligned EU-wide. At the same time, it should also be accepted that the ESAs have different tasks. ESMA has an important role to play in this respect, as it partly already performs supervisory tasks today – vis-à-vis the rating agencies, for example.

Where certain pan-European issues are concerned, it is more efficient if the ESAs operate as central authorities. That



goes, for example, for preparation of equivalence decisions by the European Commission. The ESAs have the required expertise to compare foreign regulatory regimes with EU rules and prepare a quick and sound equivalence decision. Centralised European supervision of critical benchmarks and data reporting services could also be considered.

The Association of German Banks calls, on the other hand, for retention of the current ESA funding model. Full direct funding by the financial industry would be at odds with the EU Treaty and would raise budgetary control issues. Instead, the funding by the Commission (40%) and by national supervisory authorities (60%) should be retained. Also, industry involvement in ESA regulatory procedures should be improved.

Carrying on the fight against terrorist financing and money laundering

The Association of German Banks has always supported adequate and appropriate measures to combat terrorist financing, money laundering and organised crime. At the same time, it supports a state-of-the-art framework for further developing banking services in the digital environment. EU legislators have also backed both objectives during the expiring EP legislative term – among other things, by adopting the Fifth Anti-Money Laundering Directive.

In the face of the threat posed by money laundering and terrorist financing, it is encouraging that digitalisation is also increasingly being taken into account through, for example, the inclusion of virtual currency traders among the addressees of the AML Directive ("obliged entities"). In this area, further adaptation and more precise definition are likely to be needed in future – for instance, to make a clear-cut distinction between security or utility tokens and virtual currencies.

Further specification will also be needed in future with regard to the requirements for registers of beneficial owners, particularly for the entries made by companies. The information to be entered should be uniformly reconciled EU-wide with that which obliged entities currently have to collect themselves on beneficial owners to combat money laundering and terrorist financing. Ideally, obliged entities should be able to fully rely on the information contained in the registers to meet their due diligence obligations.

The directive does not specify clearly enough what information must and may be collected under "know-your-customer" (KYC) processes and how it is to be verified. This is currently regulated differently by individual national implementing legislation, leading to a fragmentation of the single market for customer acceptance and thus indirectly hindering freedom of movement within the EU. Fully harmonised specification of the information to be collected in line with the principle of data minimisation and prudent, innovation-friendly harmonisation of the means of verification are therefore required. EU legislators should, as a matter of urgency, ensure that the bureaucratic burden on banks is reduced and that rules are consistent. In addition, arrangements suited to the internet age need to be found in this area of law as well. To enable this, reviewing the status quo jointly with practitioners from the financial sector would be helpful. The Association of German Banks will support such efforts.

Further harmonisation of the rules on combatting and preventing money laundering and terrorist financing beyond the current directive and appropriate measures to strength the European Banking Authority are to be welcomed. As far as can be judged at present, the current money laundering cases are, however, due less to deficits in regulation and more to deficits in enforcement of regulation. In the fight against money laundering and terrorist financing, effective on-site supervision and close cooperation with and between law-enforcement agencies are needed in banking practice to combat serious organised crime effectively with an intervention system operated jointly by public authorities and the private sector. To allow this, closer cross-border cooperation not only between supervisory authorities but also between law-enforcement agencies is vital. The Commission's recent proposals contain key elements in this respect; yet, on their own, they are not enough to resolve existing problems.

Setting the right focus in financial regulation

Following the financial crisis, it was right to examine the legal framework for securities business for flaws and – where required – to correct it. The Markets in Financial Instruments Directive (MiFID) has been thoroughly reviewed during the past few years to produce MiFID II and supplemented by the Markets in Financial Instruments Regulation (MiFIR), along with the Regulation on packaged retail and insurance-based investment products (PRIIPs Regulation). The new requirements and interpretive guidance that have been in force since the beginning of 2018 run to over 20,000 pages. However right individual measures may be, their interaction now needs to be analysed. Initial experience already indicates that there are various flaws that should be addressed by a review during the forthcoming legislative term. What flaws are these?

Consumers – particularly in Germany – are still not willing enough to invest on the capital markets. The growing complexity of regulation is apparently reinforcing investors' existing scepticism instead of reducing it. In addition, the guiding notion of the investor appears to be shifting more and more towards the overstrained consumer. Many investors, particularly experienced retail customers and professional clients, are increasingly feeling overprotected as a result. They are irritated by lengthier processes and the renewed increase in the amount of information they have to deal with. Customers want their banks to offer them opt-outs, while banks lack means of differentiating appropriately between different types of customer.

What is more, regulation has not been coordinated well enough. This has led to effects that were not intended by legislators. For example, simple, unstructured corporate bonds can to an increasing extent no longer be purchased by retail investors. At the same time, regulatory inconsistencies harbour the danger of confusing investors (e.g. the cost of a product is calculated differently under MiFID and the PRIIPs Regulation). Associated regulation needs to be dovetailed better in future.

In particular, crucial aspects of new requirements have not been fleshed out enough at Level 1 or Level 2 by means of technical standards. This is instead often only done by ESMA at Level 3 in the form of guidelines or just by national supervisors. In a worst-case scenario – like with setting the requirements for information on costs under MiFID II – it is not done at all. The outcome is a patchwork of regulation in the EU or subsequent cost-intensive and time-consuming adaptation of bank systems. In future, issues identified in, for example, consultation processes should be clarified at Level 1 or 2.

It is important that planned review processes are carried out carefully within the designated timeframe and include market input. Where they reveal unintended flaws in regulation, pragmatic solutions should be found to deal with these. That goes for both MiFID and the PRIIPs Regulation.

Despite all the ongoing change, investors must be able to rely on fair markets. Maintaining market integrity is therefore rightly one of supervisors' main objectives. The reporting called for under Article 26 of MiFIR can be a big help in this respect, provided it is high-quality. To enable them to comply with these new reporting requirements, German banks have upgraded their systems at considerable cost and effort. Their reporting is of a high standard ensured, not least, by the dialogue with the German Financial Supervisory Authority (BaFin). Under the MiFIR review, it is to be examined whether banks should report directly to ESMA in future. There are no structures of any kind in place for this. Such a shift in reporting would entail massive costs again for all parties. Above all, however, this could result in a significant loss in quality adversely affecting the ability to ensure market integrity. Reporting to national supervisors therefore remains the right approach. —

4. Digitalisation – Europe as a centre for the “banking” of tomorrow

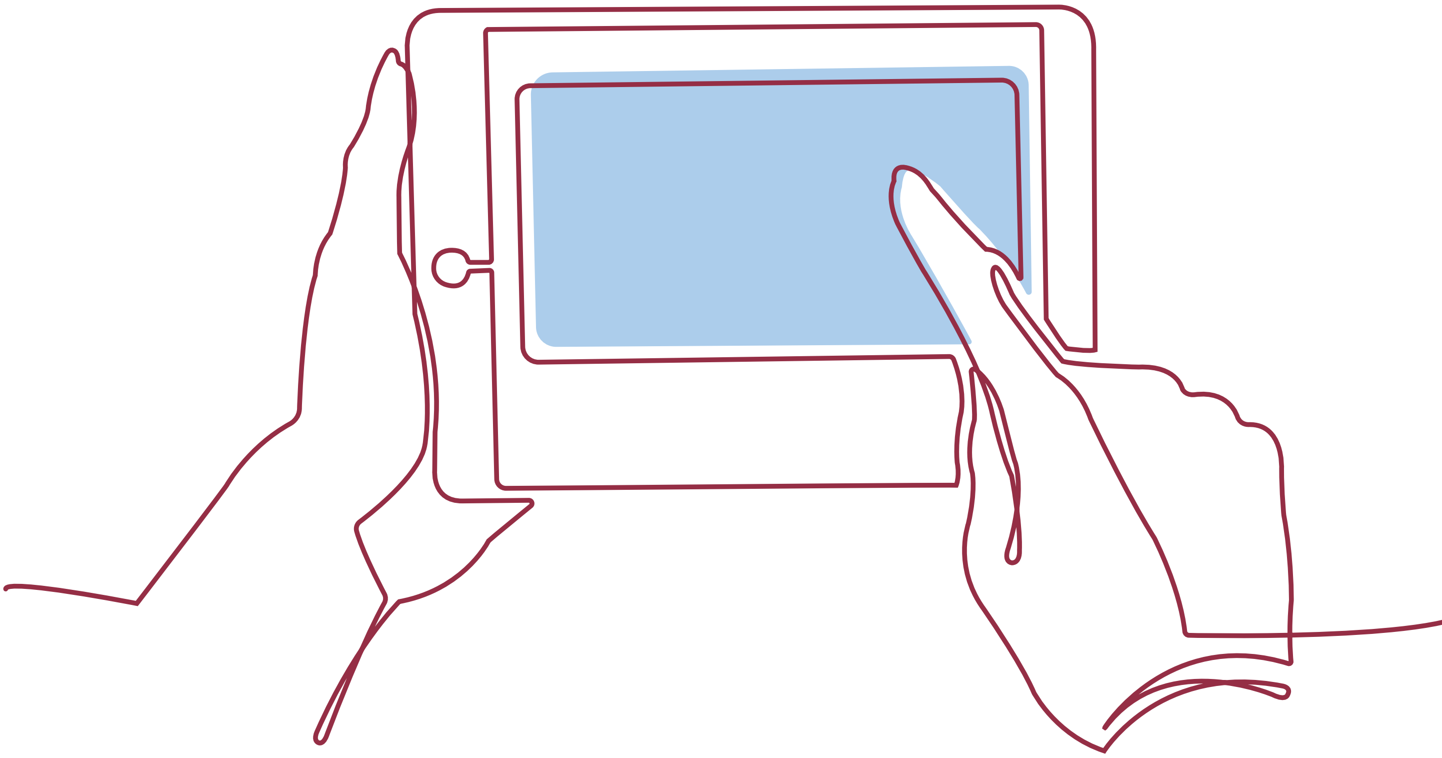
Banking is unquestionably about to undergo a sea change. If Europe is not to be left behind by developments in third countries, then here, too, we need a single European market, whose size can produce internationally competitive pan-European companies. New rules will have to be developed at European level from the outset, since digital applications know no borders.

Rules for a single digital market: European and technology-neutral

To avoid being left behind by other economic regions or newly emerging markets, we need to create an innovation-friendly environment throughout Europe for the “banking” of tomorrow. Europe must hone its profile as a centre for digital excellence. There is also room for improvement in teaching the basics of information technology in schools. The number of workers needing this rudimentary knowledge to survive in the workplace will steadily rise. To tackle this problem, we should promote both basic IT skills and continuous on-the-job training at national and European level.

At present, there is often a lack of Europe-wide impetus and standardised rules for new technologies. What is true in general, also applies to the single digital market: new rules and standards should not fragment the European market. At the same time, new rules must be not only uniform throughout Europe, but also technology-neutral so that they can be adapted to rapid changes in products and technologies. New market participants bring fresh impetus and boost competition. We warmly welcome this, as it increases the range and quality of services offered to customers. It must, however, be ensured that competition is fair and does not come at the expense of customers’ security. It is therefore essential that the same rules should apply to all providers of comparable products and services – be they banks, fintechs or bigtechs.

The primary focus should be on the big international internet platforms: they dominate digital communication and social media and infrastructure in Europe, hold large amounts of data and, through their customer interfaces, are gaining increasing influence over other industries. There is a threat of competitive distortion if market participants are not treated equally. It is unacceptable, for example, that the Payment Services Directive (PSD2) requires banks to make their customer data available to third parties via an interface, while big data companies can benefit from this but do not



have to grant access to their ever-increasing collections of data. Regulatory asymmetries to the detriment of banks run counter to the principle of fair competition and should not be tolerated.

It is surely in the interest of the EU to retain the right to decide how new technologies are used, especially where fundamental social values such as the right to personal data are concerned. This can only be achieved if the EU becomes a leading centre for digital technologies.

Data protection – strike a balance between protection and innovation

Uniform data protection rules across Europe are a prerequisite for an effective single financial market. It is therefore essential to ensure that the new European General Data Protection Regulation (GDPR) is now uniformly implemented and interpreted in member states. Guaranteeing data sovereignty and transparency is an important ancillary condition. Maintaining customer confidence in data security while at the same time offering up-to-date and user-friendly applications is, after all, a critical success factor for banks. A high level of data protection, both accorded by law and applied in practice, should therefore be seen as a locational advantage. Nevertheless, data protection should not act as a brake on future business models, but should facilitate them, and should be continuously refined to accommodate new technical possibilities. High legal standards must not be allowed to put paid to technological innovation from the outset.

It is debatable, with this in mind, whether the principles of data economy and strict purpose limitation in European data protection law are really appropriate given the current pace of innovation and the huge potential of big data. Do they perhaps, instead, cause opportunities for customers and providers to be wasted in a way that does not happen in other parts of the world? In a global data economy, data protection must also be judged by its ability to avoid placing excessively high barriers in the way of new business models. On no account should it encourage providers to migrate offshore. A balance therefore needs to be struck between the ability to innovate, on the one hand, and sensible and effective data protection, on the other. It is crucial that customers have transparency and clarity about how their data will be used. We should not, however, overwhelm them with a flood of information which may ultimately be ignored.

The German private banks therefore recommend an approach that is tailored to the needs of the customer: customers should be informed transparently and concisely about what data will be used by whom and for what purpose, about whether the data will be passed on to third parties and about where the data will be stored.

Strengthen cybersecurity

Not only banks are increasingly exposed to cyber risks – cybersecurity has become a key issue for society as a whole. Banks, which store and process sensitive data, have long protected themselves against such risks and continue to refine their standards. In addition to the state-run points of contact to which cyberattacks can be reported, there is also a need to promote other platforms where companies from all sectors can exchange information. This would enable stakeholders to consolidate their efforts more effectively, would increase efficiency and would further boost protection against attacks. On top of that, cross-border cooperation should be enhanced in the field of cybersecurity, both within Europe and beyond.

Make digital onboarding possible

The uneven implementation of anti-money laundering rules makes it difficult for a firm to acquire and onboard new customers throughout Europe. Not only do the identity documents accepted for verification purposes vary from one member state to another, but the security features of identity documents differ too. Different member states require the collection of different know-your-customer data, some of which not all consumers in the EU even have at their disposal. To make matters worse, the data collected differ not only from one country to another, but also from product to product (current account vs. securities account, for example). As a result, the "passporting" of verification methods, meaning their cross-border use across the internal market, is only possible to a very limited extent.

We are therefore in favour of user-friendly, innovative and standardised KYC processes for the EU internal market. This will require a common decision on what KYC data should be collected, the standardisation of identity documents which can be used for verification purposes (including their security features), and the specification of a standard EU identification feature (number or certificate). EU countries need to be open to new verification procedures that have been approved in another member state and can therefore be deemed sufficiently secure (principle of "most favourable treatment"): there should be uniform criteria for allowing KYC processes that have been carried out in accordance with EU law to be reused elsewhere. The Association of German Banks therefore welcomes the establishment by the European Commission of two high-level expert groups to investigate regulatory obstacles to innovation in the financial markets and analyse electronic identification and remote KYC processes. It is to be hoped that their findings will give rise to further projects in the new legislative period.

Make access to (cloud) outsourcing simple and legally certain

We are in favour of creating uniform EU-wide definitions of, and guidelines for, outsourcing. The guidelines should include concrete examples of what does and does not constitute outsourcing from a regulatory point of view. The European Banking Authority has launched a review of the 2006 CEBS (Committee of European Banking Supervisors) guidelines on outsourcing. Updated guidelines are scheduled to take effect in the course of 2019. They are intended for use by national supervisors and (for the first time) by banks subject to the Capital Requirements Regulation (CRR). In principle, we welcome a revision of the CEBS guidelines, but would prefer more binding, EU-wide rules on outsourcing in the form of technical standards, for instance. The definition of outsourcing needs to be tailored specifically to banks. It would be helpful, in addition, to describe various concrete cases of outsourcing, thus making it possible to identify beyond doubt when a situation would need to be classified as such.

We also recommend a European licensing requirement for cloud service providers wishing to offer their services to financial institutions. To obtain a licence, the provider would have to demonstrate that it met European requirements for outsourcing. This would ensure that each individual bank did not have to invest time and money in checking the cloud service provider itself. Licensed services would comply with European standards and could be used throughout the EU. Central licensing would, moreover, make the use of cloud services less expensive for customers.

Facilitate the exchange of experience in a sandbox environment

We recommend creating a European sandbox, where financial services providers and supervisors could exchange experience and views on new technologies and business ideas. The sandbox should be located at European level to give it an overview of the entire EU market. It should be open to all innovators, i.e. banks and fintechs alike. Market participants would have the opportunity to develop innovations and discuss them with supervisors at an early stage. Supervisors would gain rapid insight into market developments. Both sides would thus be able to learn and benefit from each other. In a second step, limited test phases could be conducted in which supervisors had the option of applying certain requirements less strictly or not at all without lowering the level of security for customers. All market participants should have access to the sandbox in accordance with the principle "same business, same rules".

Promote forward-looking technologies: distributed ledger technology/initial coin offerings

For new technologies such as distributed ledger technology (DLT), it is especially important to develop robust, competitively neutral standards at European level. Otherwise, European banks risk being left behind by these developments.

The most common application of DLT in the financial markets at present is initial coin offerings (ICOs). In 2017, the amount invested in ICOs significantly exceeded traditional venture capital investment. It is becoming apparent that this form of crowdfunding initiative involving the issue of digitalised assets, rights of use or stakes in a company in the form of coins or tokens will grow further.

Views across Europe differ, however, on the legal classification of ICOs and their tokens. This will give rise to considerable civil and criminal law risks for all parties involved. It is therefore vitally important to create a robust legal and regulatory framework for both investors and token-issuing companies without delay, or at least to harmonise supervisory practices with the help of the European supervisory authorities. The Association of German Banks considers the current inertia the wrong approach, not least with investor protection in mind. This is not how to respond to the rapidly progressing digitalisation and tokenisation of services and assets, nor will it allow us to fully exploit the potential unlocked by the digitalisation of very different kinds of processes and services.

As for the use of DLT, which normally forms the basis for creating these tokens, we see a need for dialogue on, and for an adjustment of, the national civil law rules and regulations governing securities. Beyond these considerations about securities, there is also a need to analyse other possible applications of DLT and develop a taxonomy for new digital products that can be generated as tokens. It is important that this debate takes place in a highly regulated environment and with the involvement of financial supervisors. Discussions should begin right away on possible legal solutions and a suitable regulatory framework for the use of DLT and for trading in products which DLT applications may give rise to and which are unregulated as things stand.

Digital payments: more competition needed

The European Commission is pursuing an ambitious growth target of creating a single digital market for goods, people, services and capital as part of its Europe 2020 strategy. Major prerequisites for achieving this single market are the promotion of mobile payment solutions with a wide reach and more competition between payment methods in e-commerce.

Mobile payment methods enable consumers to pay quickly and easily. Particularly for direct transactions between private individuals (P2P) and at the point of sale (POS), mobile methods offer an efficient, convenient and widespread alternative to traditional means of payment. They have a high level of acceptance and coverage, and at the same time are extremely secure. Essential infrastructures and technologies for processes such as authentication (e.g. by fingerprint scanner) or data transmission (e.g. by near field communication [NFC]) should be open to all payment service providers.

In e-commerce, consumers are offered various payment methods, which meet very different standards with respect to cost, security, liability and the commercial use of data. In major e-commerce segments, moreover, consumers and merchants have only limited freedom of choice when it comes to payment methods. We need clear, Europe-wide standards for payments and fair competition between payment methods and between providers. —

5. Sustainable finance – climate change concerns us all

Market dynamics in this sector are already strong. For this positive development to continue, we need a carefully coordinated European framework that takes account of the diverse and complex interaction with other areas of regulation and does not lose sight of the potential risks involved.

Support economic transformation

Banks have a key role to play in financing an economy based on sustainability principles. The German private banks and their subsidiaries embrace this responsibility and have been highly active in a number of sustainable finance segments for many years.

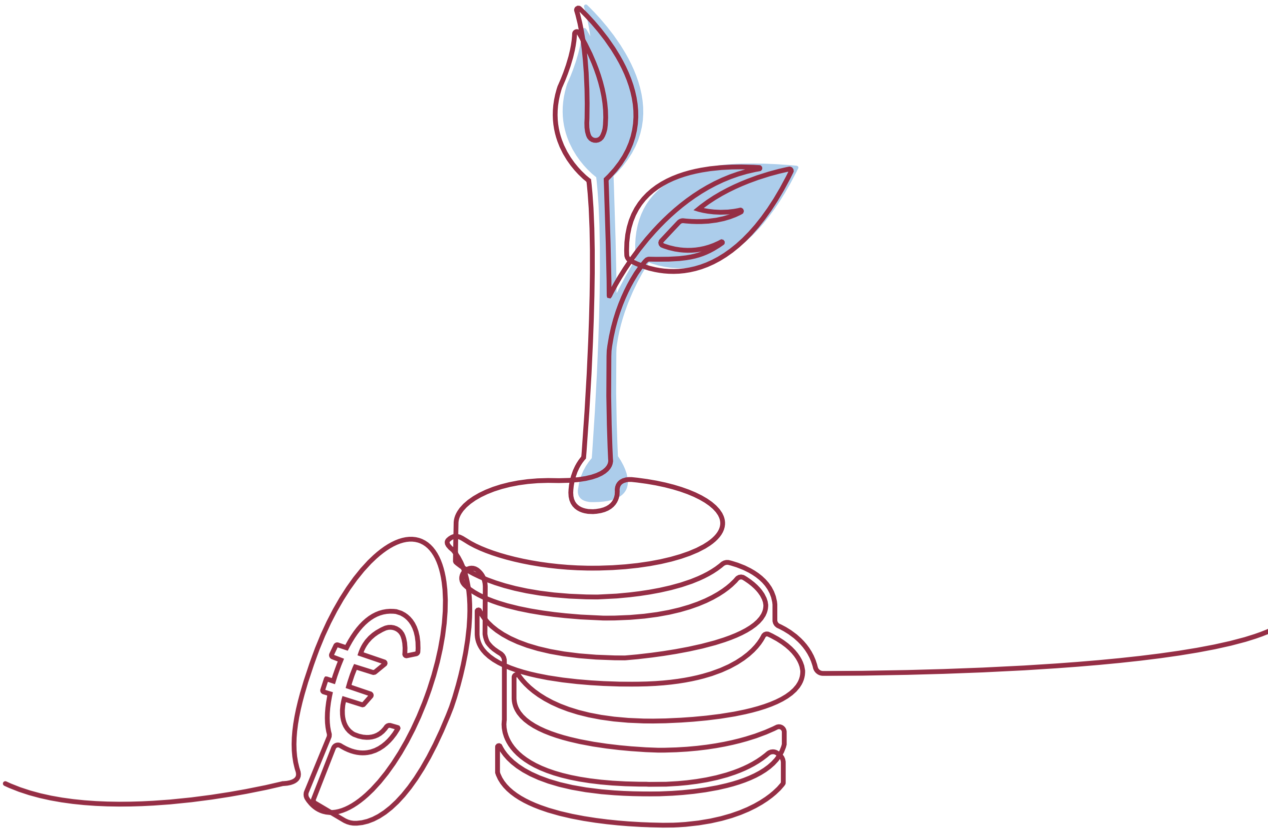
The European Commission's Action Plan: Financing Sustainable Growth and the subsequent publication of its first legislative proposals have lent huge momentum to the debate on shaping a sustainable financial system. Even prior to that, the recommendations of the Financial Stability Board's Task Force on Climate-Related Financial Disclosures, the final report of the Commission's High-Level Expert Group and an own-initiative report of the European Parliament made important contributions to the discussion. All these recommendations assign a central role to the financial sector – above all as an important provider of impetus.

The private banks warmly welcome this development, particularly with the targets of the Paris Climate Change Agreement in mind, and support policymakers in their intention to mobilise more financial resources for sustainable development and encourage the transition to a low-carbon economy.

It is important for the European Commission to keep abreast of the numerous international initiatives and take account of them in its further deliberations so that no discrepancies arise over time between action at European and global level. This goes especially for the sustainable development goals of the United Nation's Agenda 2030 and the activities the UN has announced in the area of sustainable finance.

Timetable of EU action plan highly ambitious

The Commission's action plan on sustainable finance sets out a highly ambitious agenda in terms of its timetable and content. The most important projects are to be adopted as early as mid-2019. But despite the eagerness to get things



moving, the diverse and complex interaction with other areas of regulation should not be underestimated.

It is therefore of paramount importance to implement the individual measures in the right order. First of all, we need to clarify the terminology involved, i.e. establish the classification framework with its taxonomies. Once this has been achieved, we should take stock of the situation. Only then – as a third step – can we draw sound conclusions about regulatory action. We must also remember that the basic principles of financial stability apply to sustainable finance too. The possible risks associated with sustainable finance should not be ignored. We therefore welcome the proposal by the European Parliament during its work on the risk reduction package that the EBA should carry out an initial analysis of possible capital relief for sustainable finance.

The sustainable finance agenda can only be implemented successfully if the public and private sectors work together. Close cooperation and an intensive exchange of expertise will be absolutely essential. This should always be taken into account when developing framework conditions and setting up administrative structures. In addition, governance should be transparent to all stakeholders and possible synergies with existing EU programmes and initiatives should be explored.

Retain a sense of proportion when implementing green classification system

The first and most important building block of the sustainable finance agenda is the clarification of terminology. Essentially, this will be accomplished by the proposed Regulation on the establishment of a framework to facilitate sustainable investment (Taxonomy Regulation), which will lay the groundwork for a green classification system and the development of EU taxonomies.

This process will be highly demanding both technically and organisationally and will require the extensive involvement of all stakeholders at European level. In their present form, the proposals focus first and foremost on certain capital market participants and their products. Given the findings of the Commission's impact assessment on sustainable finance, which highlights the lack of incentives for institutional investors, asset managers, investment advisers and insurance intermediaries to take environmental, social and governance

(ESG) factors into account, this is consistent and correct. It is nevertheless important that banks should also be more closely involved in the design of the taxonomies, especially in the context of the planned stakeholder platform. The involvement and active cooperation of the banking industry should also be ensured in the technical expert group which has been established to draw up a taxonomy on climate change mitigation. In addition, a close exchange of experience and views between the banking industry and the ESAs addressed in the proposed regulation should be initiated at an early stage in order to make sure that the taxonomies will also be of practical benefit to banks in the long term.

Ensure efficient action

In its sustainable finance action plan, the European Commission expressly announced that the plan would be implemented in steps, with each ESG criterion addressed one after the other. The proposal for a Taxonomy Regulation envisages a period up to the end of 2022 for the development of taxonomies in the environmental sector alone (environmental criterion). No precise point in time is mentioned at all for finalising the taxonomies covering the social and governance criteria. This approach is not reflected in the other legislative proposals relating to sustainable finance, which focus on all the ESG criteria, even in the absence of standard definitions.

The biggest problem currently facing market participants in the design and sale of sustainable investments is the lack of clear criteria for defining what the term "sustainable investment" means. It is therefore imperative to apply the step-by-step approach to all legislative proposals dealing with sustainable finance. In other words, an ESG criterion should be addressed only when robust corresponding taxonomies have been finalised. Until these foundations have been laid, no overhasty changes should be made to MiFID II or the Benchmarks Regulation, for example. —

6. Consumer protection – gear it to customer needs

Customers should enjoy the same level of consumer protection in all member states. Responsible consumers should be allowed to make their own decisions on the basis of concise information that is standardised throughout Europe without facing information overload.

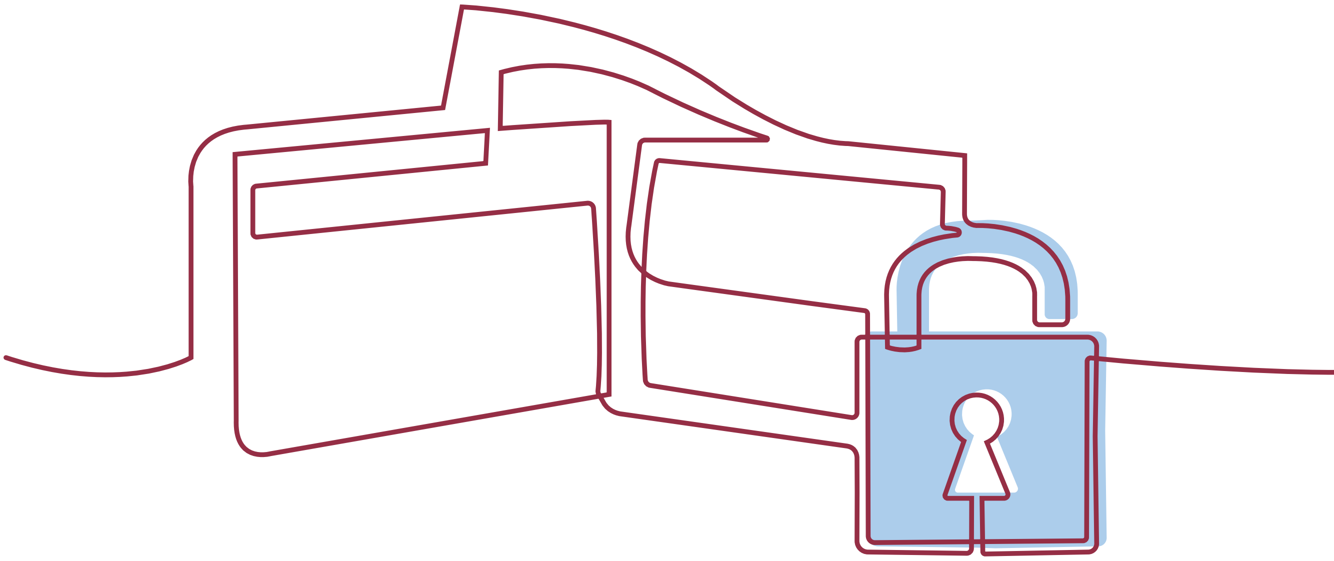
Self-determination – also in the digital world

Consumer policy should neither patronise consumers nor leave them without protection, but should always regard them as individuals able to make their own decisions. Prerequisites for such self-determination are sound information and a good education. Economics education has a particular role to play in this context because of its importance to everyone in everyday life.

Consumer policy has to strike a balance between the freedom and personal responsibility of citizens, on the one hand, and the satisfaction by the state of their fundamental need for protection and security, on the other. The "right" amount of consumer protection cannot be fixed at an absolute level, but is the result of a continuous balancing of interests in society. The question is always how far regulation can, and should, go without disproportionately restricting the freedom and self-determination of citizens, market freedom and effective competition.

In recent years, the concept of the self-determined consumer has receded further and further into the background. Not only in the regulation of financial markets (though, as a result of the financial crisis, in this area especially), we have seen the introduction of countless rules and regulations aimed at protecting the consumer. These not only serve their well-intentioned objectives, but also end up restricting consumers' freedom of action and imposing enormous bureaucratic burdens on them and the companies concerned. The challenge now is to put customers back in a position to autonomously make the right consumer choices.

If we are to create a single financial market, it is important to set pan-European rules that are, in addition, applied uniformly across Europe. This will also have the advantage of ensuring that consumers in all member states enjoy the same high level of protection. Both banks and consumers need legal clarity throughout Europe about what consumer protection rules exist and how they should be applied. Owing to the number of legal terms and new rules requiring



interpretation, it is, for example, virtually impossible as things stand to prepare right of withdrawal information in a form that can be used throughout Europe with absolute legal certainty. This gives rise to unnecessary court proceedings to the detriment of consumers and banks alike. The point at issue here is not how to avoid informing customers about their right of withdrawal, but how to provide the information in the right way.

European consumer protection rules should not, moreover, be guided by the principle that “more is better”. The amount of sometimes irrelevant information with which customers are often inundated should be reduced to a necessary minimum.

Modernise consumer credit rules

In the upcoming revision of the Consumer Credit Directive, the overall focus should be on developing balanced regulation that takes adequate account of both consumer protection and the interests of the banking industry and avoids generating disproportionate burdens. If the introduction of new requirements is considered, particular attention should be paid to the cost-benefit ratio. Many changes have taken place since the Consumer Credit Directive entered into force, both in terms of the digitalisation of services and from a legislative point of view. When reviewing the Consumer Credit Directive, the overall picture should be kept in mind.

We also recommend making proportionality a guiding principle. This goes both for the type and amount of credit involved (and thus risk for the consumer) and also for national market specificities. The difference between a mortgage loan and a consumer loan, in particular, should continue to be reflected in the rules and regulations on assessing a customer’s creditworthiness, for instance. The information provided to customers should make it easier for them to make a responsible decision; information overload, on the other hand, should be avoided.

Nowadays, loans are often made available via digital channels, and only a few clear, transparent and comprehensible items of information need to be provided. The massive changes in consumer credit markets brought about by digitalisation should also be taken into account, for example, with regard to the identification requirements for concluding a credit agreement. Thanks to digitalisation, loan providers are diversifying too. We need to ensure that consumer protection is in place, that equal conditions of competition apply and that all lenders are subject to the same supervisory rules. To offer all European consumers the same degree of effective protection, it is essential to guarantee a level playing field in this area based on the principle of "same business, same rules".

Protect the collective interests of consumers

Personal responsibility does not end at the doors to the court. That is why it is right to make it as easy as possible for citizens to access justice. The directive currently under consultation on the creation of collective actions will further strengthen consumer rights. In principle, this is to be welcomed. The directive should, however, be designed in such a way that, in legitimate cases, the same rights are available to consumers in every country throughout Europe. At the same time, we need to avoid the emergence of a "litigation industry" which takes decisions away from citizens about asserting their (real or alleged) claims in court.

Legislative proposals that may have repercussions along these lines should be rigorously opposed. In addition, the legal traditions and civil procedural rights in member states need to be respected at European level. European legislation must also safeguard basic rights with respect, for instance, to rules guaranteeing the fundamental procedural rights of the defendant and preventing the improper use of collective actions. To avoid the possible abuse by professional organisations of the right to sue, the task of representing claimants in collective actions could be given exclusively to a (neutral) public institution. —

7. Tax policy – greater fairness and transparency

A coordinated and globally competitive corporate taxation regime also has an important role to play in creating a true single market in the EU. So rules for establishing a common tax base for groups in the EU and consolidating profit and loss should be agreed along the lines of the current proposal by the European Commission.

Common consolidated corporate tax base

The Association of German Banks has always welcomed plans to establish a common consolidated corporate tax base (CCCTB) as a way of reducing or even eliminating tax compliance costs, restrictions on cross-border loss offsetting, the complex calculation of transfer prices and double taxation within the EU. We consider the consolidation element a key economic advantage of the CCCTB, as only consolidation will be able to deliver significant benefits in the form of cross-border loss offsetting, the elimination of current transfer pricing problems, the facilitation of EU-wide tax-neutral restructuring, the avoidance of double taxation and equal treatment of EU subsidiaries and permanent establishments.

We are also in favour of introducing an optional CCCTB. Compared to a mandatory CCCTB, this would have the advantage that the combination of a uniform tax base and national tax rates could be designed in such a way as to be more attractive than having to work with a number of different national tax regimes. This might encourage a shift to the new system among companies which would otherwise have reservations about the anticipated one-off switching costs. It will be essential to establish a "one-stop shop" for determining the tax base in order to harmonise tax procedures (especially for small and medium-sized enterprises) and ensure a uniform application of the rules.

A financial transaction tax would be damaging

The idea of introducing a financial transaction tax (FTT), which is still being floated at EU level in the form of enhanced cooperation – now between ten member states only – is fraught with risk. A tax of this kind would make many types of investment considerably more expensive. Institutional investors, in particular, would probably relocate at least part of their business to countries outside the scope of the additional tax. On top of that, the FTT would

represent another obstacle to entering the European market from the perspective of non-European market participants. This would be the case, for example, with the clearing of euro-denominated derivatives. In no way would this be conducive to a single European banking market.

A major disadvantage of the FTT would be its cumulative effect. The anticipated adverse consequences would not only affect trading on the stock exchange. All trading in financial products would be equally hard hit.

Contrary to the arguments of its proponents, the FTT would ultimately impact not only the financial sector but all buyers of financial products, above all savers and businesses in the real economy. German SMEs and exporting companies would be particularly affected, as sensible and necessary transactions such as hedging against interest rate, currency and commodity risks would become more expensive. Occupational and private pension schemes would suffer adverse effects as well. An FTT would impair private capital formation and undermine state support for private retirement saving for old age by sometimes cancelling out the financial incentives provided by the state. The action likely to be taken to avoid the tax would badly damage the international competitiveness not only of banks but of the European economy as a whole. All in all, the FTT poses incalculable risks to the position of Germany and Europe as a financial and business centre. Its far-reaching negative consequences have apparently been completely underestimated. Against this background, we strongly oppose the introduction of an FTT.

Taxing digital services

We naturally support European measures aimed at taxing cross-border digital transactions. It is doubtful, however, whether the long and short-term proposals for directives put forward by the European Commission will achieve their intended objective without giving rise to serious legal and economic disadvantages for EU companies operating outside the EU. In a world where international tax competition is once again heating up, there is a danger that other states or communities of states will – depending on their own economic strengths and weaknesses – themselves identify certain data or business models and place their own tax on them.

Taxing the digital economy first requires in-depth analysis and an international consensus on a taxation strategy.

A particular problem is the difficulty of differentiating between digital business models and those which are digitalised yet stationary. We should not pre-empt the findings of the parallel work which the OECD is undertaking but has not yet completed owing to the number of unresolved questions. The European Commission's proposals for directives on certain individual digital business models will not help to achieve an international consensus, in our view.

Nor do we consider it sufficient to tax only certain cross-border online transactions. The collection of user data as a basis for taxation in the source state would take us into uncharted tax territory and is internationally controversial. There are, in addition, numerous complex technical questions with regard to the distribution of taxation rights and the allocation of profits.

Given existing regulatory requirements, the difficulty of differentiating digital from digitalised banking services, especially those provided through the operation of platforms on the one hand and (possibly parallel) stationary business activities in a permanent establishment in another EU country on the other, places a double burden on banks. There is thus a risk of double taxation as a result of possible conflicts of allocation and qualification between the source state and the state of residence. It is essential to avoid this.

Treatment of losses of a permanent establishment in another EU state

The case law of the European Court of Justice (ECJ) should be followed and drawn on to a greater extent in the European legislative process. Take, for example, the ECJ's recent reaffirmation, in its ruling of June 2018, of the case law on the treatment of "final" losses of permanent establishments in another member state. This takes the view that, when it comes to realising the objectives of the fundamental freedoms with respect to the "final" losses of an EU permanent establishment, an EU principle of tax efficiency should take precedence over the principles of territoriality and of the coherence of tax systems. It is thus up to national tax regimes to put national rules in place enabling the "final" import of losses to be enforced in accordance with ECJ case law.

In the interests of fair competition, these rules should be coordinated at European level, especially with regard to determining "finality" and to demonstrating that losses are final.

EU rules could use as their starting point the European Commission's previous work of 19 December 2006 on the tax treatment of losses in a cross-border context. The European Parliament adopted a resolution expressly supporting the Commission's proposals. For banks engaged in cross-border business in other member states, a coordinated approach is essential to ensure a level playing field. This is because different national implementation, together with different national accompanying regulations to prevent abuse, would have differing impacts on banks' regulatory capital, thus distorting competition. —

8. International affairs and Brexit – strengthen open markets

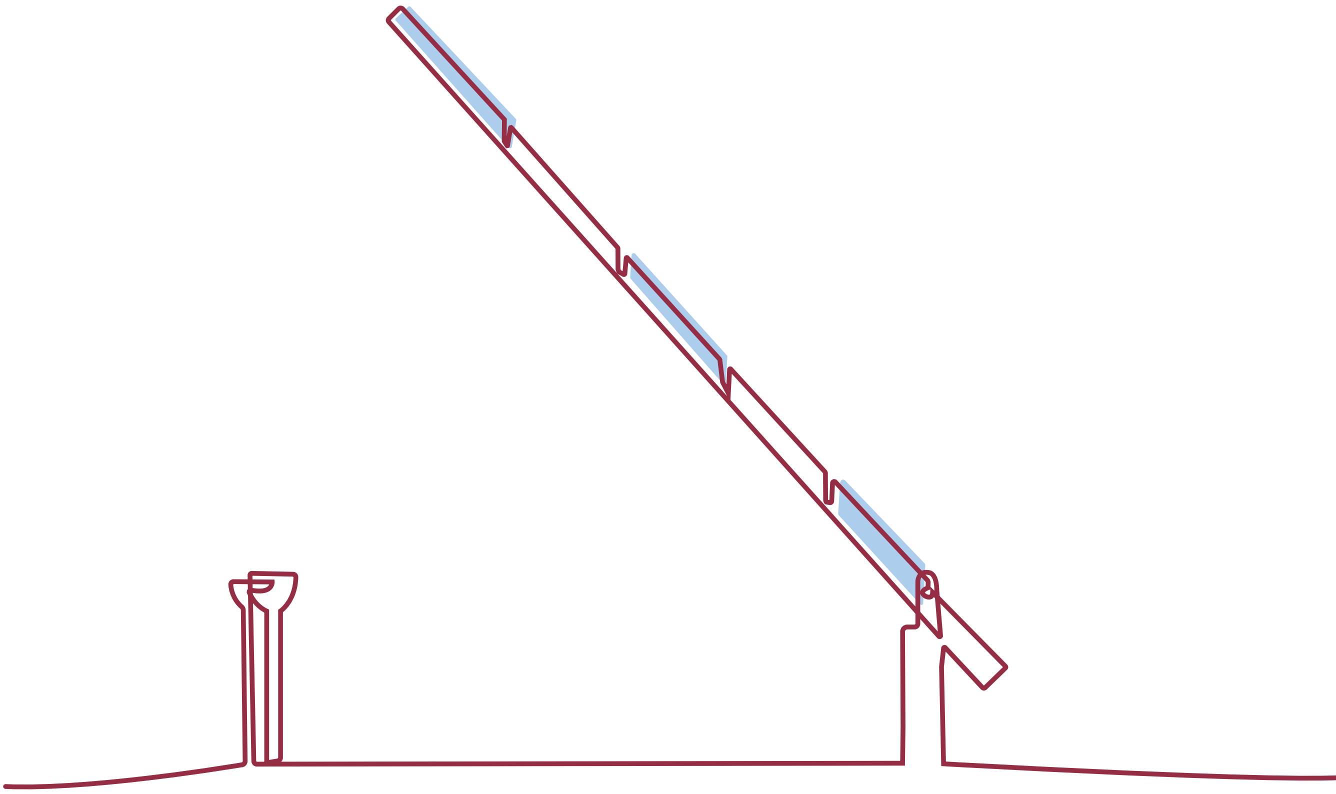
Open markets are and remain a key prerequisite for prosperity. Increasing protectionism poses a threat to the interconnected, internet-based global economy and puts the entire world economic order at risk. Banks finance growth and exports and are indispensable to an open economy. We welcome the fact that the European Commission is clearly addressing these issues and taking a more robust approach. A strategic dialogue is needed early in the next legislative period so that the interests of the business community can be brought into this process. In times of growing protectionism and with the upcoming departure of the United Kingdom from the European Union, it is therefore in the interests of the economy as a whole that the European financial market is strengthened.

Trade policy – increasing renationalisation is concerning

Globalisation has increased prosperity in many countries of the world, as shown by a comparison of per capita income trends in developing, emerging and industrialised countries over the past 30 years. Open markets are and remain a key prerequisite for prosperity.

The Association of German Banks is therefore becoming increasingly concerned about the protectionist stance of US trade policy. The special tariffs on steel and aluminium introduced under the guise of national security and the threat of protective tariffs on cars put global economic growth at risk and undermine investor confidence, investment and the expansion of world trade.

Unlike in the past, most trade nowadays is in intermediate products along global value chains. This has led to a significant decline in the proportion of domestic value added in exports. Rising protectionism poses a threat to this networked, internet-based, global method of production and will not only lead to recession, but puts the entire world economic order at risk. The interests of the European economy need to be protected without triggering a spiral of protectionism. We urge the EU to act decisively, but also prudently, so as to avoid possible trade wars. The joint statement issued by presidents Trump and Juncker in Washington in July 2018 is therefore an important sign of détente and a first step in the right direction. We welcome their willingness to dismantle existing transatlantic trade barriers. A general lowering of tariffs is better than a policy of “tariff rearmament”.



We also welcome the interest in reforming the World Trade Organisation (WTO) announced in the statement. It is more important than ever, in this time of growing protectionism, to have a strong and effective WTO, and its trade rules and dispute settlement system are crucial to fair global trade.

But words must now be followed by deeds. The public resistance to the Transatlantic Trade and Investment Partnership agreement showed that the social consensus on globalisation and open markets has diminished in recent years. This challenge should nevertheless not deter us from asserting legitimate European interests. With an internal market which is the largest common economic area in the world, the EU must show strength in the upcoming negotiations and continue to stand united against unilateral trade measures.

Sanctions – objectives can only be achieved with international consensus

Sanctions are foreign or security policy measures that essentially aim at restricting the movement of goods, services and capital, including payments. In recent years, sanctions have increasingly been discovered as a foreign policy tool and are becoming more and more ambitious in their design. While sanctions were originally imposed on entire countries (full embargo), the trend is now towards trying to change behaviour by means of targeted sanctions against specific economic sectors (e.g. Russia: energy and arms sectors; Iran: nuclear sector, etc.). This is a particular challenge for banks, as they are required to have more and more knowledge about the underlying purpose of financial transactions (dual-use, know-your-customer, etc.).

In many cases, EU sanctions are based on decisions by the United Nations (UN), but the EU also imposes sanctions of its own. If these deviate from other sanction regimes – especially US sanctions – Europe's internationally interconnected financial industry faces particular problems as many US sanctions (contrary to international law) have a significant extraterritorial effect. It is virtually impossible for banks to escape this effect since they cannot function without access to dollar clearing. Penalties of billions of dollars imposed on European banks by the US for breaking US sanctions and anti-money laundering rules speak volumes.

New US sanctions against Iran and the announced tightening of US sanctions against Russia are currently a cause for particular concern as they deviate significantly from the EU regime. The legal position was extremely complex and convoluted even before US sanctions were stepped up; reputational damage on both sides of the Atlantic represents yet another risk for banks.

The EU Blocking Regulation, recently revised to include certain US sanctions against Iran, cannot provide effective protection. On the contrary, it adds further complexity. We understand that the EU wishes, on the one hand, to send a political signal to the US while, on the other, protecting its own market participants. But the Blocking Regulation also opens the door to claims for damages which, in principle, can also be directed against European businesses and banks. Banks see themselves caught more and more between the two regimes.

On top of that, increasingly ambitious selective sanctions often produce unwanted side effects as a result of the complex and costly monitoring obligations involved. There is a growing tendency to avoid business with certain banks and markets because the costs are no longer proportionate to the income. It is becoming more and more difficult from a risk management perspective for banks to deliver humanitarian aid or engage in business desired by policymakers.

The Association of German Banks believes that, in an internationally interconnected financial industry and global economy, the political objectives pursued with sanctions in general and financial sanctions in particular can only be achieved by joint action. The existence of an accompanying political dialogue between the countries involved and a consistent legal framework is hugely important, especially for European banks. To minimise unwanted side effects, financial sanctions should be designed with practicalities in mind. And European measures should not add further legal complexity or generate additional risk for European market participants.

US financial regulation – a comparison is worthwhile

The US administration has recognised that a profitable financial sector is essential to a thriving economy. In consequence, it has begun scrutinising banking regulation and withdrawing burdens in areas where regulation has not achieved the desired results.

This is not a matter of simply reducing regulation, but of reducing complexity and bureaucracy in a way that makes sense without jeopardising financial stability.

The Treasury Report of June 2017 paved the way for a well thought-out and balanced mixture of measures aimed at making things easier for customers and banks, and promising regulatory relief for small and medium-sized banks, in particular.

Thanks to these policy decisions, the US administration, Congress and supervisory authorities have made a major contribution to strengthening the profitability of US institutions and thus the entire US banking market. This has also had a significant impact on banks in Europe. Competition with their American counterparts is becoming fiercer and European banks risk falling further behind and losing market share.

Banks finance growth and exports and are indispensable to an open economy. In this challenging international environment, it is therefore very much in the interests of the economy to strengthen the European financial market. A strong and dynamic European economic region needs a proportionate and consistent regulatory framework.

It is consequently essential to review existing European financial regulation objectively and adjust it where necessary. This review should be launched in the coming legislative period.

Brexit – close cooperation desirable despite the withdrawal

Nothing can be done about the fact that the United Kingdom will leave the EU at the end of March 2019. For the UK, Brexit will bring economic risks arising from continual uncertainty, a reluctance to invest and a more difficult trade environment. These may – albeit to a lesser extent – affect EU member states as well in their capacity as major trading partners of the UK. Close political and economic relations between the EU and the UK post-Brexit are therefore in the interests of both sides.

The Association of German Banks therefore welcomes the idea of a transitional period until 31 December 2020, in which the UK will be treated as if it were still a member of the EU. This period should be fully exploited to avert a "hard" Brexit and clarify the future economic relationship. But since there will only be a transitional period if a legally binding exit agreement is also concluded, a hard Brexit without a transitional phase and without agreement on the form of future relations remains a possible outcome of the negotiations.

When the UK becomes a third country, businesses and banks will need rules and regulations that reflect the economic relations that have developed since Britain joined the EU. It will be particularly important to protect financial services contracts that exist at the time the UK leaves the EU; they should continue to be treated – from a regulatory perspective, for instance – as if the UK were still a member of the EU ("grandfathering").

Ultimately, we will need a comprehensive economic agreement between the EU and the UK allowing extensive reciprocal market access. Financial services should be an integral part of this free trade agreement.

But the equivalence regime could also play an important role in the Brexit process, even if it can never be a substitute for passporting. As British financial regulation and prudential standards will correspond to those in the EU on the day of Brexit, the EU and UK should make mutual use of all existing equivalence provisions and revoke them only in response to changes in EU or UK law.

Modifications to aspects of regulation in the EU or UK that influence equivalence decisions may lead to the withdrawal of equivalence. They should therefore be communicated to the other party at an early stage so that both sides will be clear about the consequences.

The Commission proposal for reorganising and strengthening the supervision of central counterparties located in third countries (third-country CCPs) and its envisaged equivalence regime could also be applied appropriately and effectively to the UK. The proposed instruments and rights to intervene are sufficiently flexible to avoid unwanted adverse effects on market participants and financial market stability.

Negotiations between the EU and the UK will continue even after March 2019. The envisaged transition phase should be used to provide clarity as soon as possible about where there will be mutual market access and about how this access will function.

Brexit will not hamper the provision of financial services to private and corporate customers. At most, changes are conceivable with respect to very large financing or hedging transactions, which have taken advantage up to now of London's liquidity, risk-bearing capacity and internationality. The UK's third-country status will result in increased documentation and other processing costs and possibly reduce the number of providers. Viewed from this perspective, Brexit will be costly but manageable for banks operating in Germany, where a regime for dealing with third countries already exists and which already has extensive experience of dealing with such countries. —

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