GLI GLOBAL LEGAL INSIGHTS

Banking Regulation

2024

11th Edition

Contributing Editors: **Peter Ch. Hsu & Daniel Flühmann**

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GLOBAL LEGAL INSIGHTS – BANKING REGULATION

2024, 11th EDITION

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PREFACE

Banking has a global reach and ambition. It is also a heavily regulated industry. Simply staying abreast of the ongoing developments of the business and its regulatory environment is a challenge, even for the most dedicated specialist, let alone anticipating future change. Technological developments constantly threaten to disrupt the industry, but it remains difficult to predict whether, when or to what extent this will happen and how regulators will address the resulting challenges. Fintech has already triggered initiatives for regulatory change in numerous jurisdictions, but developments continue at a breathtaking pace. Furthermore, intermittent scandals and crises prompt regulators and lawmakers to launch new regulatory initiatives. For the legal practitioner, it is therefore important to look past the buzzwords and perform a thorough analysis from a legal and regulatory perspective in each individual case, futureproofing the advice given whenever possible.

This is where this book comes in. It provides general counsels, lawyers and regulators with a comprehensive insight into banking regulation in 19 jurisdictions around the world. The chapters have been written by leading practitioners in each jurisdiction, who provide their analysis and views on the current state of regulation and ongoing developments. To facilitate comparisons, the structure of each chapter is the same: it starts by introducing the reader to the architecture of the banking regulation in each jurisdiction, covering both the rules that are applicable to banks and the regulators in charge of supervising and enforcing them, followed by an overview of new trends and legal developments in banking and related areas.

The authors further address the key governance requirements, as well as aspects of internal control and risk management for financial institutions. The chapters extend to presenting regulatory capital requirements, analysing the role of national and international standards in defining these requirements, as well as the impact of international initiatives to improve capital and liquidity requirements in the jurisdictions that are surveyed. Finally, customer protection regulations are reviewed, covering not only rules that apply to the conduct of banks when dealing with clients, but also rules on cross-border services and anti-money laundering initiatives.

Overall, our hope is that this book will prove a stimulating and insightful read, which will prepare banks and their advisers not only to overcome but to master the challenges they and their clients are facing at a local and global level.

Peter Ch. Hsu & Daniel Flühmann
Bär & Karrer

Andorra

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Cases & Lacambra

Introduction

The Principality of Andorra ("**Andorra**") is a microstate situated in the southwest of Europe, embedded in the eastern side of the Pyrenees, bordered by Spain and France. Andorra has a unique institutional system headed by two co-princes, the Bishop of Urgell and the President of the French Republic. In 1993, the Constitution was approved by referendum, which allowed Andorra to achieve international recognition and become a member of the United Nations and the Council of Europe. In this sense, Andorra, which is structured into seven administrative regions known as "parishes", established itself as a parliamentary democracy with a Head of Government elected by the General Council ("*Consell General*"), its Parliament and, as mentioned above, with the co-princes as its Head of State.

Andorra has historically based its significant economic prosperity on a competitive model based on tourism, trade, construction and its capacity as a financial hub. The financial system, along with the insurance sector, plays a fundamental role in the Andorran economy, contributing significantly to the country's GDP.

The 2008 financial crisis, which affected the bordering states, was the starting point of a transition from a rather closed tax haven to a competitive, open and low-taxation jurisdiction. The change in the economic model has been accompanied by a new regulatory environment in line with international standards, the liberalisation of foreign investment and human capital and competitiveness.

Therefore, Andorra has opted for a standardisation of the level playing field with other European countries and the recommendations of the Organisation for Economic Co-operation and Development ("**OECD**"), but modulating certain distinctive features in order to enable Andorra to be more competitive in the services it offers, particularly in trade and tourism, and also to enable the country to become one of the most attractive jurisdictions in Europe with respect to the development of investment projects and business initiatives worldwide.

Andorra's new economic model, based on the liberalisation of foreign investment, provides a host of international strategic opportunities at both corporate and individual level, which is complemented by a competitive tax framework and an exceptional living standard.

Andorra has a very strong financial industry, with a local financial system that makes it one of the most relevant financial investment hubs, comparable to Luxembourg or Switzerland. The Andorran financial sector is the backbone of the Andorran economy, its core being the banking sector. To the extent that Andorra has a significant banking sector that operates in close connection with EU member countries, relevant EU banking and financial legislation is in force, such as legislation concerning the prevention of money laundering, terrorist financing and fraud, statistical reporting requirements, and investor protection, among others.

In June 2011, Andorra signed a Monetary Agreement with the European Union. The Monetary Agreement not only recognises the euro as the official currency of Andorra, but also the right to issue euro coins and the obligation to grant legal tender status to euro banknotes and coins issued by the Eurosystem. The Monetary Agreement represents the cornerstone of the legal changes envisaged for the next 10 years, as it requires Andorra to adopt within certain timeframes a substantial part of all EU financial legislation.

Furthermore, in September 2013, the International Organization of Securities Commissions ("**IOSCO**") protocol for a multilateral agreement on consultations was signed.

To this extent, the Andorran legal system has changed since the Monetary Agreement came into effect on 1 April 2012, as it allowed reciprocal cooperation, assistance and exchange of information at an international level with the regulatory and supervisory authorities of global markets.

Negotiations between Andorra and the European Union for reaching an Association Agreement started in April 2014. As of the drafting of this chapter, negotiations between Andorra and the European Union for an Association Agreement are reaching their final stages, with key areas – such as financial services – still under discussion. The Association Agreement aims to facilitate Andorra's progressive integration into the European internal market, allowing for the transposition of the EU acquis in the upcoming years. The anticipated timeline envisions the conclusion of negotiations by the end of 2024, followed by a period of public consultation and a subsequent referendum. The Association Agreement reflects a strategic effort to align Andorra's financial regulations more closely with global standards. As part of this alignment, there is a growing emphasis on enhancing regulatory frameworks to ensure transparency, compliance, and adherence to international banking and securities standards. This shift is not only in response to global expectations but is also driven by the recognition that a more integrated and harmonised regulatory environment will foster economic stability and growth.

As a result of the Association Agreement, the banking sector in Andorra is expected to undergo transformative changes. While traditionally rooted in discretion, the sector is adapting to embrace greater transparency and regulatory scrutiny. This evolution is viewed as a positive step towards bolstering investor confidence, attracting foreign investments, and positioning Andorra as a competitive player in the global financial landscape. On another note, the functioning of the Andorran economy needs the Andorran banking sector to be prepared for future challenges, including the supervisory authority and other bodies involved in investment and financing activities. Accordingly, Andorran banking entities are continuously monitoring the most up-to-date, significant developments in banking regulation, such as good practice requirements defined by the Basel Committee, and the challenges of ensuring financial and insurance products, corporate governance, among others, with the clear purpose of positioning themselves within the global markets.

The progressive convergence of the Andorran and EU legal framework by means of the Monetary Agreement – which foresees the implementation of the second Markets in Financial Instruments Directive ("**MiFID II**") and the Markets in Financial Instruments Regulation ("**MiFIR**") – represents a significant regulatory shift. This transformation will impose growing regulatory and adaptation costs on Andorran financial entities. Additionally, Andorran financial entities will be compelled to allocate substantial resources to technological innovation and digital transformation.

In line with the foregoing, on 15 November 2023, the Andorran General Council passed a bill addressing the organisational aspects and operations of entities within the financial system, alongside measures targeting market abuse, incorporating MiFID II in Andorra as

an amendment to the Financial Securities Act ("**MiFID II Draft Bill**"). The MiFID II Draft Bill has the main purpose of incorporating the provisions of MiFID II into the Andorran legal framework, in order to align Andorran regulations with MiFID II standards concerning, among others, advisory services, portfolio management, appropriateness and suitability criteria, product governance standards, client information, inducements and remuneration, conflicts of interest, asset safeguarding, record-keeping practices, best execution policies, and internal control measures.

In addition to this, the Andorran Government is actively promoting the use of innovative and disruptive technologies. To this extent, the Andorran Government announced in July 2020 the so-called "Horitzó 23", a plan adapted to the new scenario that emerged from the health crisis caused by SARS-CoV-2, known as COVID-19, in order to promote "making Andorra a resilient, sustainable and global country".

In this emerging scenario, Andorran banking entities, predominantly digital, may benefit in terms of collaboration agreements entered into with FinTech entities, the new players, in order to reduce costs and provide more sophisticated services to end investors.

To illustrate this, the following pieces of legislation have been approved: Law 42/2022 of 1 December 2022 on digital economy and entrepreneurship, which introduces crowdfunding platforms as regulated activities in Andorra; Law 37/2021 of 16 December amending Law 14/2017, which introduces cryptocurrency exchange platforms and custodians as obliged entities; Law 7/2021 of 29 April on the restructuring and resolution of banking entities and investment entities, and Law 35/2022 of 24 November, amending Law 8/2013 of 9 May, on the organisational requirements and operating conditions of the operating entities of the financial system, investor protection, market abuse and financial guarantee agreements, transposing Regulation (EU) 648/2012 on over-the-counter derivatives, central counterparties and trade repositories ("**EMIR**"); Law 22/2022 on cybersecurity law of 9 June 2022, aligned with the standards set by Directive (EU) 2016/1148; and Law 24/2022 of 30 June on digital representation of assets and cryptography and distributed ledger/blockchain technology.

Regulatory architecture: Overview of banking regulators and key regulations

Andorran banking regulators

Under the Andorran Constitution, the legislative initiative lies jointly with the General Council and the Andorran Government. The General Council exercises legislative power in the Andorran jurisdiction and is composed of 28 general councillors, elected by universal suffrage for a period of four years. By law, the General Council can delegate the exercise of legislative function to the Andorran Government. In case of extreme urgency and necessity, the Government may submit to the General Council a draft articulated text for its approval as a law within 48 hours.

The Andorran Financial Authority ("**AFA**") is the regulatory and supervisory authority of the Andorran financial system; the AFA is granted powers to issue, among others, technical communications and recommendations in order to develop regulations and standards regarding the exercise of banking, financial and insurance activities. Furthermore, its constitutive law grants the AFA the ability to set the applicable fallback of international standards for interpretational and prudential supervision purposes.

As the authority of the Andorran financial system, its functions encompass: (i) promoting and ensuring the functioning of the Andorran financial system; (ii) ensuring the stability and safeguarding the reputation of the Andorran financial system; (iii) ensuring adequate protection of clients and investors; (iv) promoting the competitiveness of the Andorran financial system; and (v) reducing the systemic risk arising from the instability of the financial markets.

In addition, the AFA: (i) has the power to carry out all the actions that are necessary to ensure the correct development of its supervision and control functions to the entities that compose the Andorran financial system (and their consolidated groups); (ii) exercises disciplinary and sanctioning power over these entities; (iii) provides treasury and public debt management services; (iv) manages customer complaints that are submitted to the AFA; (v) is responsible for international relations with central banks and other supervisory authorities; and (vi) submits reports and opinions on financial legislation to the Andorran Government.

On 17 September 2013, the AFA was accepted as a new ordinary member of IOSCO.

There are other bodies involved in financial activities whose functions are not strictly regulatory, but their role is essential for the adequate functioning of the Andorran financial system.

The Andorran Financial Intelligence Unit ("**UIFAND**") is an independent body created to promote and coordinate measures to prevent money laundering and terrorist financing. This unit was created in 2000 under the law for international cooperation on criminal matters and the fight against money laundering arising from international crime, following recommendations of the European Council's MONEYVAL Committee and the 40 recommendations of the Financial Action Task Force ("**FATF**").

UIFAND has the following functions: (i) to manage and promote the activities of prevention and the fight against the use of the financial system for money laundering or terrorist financing; (ii) to issue technical communications; (iii) to request any information or documents to reporting subjects, including Andorran banking entities; (iv) to conduct on-site inspections; (v) to request and receive certificates from the competent judicial authorities for criminal records; (vi) to receive and analyse the statements and all written or oral communications from reporting subjects; (vii) to cooperate with other foreign organisations; (viii) to sanction minor administrative offences; (ix) to submit to the Public Prosecutor all appropriate cases where there are reasonable suspicions of having committed a criminal offence; and (x) to submit proposed regulations to the Andorran Government relating to the fight against money laundering and terrorist financing.

The State Agency for the Resolution of Banking Institutions ("**AREB**") is a public institution created by Law 8/2015 on urgent measures to introduce mechanisms for the recovery and resolution of banking institutions of 2 April. This law attributes to this agency the management of the processes for the winding-up and resolution of banking entities.

The Andorran Fund for the Resolution of Banking Institutions ("**FAREB**") was created for the purpose of financing the measures agreed by the AREB in the application of Law 8/2015. This institution, which does not have legal personality, is managed by the AREB.

The Andorran Data Protection Agency, created by the Andorran Data Protection Act 15/2003 of 18 December 2003, is a public institution that exercises independent authority over the treatment of personal information provided by individuals, private entities and Andorra's Public Administration in order to ensure respect for the fundamental rights of individuals in all automated or manual processes involving an exchange of information.

The Commerce and Consumer Unit ("**UCiC**") is responsible for the development, promotion and implementation of policies in order to improve the Andorran commercial sector as well as the rights and protection of consumers. The UCiC is composed of three specific institutions: the Registry of Commerce; the Commerce and Consumer Affairs Inspectorate; and the Consumer Affairs Service.

The Association of Andorran Banks ("**ABA**") was founded on 11 November 1960. The ABA is an association that represents the collective interests of all its members, the Andorran banking entities, while guaranteeing good banking practices. The ABA provides information for its members and the public in general, proposes appropriate recommendations and promotes cooperation among its members.

Lastly, as Andorran banking entities operate in international markets, the supervision and verification of the origin and destination of funds deposited in the Andorran banking entities are guaranteed by the International Monetary Fund ("**IMF**") and the European Council.

The key legislation or regulations applicable to banks in the Andorran jurisdiction

The Andorran banking system is based on a universal banking model, in which Andorran banking entities offer a complete range of banking services (retail and private banking), asset management, brokering, credit transactions, equity management and other financial services.

Andorran legislation strictly prohibits opaque structures, such as trusts or private foundations, to promote offshore investment structures, which prevent the identification of beneficiaries.

The Andorran legal framework is aligned with neighbouring EU countries and regulates banking and finance issues related to banking entities' regimes, solvency, capital requirements, supervision, anti-money laundering and terrorist financing, and investor protection.

Since the Monetary Agreement was signed between Andorra and the European Union in 2011, Andorra has implemented several European regulations on banking and financial issues. The most important European regulations already transposed to Andorran legislation are the following:

- Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities.
- Directive 2009/14/EC of the European Parliament and of the Council of 11 March 2009 amending Directive 94/19/EC on deposit guarantee schemes as regards the coverage level and the payout delay.
- Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements.
- Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments and Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive ("**MiFID I**").
- Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing ("**Fourth Money Laundering Directive**").
- Regulation (EU) 2015/847 of the European Parliament and of the Council of 20 May 2015 on information accompanying transfers of funds.
- Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market and Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market.
- Directive 2009/110/EC of the European Parliament and of the Council of 16 September 2009 on the taking-up, pursuit and prudential supervision of the business of electronic money institutions.

- Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes.
- Directive 97/9/EC of the European Parliament and of the Council of 3 March 1997 on investor compensation schemes.
- 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 ("**BRRD**").
- Regulation (EU) 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse.
- 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 ("**CRD IV**").
- Regulation (EU) 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) 648/2012 ("**CRR**").
- 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 ("**AML 5**").
- Regulation (EU) 648/2012 of the European Parliament and of the Council of 4 July 2012 on over-the-counter derivatives, central counterparties and trade repositories ("**EMIR**").
- Directive (EU) 2016/1148 of the European Parliament and of the Council of 6 July 2016 concerning measures for a high common level of security of network and information systems across the Union.

Regime for banking entities

Law 35/2010 on the legal regime for authorising the creation of new operating entities within the Andorran financial system, dated 3 June 2010. This law regulates the legal regime for authorising the creation of new Andorran operating entities.

Law 7/2013 on the legal regime of the entities operating within the Andorran financial system and other provisions regulating the exercise of financial activities in the Principality of Andorra, dated 9 May 2013. This law sets out the legal regime of entities operating within the financial system and regulates financial activities within Andorra.

Law 8/2013 on the organisational requirements and the operational conditions of entities operating within the financial system, investor protection, market abuse and contractual netting arrangements, dated 9 May 2013, which was amended by Law 17/2019 of 9 May and fully transposes MiFID I within Andorra. This law is in the process of development through the transposition of MiFID II. As discussed above, on 15 November 2023, the Andorran General Council passed a bill addressing the organisational aspects and operations of entities within the financial system, alongside measures targeting market abuse, incorporating MiFID II in Andorra as an amendment to the MiFID II Draft Bill. The MiFID II Draft Bill has the main purpose of incorporating the provisions of MiFID II into the Andorran legal framework. This legislative initiative acts as an amendment to Law 8/2013. This law establishes: the organisational requirements and operating conditions for the exercise of the activities of entities operating within the financial system; the minimum requirements to be followed by these entities to safeguard investor protection; the obligations, prohibitions and the penalties system for market abuse; and the regulatory framework of the contractual netting agreements.

In accordance with the aforementioned legislation, the composition of the Andorran financial system is as follows:

- The financial activities regulated and exercised by the entities operating within the Andorran financial system, which are: (i) banking entities; (ii) financial investment entities (financial investment companies, financial investment agencies, asset management companies, financial consultants); (iii) management companies of collective investment undertakings; (iv) non-banking financial institutions, in specialised credit; (v) payment entities ("*entitats de pagament*"); and (vi) electronic money institutions ("*entitats de diner electrònic*").
- Financial agents ("*agents financers*") acting on behalf of any of the entities listed above and Andorran insurance or reinsurance entities ("*entitats asseguradores i reasseguradores*") that are also operating entities in the Andorran financial system.
- The Andorran financial markets.
- Other activities related to the entities operating within the financial system and the Andorran financial markets, including professional associations in the financial sector.

Law 10/2008 regulating Andorran collective investment undertakings, dated 12 June. This law includes the constitution of investment undertakings in Andorra, and regulates their functioning and distribution. Depending on the type of investor, purpose of the vehicle and advertising involved, we can find fully regulated collective investment vehicles to closed alternative investment funds.

Supervision

Law 10/2013 of the Andorran National Institute of Finance, dated 23 May 2013. This law regulates the nature and legal status of the AFA, its objectives, functions, competences and responsibilities, as well as its organisation, the obligation to secrecy and international cooperation. Law 10/2013 was modified in 2018, in order to change the denomination from "INAF" to "AFA". This regulatory body has supervised the Andorran insurance and reinsurance sector since 2018.

Law 7/2021 on recovery and resolution of banking and investment entities, dated 29 April 2021. This piece of legislation is based on the provisions within BRRD. In addition, this law regulates the nature and legal status of the AREB as the competent authority and the FAREB, with the aim of financing the measures agreed by the AREB.

The Memorandum of Understanding ("**MoU**") was signed between Andorra and Spain on 4 April 2011. The MoU: (i) constitutes an agreement for consolidated cooperation in the supervisory framework between the AFA and the Bank of Spain ("*Banco de España*"); (ii) establishes the terms of the protocol for the relationship and collaboration between both authorities; and (iii) enables the supervisory authority of the country of origin to request information of consolidated risks of banking groups from the relevant authority of the country where the entity has subsidiaries.

Financial system

Law 20/2018 of 13 September, regulating the Andorran Guarantee Deposit Fund and Andorran Investment Guarantee System. This law adapts Andorran legislation to the requirements of the European Union and establishes a regime designed to protect the robustness and capital adequacy of the Andorran financial system in relation to the depositors. The maximum amount covered is €100,000 per depositor and €100,000 per investor for each entity (based on an *ex post* guarantee system).

Law regulating the disciplinary regime of the financial system, dated 27 November 1997. This law establishes the disciplinary regime applicable to the entities that compose the Andorran financial system in order to guarantee its stability and solvency.

Law 35/2018 on solvency, liquidity and prudential supervision of banking entities and investment firms, dated 20 December 2018 ("**Capital Adequacy and Solvency Law**"), which implements CRR and CRD IV provisions on prudential, solvency and liquidity requirements. Both pieces of regulation establish the capital adequacy ratio at a minimum of 10%, and the liquidity ratio at a minimum of 100%.

Decree approving the accounting framework for entities and collective investment undertakings created under Andorran law operating in the Andorran financial system, dated 22 December 2016, which requires entities operating in the Andorran financial system and Andorran collective investment undertakings to prepare their individual and consolidated annual accounts in accordance with the international financial reporting standards adopted by the European Union.

Insurance sector

Law 12/2017 on regulation and supervision of insurances and reinsurances in the Principality of Andorra, dated 22 June 2017 ("**Insurance Law**"). This law establishes the applicable regulation for the Andorran insurance and reinsurance market, with the aim of creating a modern, comprehensive and efficient regulatory framework in order to align its regulatory system with the changes produced in the European regulatory environment, and guarantees challenges to come for the Andorran financial system. Under the Insurance Law, supervision over the Andorran insurance and reinsurance market, jointly with the banking and financial investment sector, will be conducted by the AFA, which emerges as a macroprudential supervisory authority.

International cooperation on criminal issues and anti-money laundering/terrorist financing provisions

Law 14/2017 on the prevention and fight against money or securities laundering and terrorism financing, dated 22 June 2017 ("**AML Law**"). This law establishes procedures to identify customers, adequate procedures and controls to detect suspicious operations arising from organised crime, the training of personnel in specific money laundering prevention programmes, and an external auditor to review the level of anti-money laundering compliance. This law implements the Fourth Money Laundering Directive provisions and the recommendations provided by the FATF to adapt the Andorran legal framework to the latest international standards in these areas. The regulation for development of the AML Law ("**AML Regulation**") was also passed and entered into force on 6 June 2019. Furthermore, Andorra has partially projected the AML 5 provisions.

Law 20/2014, regulating electronic contracting and operators that develop their economic activity in a digital space, dated 16 October 2014. This law: establishes the obligations of operators, the regime of liability of operators and, in particular, providers of brokerage of such services; establishes the regime of electronic commercial communications; and includes provisions regarding extrajudicial conflict resolution and the use of instruments of self-regulation, codes of conduct and guarantees. The aim of this law is to establish a basic legal framework for the development of economic activities in the digital space and electronic contracting, particularly electronic commercial communications, the process of formation and perfection of the contracts, and the conditions for its enforcement.

Law 13/2013, which regulates effective competition and consumer protection, dated 13 June 2013. This law aims to improve conditions for consumer protection and market efficiency, with the ultimate goal of having a system that provides an adequate legal instrument to protect consumers. The provisions regulate antitrust, unfair competition and consumer protection. In the area of antitrust, the objective is to get companies operating independently in the market. Regarding unfair competition, this law seeks to limit unfair and dishonest practices in industrial and commercial fields. In the area of consumer protection, this law intends to modernise the existing regulations in Andorra that will guarantee efficient access to goods and services for citizens.

Decree regulating the cessation of payments and insolvency, dated 4 October 1969, which is the insolvency provision of Andorra. This Decree regulates the premises for the declaration of insolvency, through an arrangement with creditors or the liquidation of the company.

Law 9/2005, which regulates the Andorran Criminal Code, dated 21 February 2005, includes the violation of professional secrecy as a criminal offence and is punished with imprisonment of between three months and three years.

Law 29/2021 on the protection of personal data, dated 28 October 2021, which is intended to guarantee and protect personal data. This law establishes not only general principles applicable to all processing of personal data but also specific requirements governing the collection and processing of data carried out by both public and private entities. Note that Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data ("**GDPR**") could impact on the transfer of personal data carried out from Andorra due to its extraterritorial scope of application.

Law 10/2012 on foreign investments, dated 21 June 2012. The aim of this law is to liberalise foreign investment in Andorra. This law removes the previous requirement whereby a local partner had to be authorised prior to investing in any kind of business, corporation or assets located in Andorra. Currently, the only requirement is prior authorisation of the Andorran Government for foreign investments that exceed a 10% stake in a local company. This authorisation is given within 30 days of the application being submitted. There are three requirements to be fulfilled: (i) the partners' identity; (ii) the invested capital; and (iii) the business plan. Its impact on foreign banking entities that aim to set up in the Andorran jurisdiction is related to the fact that prior authorisation of the Andorran Government is needed for its constitution.

Law 19/2016 on international automatic exchange of information in tax matters, dated 30 November 2016 ("**Tax Information Exchange Law**") entered into force in Andorra on 1 January 2017, in order to implement internally the Common Reporting Standard ("**CRS**") approved by the OECD in July 2014 and, especially, the International Protocol executed on 12 February 2016 between the European Union and Andorra introducing the automatic exchange-of-tax-information standard between Andorra and the 27 member countries of the European Union.

The reporting parties under the Tax Information Exchange Law are Andorran financial entities, described by law as follows: (i) banking entities; (ii) investment financial entities; (iii) investment financial agencies; (iv) asset management firms; (v) collective investment management entities – the basic criteria for the exchange of tax information will be based on the tax residence of the owner(s) or person(s) who exercise(s) control over the legal person, or the owner(s) of the current account/deposit account/securities/life insurance "cash value" at the end of each calendar year; and (vi) insurance entities.

The scope of the automatic exchange of tax information is limited by the OECD to financial matters and, therefore, does not affect non-financial assets (e.g. real estate, works of art or precious metals). Therefore, the tax residence must be audited by the compliance departments of the respective financial institutions obliged by the law on 31 December of each calendar year, in order to verify whether an account/person/entity (or controlling persons of entities) is subject to reporting.

The subjective scope of reporting will be as follows: (i) individuals; (ii) individuals controlling entities that are considered non-financial passive investment entities; and (iii) companies carrying out business activities (active entities). The law introduces particularities in relation to non-reportable accounts out of the general CRS/OECD standard (i.e. home-savings accounts and public debt accounts). Moreover, the Tax Information Exchange Law includes an open clause that allows the Andorran Government to exclude in the future other financial accounts that are not relevant according to the spirit of the law and the CRS. In terms of deadlines for the reporting, there are different dates in relation to the amount of the account (major or low-value accounts) and the kind of accountholders that must be reported.

In this regard, the dates are focused on the actual reporting of the financial information to the country of tax residence, but this does not necessarily mean that those are the dates as from when the information will be collected and reported ("cut-off date"): (i) Andorran financial entities had until 30 June 2018 to forward the information of pre-existing accounts owned by individuals of more than US$ 1 million (high-value accounts) to the Government (and the Government reported them for the first time to the tax-residence country in September/October 2018); (ii) Andorran financial entities had until 30 June 2019 to forward pre-existing accounts owned by individuals of less than US$ 1 million (low-value accounts) to the Government (the Government reported them for first time in September/October 2019); and (iii) information of pre-existing, non-financial passive entities, with a balance below US$ 250,000, had to be submitted to the Government before 30 June 2019.

As a consequence of the international cooperation of Andorra towards tax transparency, and particularly the adoption of the standards of the OECD and the execution of multiple International Tax Exchange Agreements, Andorra has been taken off the list of tax havens and blacklists of the OECD and the vast majority of the most relevant and developed jurisdictions.

The last modification of the Tax Information Exchange Law introduced the so-called "wider approach", on whose grounds reporting parties must request each new client to complete the CRS self-certification form.

On 11 June 2015, Andorra ratified the Hague Convention on Private International Law statute, becoming a full member of the Hague Convention.

Lastly, Act 13/2018, enacted on 31 May, created the Andorran Arbitral Tribunal.

<u>The influence of supra-national regulatory regimes or bodies</u>

Pursuant to article 3 of the Andorran Constitution, the universally recognised principles of public international law are incorporated into the Andorran jurisdiction, and the integration of international treaties and agreements shall require their publication in the Official Gazette of Andorra. They have an infra-constitutional and supra-legal status, which means that they are above Andorran law but are at a lower level than the Constitution.

In addition, the Universal Declaration of Human Rights is also in force in Andorra. As mentioned above, the AFA, within the framework of its regulatory and supervisory activity, applies international standards.

Furthermore, it is worth noting the extraterritorial impact of the common rules within the European Union, including those enacted by non-community authorities and institutions such as EMIR, the US Foreign Account Tax Compliance Act and the GDPR, as indicated above.

Negotiations for the Association Agreement between Andorra and the European Union represent a crucial milestone in Andorra's journey towards closer integration with the European market.

Banking activity restrictions

As of the date hereof, Andorra is not a member nor an associate estate of the European Union. Accordingly, the freedom of provision of financial and investment services granted by the European passport does not apply. All financial and investment activities directly carried out within the Andorran jurisdiction: (i) are subject to prior authorisation by the AFA; and (ii) can only be carried out directly by the locally authorised entities that compose the Andorran financial system. However, international firms and investment banks may provide, under very specific circumstances as explained below, wholesale cross-border financial services in the Andorran jurisdiction.

As there is no central bank in the Andorran jurisdiction, financial and investment services rendered by Andorran banking entities have mandatorily required the use of foreign correspondent banks for all kinds of assets. In October 2020, Andorra adhered to the IMF, mainly with the goal of gaining access to a lender of last resort.

Deposit-taking, which includes taking deposits and other repayable funds, is a regulated activity in the Andorran jurisdiction, and it must only be rendered by Andorran banking entities.

Technical communication 163/05, issued by the AFA regarding rules for ethics and behaviour for Andorran banking entities, establishes the prohibition of: (i) carrying out own-account operations under identical or better conditions than those of clients to the latter's detriment; and (ii) providing incentives and compensation to clients with relevant influence on the entity.

Changes to the regulatory architecture

The financial crisis in 2008 did not play a significant role in Andorra, as Andorran financial entities are characterised by their high solvency and liquidity ratios, due to prudent and conservative management that was not highly impacted by the global crisis. Accordingly, no changes were made to the regulatory regime for banks for this purpose.

To the extent that Andorra is a country in evolution and with a clear projection abroad, it has been rapidly and constantly adapting its legislative framework to international standards. Nowadays, Andorra is making a significant effort to bring its legislative framework in line with the European Union, particularly in relation to banking and finance legislation.

Since the Monetary Agreement was agreed by Andorra and the European Union, Andorra became engaged to implement and apply the European provisions set down in the annex to the Monetary Agreement. In fulfilment of this obligation, several European provisions have already been implemented into Andorran law, while others are to be integrated shortly.

Upcoming law projects entering into force shortly include new regulations to provide even higher legal security to foreign investors, and new procedural regulations to provide greater guarantees for creditors and to simplify credit execution procedures.

In this respect, Andorra is in the process of implementing MiFID II by means of the MiFID II Draft Bill. This tremendous shift in the Andorran regulatory landscape, transitioning from a reduced framework to an EU-level playing field, will most likely result in a burdensome

process for Andorran financial entities, which face not only an impact on their customer base (e.g. loss of customers due to the entry into force of the CRS regime) but also a direct shock to their profit and loss accounts.

Recent regulatory themes and key regulatory developments in Andorra

The principal regulatory developments in relation to banks in Andorra focus on the implementation of the commitments contained in the Monetary Agreement.

Furthermore, the Andorran Government is currently preparing with the AFA a draft of the financial code to combine all Andorran financial laws into a single regulatory body, while amending some aspects to align local financial regulation with the latest international standards.

Bank governance and internal controls

Banking governance key requirements

The number of directorships that may be held by a member of the management body at the same time shall take into account individual circumstances and the nature, scale and complexity of the institution's activities. Notwithstanding the foregoing, and in line with CRD IV, local banking regulation has laid down that banking entities may not hold more than one of the following combinations of directorships at the same time: (a) one executive directorship with two non-executive directorships; and (b) four non-executive directorships.

Moreover, board members must be persons of recognised commercial and professional honourability, and also possess adequate knowledge and experience in order to exercise their duties.

The provisions above also apply to the management companies of collective investment institutions and non-banking financial institutions, with the exception of the minimum number of board members, which in the following cases shall be at least three.

Furthermore, the AFA, as the authority of the Andorran financial system, is bound by specific corporate governance rules. In particular, the AFA, in the exercise of its functions and competences, shall, among others: (i) act in a transparent, autonomous and independent manner; (ii) consider international standards in all matters; (iii) strictly follow corporate governance rules; and (iv) use resources in an efficient way.

The board of directors is also obliged to create commissions that are considered necessary in order to either improve the performance of its powers or to reinforce transparency. In particular, Appointments and Remuneration, Internal Audit, and Risk Committees must be constituted.

Upon the entry into force of CRD IV, Andorra must implement requirements laid down thereof and the Basel Committee on Banking Supervision Guidelines, titled the "Corporate governance principles for banks".

Furthermore, Andorran remuneration policy provisions are in line with the remuneration principles set out in CRD IV and the European Banking Authority guidelines on sound remuneration. Financial entities shall set the appropriate ratios between the fixed and variable components of the total remuneration, whereby the following principles shall apply: (i) the variable component shall not exceed 100% of the fixed component of the total remuneration for each individual; and (ii) financial entities may allow shareholders or owners or members of the institution to approve a higher maximum level of the ratio

between the fixed and variable components of remuneration, provided that the overall level of the variable component does not exceed 200% of the fixed component of the total remuneration for each individual.

Internal controls

Financial entities are obliged to have a compliance function, a risk management function and an internal audit department. In any case, each of them shall act independently from the others.

Firstly, the compliance function is in charge of the supervision, monitoring and verification of the permanent and effective compliance of the legal obligations, ethics and conduct by the employers and financial agents, in order to protect clients and reduce the compliance risk, among others. Moreover, in order to guarantee that the compliance function works appropriately, the entities must ensure that: (i) it is provided with the adequate authority and technical and human resources; (ii) a person in charge of the compliance function has been designated; and (iii) those in charge of the referred function cannot participate in the election of either the controlling services or activities.

Secondly, regarding the risk management function, the law establishes that the entities of the financial system must carry out the following activities: (i) advise senior management relating to the risk management policies and the determination of the level of risk tolerance; (ii) introduce, apply and maintain risk management procedures allowing the identification, evaluation, management, and so on, of the risk management report resulting from the activities of the entity; and (iii) in general, supervise that the measures are suitable regarding the level of risk, and that the entity is complying with the requirements established in the regulations.

Finally, considering the nature, complexity and level of their activity, as well as the risks to which the activities are exposed, financial entities shall have a department that is in charge of the internal auditory function, in order to evaluate and supervise the efficiency of internal controls. When appropriate, the entity shall designate someone working therein in order to make sure that the level of independence is suitable regarding the circumstances of the entity. The internal audit function must prepare, on an annual basis, a report establishing its opinion regarding the efficiency and design of the internal control system and the risk management of the entity. This report is addressed to the directors of the entity for review. A copy of that report must also be addressed to the AFA within the first semester following the closing of the exercise.

Regarding the management policy of conflicts of interest, article 13 of Law 8/2013 establishes as a general principle that any entity operating within the financial system shall take all the necessary measures in order to detect and prevent any conflict of interest that may arise during the performance of the activities by any employer, director or assistant, and that may cause any prejudice to a client. Accordingly, the entities must adopt in writing both the policy and proceedings on the prevention and solution of the conflict of interest, considering the organisation, volume and complexity of the provided activities.

The areas or departments of the entity involving activities with securities or financial instruments shall remain separated in order to ensure that activities are pursued autonomously to prevent any conflict of interest, and to avoid undue transmission of privileged information. Activities relating to managing their own or third-party portfolios will be carried out in separate departments.

Outsourcing of functions

As contemplated in article 8 of Law 8/2013, the outsourcing of functions needs previous authorisation by the AFA, and the adoption by the financial entity of as many measures as

appropriate in order to avoid increasing its operational risk. Under no circumstances may the outsourcing of a function result in an exclusion of liability by those financial entities operating within the Andorran financial sector.

Bank capital requirements

On 20 December 2018, the General Council approved the Capital Adequacy and Solvency Law implementing CRD IV and, on 6 March 2019, the regulation of the Capital Adequacy and Solvency Law, which implements CRR in the jurisdiction.

The Capital Adequacy and Solvency Law establishes the capital adequacy ratio at a minimum of 10%, and the liquidity ratio at a minimum of 100%.

Additionally, in order to fulfil the obligations, Andorran banking entities must maintain a reserve to fulfil the covered guarantees, and an amount equivalent to this reserve must be invested in secure and liquid assets that fulfil a series of requirements established by the law for this purpose.

The regulatory capital and liquidity requirements derive from the application of Basel III provisions.

Rules governing banks' relationships with their customers and other third parties

Banking and investment services rendered within the Andorran jurisdiction

Banking and investment activities are basically regulated by Law 7/2013 and Law 8/2013, which cover the organisational requirements and operating conditions of the operating entities in the Andorran financial system, investor protection, market abuse and financial securities agreements.

Under Andorran law, all banking and investment activities rendered inside the jurisdiction can only be carried out directly, with the limitations and conditions set forth in the laws, by the locally authorised entities that compose the Andorran financial system.

From a regulatory point of view, banking and investment activities in Andorra are subject to local licensing requirements, which apply to deposit-taking activities, lending activities, investment services and proprietary trading activities. While deposit-taking activities can only be performed by duly authorised banking entities, specialised credit institutions are allowed to carry out lending activities and investment services, and proprietary trading activities can be rendered by any investment financial entity.

Customers' protection provisions

Banks' dealings with third parties are expressly regulated in Law 8/2013, as are the rules for ethical behaviour in the Andorran financial system, which explicitly defines the duties to be complied with by entities integrated in the financial system. This regulation ensures a full and correct transposition of MiFID I, seeks to maintain and strengthen certain ethical and behavioural principles, and prohibits certain practices that are actively combatted internationally. The MiFID II Draft Bill will provide a comprehensive overview of articles aimed at bolstering customer protection, encompassing aspects such as remuneration provisions and customer services, among other elements.

According to Andorran legislation, a retail investor/client is any individual or legal person other than a professional investor/client. A professional investor is a client who possesses the experience, knowledge and expertise to make its own investment decisions and to properly assess the risks incurred.

Additionally, general provisions on consumer protection established in Law 13/2013, which guide principles on the rights of consumption, basic rights of consumers, regulatory requirements common to all consumer relations, the offences and sanctions regime and administrative protection of the consumer, apply to banks' dealings with third parties.

According to Law 8/2013, financial entities must establish, implement and maintain effective and transparent procedures to allow a reasonable and swift treatment of claims filed by customers or potential customers, and must keep a record of each complaint and the resolution measures adopted.

Additionally, any individual or legal person being a client of a bank or financial institution supervised by the AFA, and wanting to make a complaint related to any such supervised entities, may present a complaint to this authority. Before filing a complaint within the AFA, the client and/or claimant must have filed the related claim directly to the bank or financial institution.

If no reply is received from the entity within a reasonable time since the client complained, a complaint form may be filed before the AFA, which, as the financial system supervisor, will analyse the claim.

Reports issued by the AFA Claims Service are not binding in relation to contractual responsibilities between the client and the entity, which matter is reserved to the courts' jurisdiction.

If the analysis of the complaint put forward to the AFA reveals a prudential concern that goes beyond a single customer complaint, the AFA may implement specific controls under prudential supervision. Steps undertaken by the AFA in the framework of a prudential supervision cannot be shared with clients due to confidentiality.

In this sense, the MiFID II Draft Bill establishes that Andorran financial entities are required to establish robust and transparent policies and procedures to handle customer complaints promptly and reasonably. Each complaint must be meticulously documented, detailing the measures taken for resolution. Operational entities within the financial system are obligated to furnish the AFA with information concerning complaints and their resolution. Complaints management policies, endorsed by top management, should offer clear, accurate, and up-to-date information on the complaints handling process. Furthermore, entities must proactively publish these details, including the complaints management policy and contact information for the complaints management function, on their website in an easily accessible manner. A dedicated complaints management function, possibly carried out by the compliance function, is tasked with investigating complaints responsibly. Entities are obliged to communicate with customers in a clear and simple language, addressing complaints without unjustified delays. Importantly, customers should be informed of their options, including the potential escalation of the complaint to an alternative dispute resolution entity or pursuing legal action. The compliance function of financial entities must conduct a thorough analysis of complaints and related data to detect and address all associated risks or issues.

In addition, the Andorran Government has created the UCiC, which is intended to ensure efficient and effective protection of consumer rights. This entity is intended to: (i) inform and guide consumers and entrepreneurs; (ii) receive and process complaints of consumers; (iii) disseminate actions to improve consumption; (iv) develop inspection and control functions in the field of consumption; and (v) establish agreements with organisations aiming to protect consumer rights.

Andorra also has the institution of the Citizen's Ombudsman, which defends and oversees the application of the rights and liberties included in the Constitution and compliance therewith, acting as a commissioner or delegate for the General Council. This institution ensures effective government operations and defends citizens' constitutional rights and freedoms, complementing the courts' oversight of government activities. The Ombudsman receives and processes all complaints and claims relating to citizens' dealings with all public administrative entities in Andorra, responding with independence and impartiality. Under Andorran law, the Ombudsman is known as "*raonador del ciutadà*".

Moreover, in Andorra, there is a regulatory framework for arbitration proceedings in commercial disputes established by Law 47/2014, which came into effect on 22 January 2015. As of the date hereof, the Andorran Arbitration Court ("*Tribunal d'Arbitratge*") is operative but has not yet had any disputes submitted to it. The New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, and the referral by a court to arbitration, have been in force in Andorra since September 2015.

Compensation schemes

Regarding compensation schemes, the Andorran deposit guarantee system matches European standards. Act 20/2018 on banks' deposit guarantee systems fixes the maximum amount of coverage at €100,000 per depositor and €100,000 per investor for each entity.

The assessment of the various guarantee schemes applied to comparative reference systems (*ex ante* and *ex post*) and the particularities of the banking sector (high concentration level) have configured the system in this Act as a mechanism to guarantee *ex post* by paying the corresponding amounts secured in case of intervention or forced liquidation of the member organisations.

Cross-border provision of financial and investment services

As no Andorran law or provision establishes when such services are rendered inside or outside the Andorran jurisdiction, it has to be deduced by the analysis of the nexus between the services rendered or the products provided and the relevant jurisdiction where the service is rendered in Andorra, or on a cross-border basis (i.e. where the agreement was made/accepted, where the product was marketed, where the accounts were located or where the payments were made).

Notwithstanding the foregoing, these activities can be carried out without triggering any licensing requirements, with some limitations, on a cross-border basis to professional investors, under a genuine reverse solicitation scenario, as it is understood that these activities are rendered outside the jurisdiction.

Also, some activities, such as funds distribution, can be performed by foreign entities without triggering licensing requirements by means of indirect distribution through a cross-border execution transaction if they are entered into with a local banking entity on a principal-to-principal basis, and with no marketing activities performed by the foreign entity towards end-users based in Andorra.

In general, the marketing/commercialisation and/or sales promotion of financial services in the jurisdiction, which are carried out in a manner that is deemed to be active commercialisation ("*comercialització activa*"), will trigger local licensing requirements. In this sense, all active marketing activities conducted within the Andorran jurisdiction (by telephone, email, mail or in person), which include naming the services or products, may constitute marketing activities and therefore be subject to licensing requirements.

However, the circulation of generic information to potential investors (i.e. information that does not refer (directly or indirectly) to specific products), or initial contact to gauge interest that involves discreet one-to-one discussions with a limited number of investors, is unlikely to constitute a marketing activity.

Anti-money laundering provisions

Andorra follows the international standards of anti-money laundering and terrorist financing by means of the implementation of the Fourth Money Laundering Directive through the AML Law, complemented by the AML Regulation. At present, Andorra has transposed AML 5 provisions in Law 37/2021, which amends the AML Law accordingly.

The law recognises cryptocurrency exchange platforms and custodians as obliged entities.

Specifically, financial entities shall comply with the following obligations:

- *Formal identification and beneficial owner identification*: Prior to the commencement of the business relation, the entity shall request all the details regarding the client and transaction that were necessary in order to identify the client. Thus, the entity involved shall fill in an official form of UIFAND.
- *Obligation to declare*: The obliged persons shall declare to UIFAND any transaction, project or operation that could involve money laundering or terrorist financing.
- *Suspicious transaction communication*: The financial entities must communicate to UIFAND any transaction that might be susceptible or seems suspicious regarding money laundering. However, keeping the information confidential constitutes another obligation, as the information about the identity of the issuer of the suspicious declarations in any administrative or judicial proceedings with origin or relation of the declarations shall be treated as confidential.
- *Due diligence measures*: Simplified and enhanced due diligence measures may be applied regarding both the risk degree and, depending on the client profile, business relation, product or transaction. These issues need to be in conformity with the clients' admission policy. The obliged persons must be able to demonstrate that the adopted measures are enough, taking into account the risk of money laundering or terrorist financing of the transaction. The risk degree must be in writing. However, simplified due diligence measures may be adopted in appropriate circumstances when there is a low degree of risk.
- *Record-keeping*: The financial entities must keep the documentation for a period of at least 10 years.

Andorra has established a very similar system to that of other Member States of the European Union, such as, for example, Spain and France. When comparing both systems, it is clear that many of the provisions and obligations are aligned.

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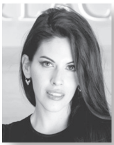

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Laura Nieto Silvente is a Partner of Cases & Lacambra and a member of the Markets & Financial Services practice at the firm's office in Andorra.
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Her practice includes the pre-contracting, contracting and post-contracting of financial instruments and structured products, as well as global legal advice on netting market agreements and financial collateral arrangements (i.e., ISDA MA, GMRA, GMSLA). Laura's practice also includes cross-border transactions and funds distribution.
Throughout her career, she has undertaken projects relating to compliance with AML, market abuse (MAR), investor protection (MiFID), data protection and CRD IV-CRR regulations, including corporate governance and solvency and capital requirements.
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Austria

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Introduction

Due to its structural importance for the functioning of the economy, the banking sector is one of the most strictly regulated sectors in Austria. Detailed regulations at European and national level, as well as strict banking supervision by specialised authorities, are intended to ensure the proper functioning of the banking system.

As a result of these strict regulatory and supervisory measures, the Austrian banking sector is one of the most resilient in the world, as recently confirmed (for example) by S&P's Banking Industry Country Risk Assessment.[1]

With regard to regulatory measures, the main impetus driving change in banking legislation is given by the European Union (EU). On the one hand, the EU co-legislators pass legal acts that are directly applicable in Austria (Regulations). On the other hand, the EU sets targets via Directives, which are then transposed into national law.

The high regulatory requirements applied to the Austrian banking sector and strict supervision measures are very challenging for the industry. As the banking structure in Austria is characterised by an above-average number of small and medium-sized credit institutions, which are more affected by bureaucratic burdens than large credit institutions, a consolidation of the market has been evident in the past and is expected to continue in the coming years.

However, the legal framework for credit institutions in Austria results in a very resilient industry that is well prepared for future crises. As the regulatory environment in the EU is becoming increasingly harmonised and the domestic banking sector is also well connected with decision-makers at national and European level (e.g., via business advocacy groups), it is unlikely that Austrian credit institutions will be at a competitive disadvantage compared to their European competitors in 2024.

Regulatory architecture: Overview of banking regulators and key regulations

Regulation

Legislation regarding the banking sector is primarily driven by the EU. Either the EU passes directly applicable Regulations or it sets out regulatory objectives via Directives, which are subsequently transposed to national legislation by the Austrian Parliament (usually following a legislative proposal presented by the Austrian Government).

The Austrian Financial Market Authority (FMA) itself plays a crucial role in banking regulation. It passes legally binding regulations that are based on national laws. Furthermore, the FMA frequently issues Circulars and Guidelines. These are not legally binding but set out the FMA's legal opinion on specific topics, thus ensuring a common understanding and predictability of decisions.

Supervision

Under the EU's Single Supervisory Mechanism, the supervision of banks in the euro area is a divided task. The European Central Bank (ECB) directly supervises banks that are deemed "significant institutions". By contrast, "less significant institutions" are supervised by authorities in the Member States. In Austria, this responsibility is shared between the FMA, the Austrian National Bank (OeNB) and the Austrian Ministry of Finance (MoF) under the supervision of the ECB:

- The FMA is the responsible authority for banking supervision and macroprudential supervision. It ensures that banks comply with the relevant rules. Furthermore, the FMA is the Austrian resolution authority.
- The OeNB observes the stability of the Austrian financial market. With regard to the supervision of banks, the OeNB is in charge of fact finding (i.e., it undertakes on-site inspections, analyses financial information and drafts reports).
- The MoF sets the applicable legal framework by drafting government bills and transposing relevant EU Directives.

In accordance with EBA Guidelines, the ECB, the FMA and the OeNB cooperate to annually conduct a supervisory review and evaluation process (SREP), thus ensuring the sustained viability of credit institutions.

At the heart of this supervisory process are the following areas:

- business model assessment;
- governance and risk management assessment;
- assessment of risks to capital;
- assessment of risks to liquidity and funding; and
- assessment of compliance with all relevant regulations.

Taking into account the size and complexity of a specific credit institution, the SREP findings are used to compile an overall assessment, which results in concrete measures to be taken by the FMA.

The supervisory process relies on off-site analysis (key data sources used are, for example, credit institutions' regulatory reporting data, regulatory stress test results or recovery plans) as well as on-site inspections.

On-site inspections typically include an assessment of the relevant risk management systems and processes and the corresponding internal documentation as well as sample checks of individual transactions. The ECB, the FMA and the OeNB jointly elaborate annual inspection plans and inform credit institutions of upcoming inspections unless an advance notification is expected to affect the effectiveness of the review. In addition to planned supervisory measures, *ad hoc* on-site inspections can be performed for macroeconomic reasons or to investigate possible breaches of relevant regulations.

Depending on the size and complexity of a credit institution as well as the scope of examination, on-site inspections typically last a couple of weeks. Based on the inspection's outcome, a comprehensive report is compiled and transferred to the authority that requested the inspection (the ECB or the FMA) and the credit institution itself.

Key legislation

The majority of the applicable rules in Austria rely on EU Directives and Regulations. The following (main) legislative acts govern the banking industry in Austria:

- Austrian Banking Act (BWG);[2]
- E-Money Act 2010;[3]
- Payment Services Act 2018;[4]

- Federal Act on the Recovery and Resolution of Banks (BaSAG);[5]
- Deposit Guarantee Schemes and Investor Compensation Act (ESAEG);[6]
- Financial Market Authority Act;[7]
- Financial Conglomerates Act;[8]
- Alternative Financing Act;[9]
- Austrian Building Society Act;[10]
- Financial Markets Anti-Money Laundering Act (FM-GwG);[11]
- Capital Market Act 2019;[12]
- STS Securitisation Enforcement Act;[13]
- Consumer Payment Account Act;[14]
- Savings Bank Act;[15]
- Austrian Investment Firms Act;[16]
- Consumer Credit Act;[17]
- Distance and Outward Transactions Act (FAGG);[18]
- Distance Financial Services Act (FernFinG);[19]
- Mortgage and Real Estate Credit Act;[20]
- Consumer Payment Accounts Act;[21]
- Single Resolution Mechanism Regulation;[22]
- Capital Requirements Regulation (CRR);[23] and
- Securities Supervision Act.[24]

Restrictions on the activities of banks

Entities that conduct "banking transactions" for commercial purposes require a specific banking licence issued by the competent supervisory authority. According to Article 1 para. 1 BWG, the following transactions are considered "banking transactions" and therefore require a licence:

- deposit business;
- current account business;
- lending business;
- discounting business;
- custody business;
- issuance and administration of payment instruments such as credit cards, bankers' drafts and traveller's cheques;
- trading for one's own account or on behalf of others on specific markets or with certain instruments (e.g., money market instruments, futures and options, transferable securities);
- guarantee business;
- securities underwriting business;
- miscellaneous securities underwriting business;
- building savings and loan business;
- investment fund business;
- real estate investment fund business;
- capital financing business;
- factoring business;
- money brokering business on the interbank market;
- severance and retirement fund business; and
- exchange bureau business.

A banking licence is not issued for the provision of banking transactions in general, but for a clearly defined list of banking transactions that the respective company has applied for. In

other words, licences may be limited to one or more of the types of transactions listed under Article 1 para. 1 BWG, and the scope of the licence may exclude parts of the individual types of banking transactions.

The scope of the licence(s) granted to an entity is publicly available in the FMA's company database.

Recent regulatory themes and key regulatory developments in Austria

The following topics represent current trends that influence banking regulation:

- resilience and stability;
- sustainability;
- digitisation;
- cybersecurity;
- consumer protection; and
- data protection.

As the following examples illustrate, these trends trigger specific legislative initiatives, some of which represent major challenges for the banking sector:

- the implementation of Basel IV and in particular the approaching limitation of banks' variability of capital levels computed by using internal models via the "output floor";
- the development of ESG policies and the "green book", which still pose many challenges to banks both legally and in terms of business implications;
- the EU Commission's retail investment package that places the consumers' interests at the centre of retail investing will empower "consumer investors" by allowing them to make investment decisions that are aligned with their needs and preferences;
- the EU Commission's legislative proposal establishing the legal framework for a possible digital euro as a complement to euro banknotes and coins; and
- at national level, the Regulation on real estate financing measures (KIM-V), which tightens the requirements for granting residential real estate loans (e.g., minimum equity ratio of 20 per cent, maximum debt service ratio of 40 per cent, maximum loan term of 35 years). This legal act provoked significant criticism from the Austrian financial sector, which has led to recent amendments that slightly improved the situation for credit institutions.

Against the backdrop of current trends, challenges and risks, the FMA formulated six thematic areas as priorities for banking supervision and inspections in 2024:

- resilience and stability: strengthening the crisis resilience of supervised financial service providers as well as safeguarding the stability of the Austrian financial market as a whole;
- digital transformation: exploiting the opportunities of digitalisation, while at the same time consistently addressing the associated risks;
- new business models: accompanying innovative business models in terms of supervision from as early a stage as possible, in order to promote the innovative power of the Austrian financial market, ensuring fair competitive conditions and guaranteeing appropriate consumer protection;
- collective consumer protection: further development of consumer protection in a rapidly changing environment under the buzzwords "digital transformation", "changing consumer behaviour", "demographic development" and the "change in interest rates";
- sustainability: to provide regulatory and supervisory support to the financial market and all its participants as they make the transition to a sustainable economic model; and
- a clean financial centre: to ensure that the Austrian financial market is a clean market at every level.

Bank governance and internal controls

In Austria, credit institutions must be established in the legal form of a joint-stock company (AG, GmbH or SE), a cooperative society or a savings bank (Article 5 para. 1, 1 BWG).

The FMA only issues a banking licence if the initial capital or initial endowment of the legal entity amounts to at least EUR 5 million and is freely available to the directors without restrictions or charges in Austria (Article 5 para. 1, 5 BWG).

Control environment

According to Article 39 paras 1 and 2 BWG, directors of a credit institution must obtain information on and control, monitor and limit the risks of banking transactions and banking operations using appropriate strategies and mechanisms. To this end, credit institutions are required to have administrative, accounting and control procedures in place to capture, assess, control and monitor risks arising from banking transactions and banking operations. These mechanisms must be appropriate to the type, scope and complexity of the banking transactions conducted.

Article 42 paras 1 and 2 BWG stipulate that credit institutions have to set up an internal audit unit that reports directly to the directors and that serves the exclusive purpose of ongoing and comprehensive reviews of the legal compliance, appropriateness and suitability of the entire undertaking. This internal audit unit must draw up an annual auditing plan and carry out audits in accordance with that plan. In addition, the internal audit unit must also carry out unscheduled audits whenever necessary.

Certain control bodies must be set up if the respective credit institution exceeds certain thresholds. Credit institutions of any legal form, whose total assets exceed EUR 1 billion or which have issued transferable securities that are admitted to trading on a regulated market, must establish an audit committee consisting of at least three members of the supervisory body. This committee supervises the audit and issuance of financial statements, the internal control system, audit function and risk management system.

Credit institutions whose total assets on average have reached or exceeded EUR 5 billion at the relevant reporting dates of the past three completed business years are considered to be of significant relevance. Such a credit institution of significant relevance must put in place the following control entities:

- a risk management department that is independent from operational business and that has direct access to the directors (Article 39 para. 5 BWG);
- a permanent, effective and independently operating compliance function with direct access to the directors (Article 39 para. 6 BWG);
- a nomination committee that, *inter alia*, considers applicants for the filling of managerial vacancies and proposes candidates to the supervisory board (Article 29 BWG);
- a remuneration committee whose duties entail the preparation of resolutions on subjects relating to remuneration as well as the monitoring of the remuneration policy, the remuneration practices and of the incentive structures relevant to remuneration (Article 39c BWG); and
- a risk committee whose tasks comprise, *inter alia*, advising the management on the credit institution's current and future risk appetite and risk strategy as well as monitoring implementation of that risk strategy (Article 39d BWG).

Composition of credit institutions' boards and senior management

A credit institution's board of directors has to consist of a minimum of two directors. Regarding each director's legal powers, the articles of association of the credit institution

must rule out individual powers of representation, individual powers of commercial representation and individual commercial powers of attorney for the entire business operation (Article 5 para. 1, 12 BWG).

The BWG stipulates certain criteria that must be met by directors of credit institutions (according to Article 28a paras 3 and 5 BWG, similar criteria apply to the members of a supervisory board):

- stable financial situation (no bankruptcy proceedings have been initiated for the assets of a director) (Article 6 para. 1, 6);
- no conviction to a prison sentence of more than three months (Article 6 para. 1, 6);
- no facts are known that would raise doubts as to personal reliability, honesty and independence of mind (Article 6 para. 1, 7);
- possession of the professional qualifications and experience necessary for operating the credit institution (including sufficient theoretical and practical knowledge of banking transactions as well as management experience) (Article 6 para. 1, 8); and
- at least one director must have a command of the German language (Article 6 para. 1, 11).

To ensure the necessary level of skills, experience, and integrity, directors must undergo a dedicated fit and proper assessment conducted by the competent supervisory authority (either the FMA or the ECB). As part of this assessment, the supervisory authorities may review criminal records, organise hearings and seek references from previous employers or other relevant parties (see the FMA's Fit and Proper Circular published on 18 March 2023).

In addition to these fit and proper assessments, banks must provide ongoing training for their governing bodies and employees.

Directors must not practise another main profession outside the banking industry, outside insurance undertakings or "*Pensionskassen*", outside payment institutions or e-money institutions, or outside investment firms or investment service providers (Article 6 para. 1, 13 BWG).

Furthermore, they must dedicate sufficient time to the performance of their duties at the credit institution. Directors of credit institutions considered to be of significant relevance shall only be allowed to exercise one activity in a managerial function as well as an additional two activities as a supervisory board member (Article 6 para. 1, 9a BWG).

<u>Remuneration rules</u>

Articles 39, 39b and 39c BWG, the corresponding Circular last published by the FMA on 15 June 2022 as well as the EBA's Guidelines on sound remuneration policies provide the legal framework for remunerations paid by credit institutions in Austria.

The remuneration policy shall be consistent with and promote sound and effective risk management and shall not encourage risk-taking that exceeds the level of tolerated risk of the credit institution. It shall be in line with the business strategy, objectives, values and long-term interests of the credit institution, and shall incorporate measures to avoid conflicts of interest.

Fixed and variable components of total remuneration shall be appropriately balanced. The remuneration policy shall make a distinction between criteria for fixed and variable remuneration components:

- Criteria for determining fixed remuneration components include the person's professional experience and the specific activity performed, taking into account the associated level of responsibility.
- Criteria for determining variable remuneration components comprise sustainable and risk-adjusted performance and performance that extends beyond the stipulated performance objectives.

These and more detailed rules stipulated in the annex to Article 39b BWG apply to all employees whose professional activities have a material effect on the credit institution's risk profile, including, in any case, remunerations of directors, members of the supervisory board, members of the senior management, staff members with managerial responsibility for control duties or material business lines and, under certain circumstances, staff members having a claim to a remuneration of at least EUR 500,000 (Article 39b para. 2 BWG).

Credit institutions must disclose on their websites the manner and means by which they comply with the remuneration policies described above (Article 65a BWG).

Outsourcing of functions

Article 25 BWG and the corresponding annex define rules that must be observed, if a credit institution plans to outsource material operational tasks. In any case, entrusting a service provider with material operational tasks must not deteriorate the quality of the credit institution's internal control mechanisms as well as the FMA's ability to supervise the credit institution. When concluding, implementing or terminating an agreement in relation to the outsourcing of material tasks, credit institutions must proceed with due required professionalism and diligence. In particular, the division of rights and obligations between the credit institution and the service provider must be clearly stated in the form of a written agreement (Article 25 para. 1 BWG).

Among the conditions to be observed by credit institutions that intend to outsource certain material tasks (see annex to Article 25 BWG) are:

- the service provider shall possess the relevant qualifications, capacity, as well as all authorisations required by law to perform the outsourced tasks, services, or activities in a reliable and professional manner;
- the service provider shall perform the outsourced services efficiently. The credit institution shall determine methodologies to assess the service provider's performance;
- the service provider shall duly monitor the performance of the outsourced tasks and reasonably control any risks associated with such outsourcing;
- the service provider shall cooperate with the FMA and the OeNB with regard to the outsourced activities; and
- the service provider shall protect all confidential information about the credit institution and its customers.

Under certain circumstances, the outsourcing of material tasks is prohibited by Article 25 para. 3 BWG:

- senior management tasks must not be delegated;
- the relationship and obligations between a credit institution and its business partners/customers as set out by the BWG must not be altered; and
- compliance with a series of legal acts relevant to the banking industry (as listed in Article 69 BWG) must not be prevented or impeded.

Bank capital requirements

After the banking and financial crisis that hit the markets in 2008 and the years that followed, the Basel Committee on Banking Supervision (BCBS) elaborated a set of international standards for bank capital adequacy, stress testing, and liquidity requirements in order to increase credit institutions' level of resilience. The FMA is represented in the Basel Conference, which is part of the BCBS.

The BCBS standards primarily influence the regulatory framework in Austria via the EU, which implements these standards. On the one hand, the CRR is directly applicable in

Austria. On the other hand, the Capital Requirements Directive (CRD) was transposed by Austria into national law.

Capital adequacy requirements are stipulated in Article 92 CRR as well as in Article 22 *et seqq*. BWG. According to these rules, credit institutions shall at all times ensure a Common Equity Tier 1 capital ratio of 4.5 per cent, a Tier 1 capital ratio of 6 per cent and a total capital ratio of 8 per cent. In addition, credit institutions shall also hold a capital conservation buffer made up of Common Equity Tier 1 equal to 2.5 per cent of the total risk exposure amount as well as a countercyclical capital buffer and – if applicable – a capital buffer for Global Systemically Important Institutions, which may vary in scope.

With regard to liquidity requirements, the CRR adopts two liquidity standards to ensure that financial institutions are stable:

- Liquidity Coverage Ratio (LCR): credit institutions are required to hold liquid assets at all times, the total value of which equals, or is greater than, the net liquidity outflows that might be experienced under stressed conditions over a short period of time (30 days) (Article 412 CRR).
- Net Stable Funding Requirement (NSFR): financial institutions are required on an ongoing basis to raise stable funding (equity and liability financing expected to remain stable over a one-year time horizon) at least equal to their stable assets or illiquid assets that cannot be easily turned into cash over the following 12 months (Article 413 CRR).

The observance of capital requirements by credit institutions is monitored by the FMA. If a credit institution does not observe the capital adequacy requirements, Article 70 BWG empowers the FMA to take various measures, including:

- an instruction to restore legal compliance under threat of a coercive penalty;
- imposing additional reporting obligations or shorter reporting intervals;
- a request requiring credit institutions to use net profits to strengthen own funds;
- in cases of repeated or continued violations, completely or partly prohibiting directors from managing the credit institution; and
- a revocation of the credit institution's banking licence (which entails the dissolution of the credit institution) in cases where other measures cannot ensure the functioning of the credit institution.

Rules governing banks' relationships with their customers and other third parties

The Austrian legal system does not provide a dedicated law applicable to banks' dealings with third parties. Rather, the Civil Code (ABGB) represents the legal framework governing banks' relationships with clients and other third parties.

When establishing their contractual relationships with business partners and customers, banks typically use general terms and conditions that must comply with the strict clause control mechanisms enshrined in the ABGB and, if applicable, the Austrian Consumer Protection Act (KSchG).

For specific banking transactions, the ABGB is supplemented by a large number of accompanying laws, most of which pursue consumer protection objectives. Among these specific laws are the Consumer Credit Act, the Mortgage and Real Estate Credit Act, the FernFinG, the Consumer Payment Account Act, the KSchG, as well as individual consumer protection provisions in the BWG or the Payment Services Act.

Typically, laws that aim at consumer protection are unilaterally binding, i.e., it is not possible to deviate from specific provisions to the detriment of consumers.

Legal enforcement

In the banking sector, there are a number of dispute resolution mechanisms that can be invoked voluntarily prior to legal enforcement actions via ordinary courts.

Firstly, customers may directly contact the respective credit institution. Article 39e BWG stipulates that credit institutions shall establish transparent and adequate procedures for processing of complaints by customers and business partners, in order to be able to identify, analyse and remedy risks. Credit institutions are obliged to provide information about the complaints process. Furthermore, they must accept a complaint and respond to it without undue delay. If the request that was the reason for the complaint is rejected, this must be justified.

If the complaint management is not satisfactory, the FMA can be called upon to examine whether a specific credit institution is complying with its obligations regarding the complaints procedure. However, the FMA is not an arbitration body and cannot make binding decisions on individual disputes.

To proactively solve a dispute, customers may contact the Ombudsman of the Austrian Bankers' Association. This body is a neutral mediator that offers free assistance to retail customers of member banks, helping them to clarify banking issues and cases of disagreement. Procedures mediated by the Ombudsman of the Austrian Bankers' Association focus on clarifying matters or achieving consensual agreement between customers and banks. They do not, however, result in binding decisions.

Similarly to the aforementioned Ombudsman, the Independent Joint Arbitration Body of the Austrian Banking Industry supports the consensual settlement of disagreements between customers and credit institutions. The Joint Arbitration Body can submit a concrete proposal for a solution. Both parties may accept or reject this proposal. Regardless of whether the parties reach an agreement or not, they have the possibility of taking the matter to the ordinary courts, which is the final remedy to enforce parties' rights. Parties may take action before the competent ordinary court themselves. Additionally, with regard to many consumer rights, there is the possibility of legal enforcement by certain associations such as the Chamber of Labour (AK) or the Association for Consumer Information (VKI). Even though the Austrian legal system does not (yet) recognise the instrument of class actions, the enforcement of consumer rights by associations like AK or VKI is comparable to a class action. For that reason, this procedure is also referred to as the "Austrian-style class action".

Compensation schemes for bank failures

In Austria, the ESAEG entered into force on 15 August 2015. According to this law, every credit institution with its registered office in Austria that takes deposits from customers is required to be affiliated to a statutory deposit guarantee scheme. If a credit institution does not belong to any deposit guarantee schemes, its licence to take deposits expires (§ 8 ESAEG).

The established deposit guarantee schemes ensure that customers' deposits are protected in general up to EUR 100,000 per customer and bank at all times (higher amounts can apply in certain cases). In case of a payout event (e.g., if a bank is placed into insolvency or becomes illiquid), depositors are repaid by the deposit guarantee scheme (§ 13 ESAEG).

In Austria, deposit guarantee schemes are not funded by the Government. Instead, potential payouts are financed by a deposit insurance fund, to which the member banks of the respective deposit guarantee scheme make annual contributions. In other words, credit institutions, and not the public sector, must bear the financial consequences of payout events (§§ 18 and 21 ESAEG).

Currently, the following three deposit guarantee schemes coexist in Austria: Einlagensicherung AUSTRIA Ges.m.b.H.; Österreichische Raiffeisen-Sicherungseinrichtung eGen; and Sparkassen-Haftungs GmbH.

Regulatory framework on anti-money laundering

Credit institutions in Austria must comply with specific anti-money laundering legislation to prevent the abuse of the financial market and the financial system for disguising and channelling of assets of illegal origin as well as the financing of terrorist activities.

In this context, the FM-GwG and the Beneficial Owners Register Act (WiEReG) form the backbone of Austria's anti-money laundering legislation. Both national legal acts rely on EU legislation, in particular the 5th Anti-Money Laundering Directive and the Regulation on information accompanying the transfer of funds and certain crypto-assets.

The FM-GwG obliges credit institutions to implement measures to detect and prevent money laundering and terrorist finance. They must report suspicious transactions to the authorities without delay. Furthermore, credit institutions have to maintain records of all transactions for at least five years.

According to the "know-your-customer principle", credit institutions are obliged to verify the identity of their customers according to certain standards and to assess the potential money laundering and terrorist financing risks associated with the respective customer before carrying out a banking transaction with the person in question.

The WiEReG contains provisions relating to beneficial ownership. According to this law, legal entities domiciled in Austria have to determine and verify their beneficial owners once a year. Legal entities must report their beneficial owners within four weeks of their initial entry into the respective master register. In addition, legal entities must, within four weeks of the due date of the annual review, report any changes identified during the review or confirm the reported data.

Compliance with anti-money laundering legislation is supervised by the FMA.

Regulatory framework on international sanctions

The OeNB is the competent authority for international financial sanctions, in particular with regard to the freezing or release of funds of sanctioned persons. The OeNB issues specific sanction measures against certain persons, grants exemptions and monitors compliance with sanctions law measures in the financial sector.

The Austrian Sanctions List contains individuals and entities against whom financial sanctions have been imposed to combat terrorism. These national targeted financial sanctions supplement the sanctions of the EU consolidated in the Consolidated Financial Sanctions Party List.

The primary legal foundation of the OeNB's competence in sanctions matters is the Sanctions Act 2010 and the Foreign Exchange Act 2004.

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Endnotes

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Introduction

Brazil has a modern and solid banking system. The competitive environment and huge consumer market have created good conditions for the incorporation of companies that mix financial services with technologies, creating an important market segment comprising fintech. Fintech has proven to be important to the economy and to the quality of the financial services provided to consumers. The market of financial and payments services in Brazil has a large variety of functionalities available and this broadness attracts foreign investors willing to enter the competitive Brazilian fintech market and provide services of foreign exchange, payments, investments, and credit, among others.

The framework of the Brazilian banking system is in constant interaction with the regulator, seeking to improve the conditions for national and foreign investments and a private sector with the technological resources to develop the services even further. This ongoing dialogue between the public and private sectors has enhanced the legal and regulatory framework of the Brazilian banking system, while technology has proven to be an important factor that encouraged the entry of new players and increased competition.

Recently, regulators and legislators have made an effort to modernise outdated laws and regulations, updating most of the current legal and regulatory apparatus to face the non-stop innovations brought by the private sector and to ensure a secure system. In this innovative environment, Brazilian legislation started to accept, regulate, and promote new ideas in the financial system, making Brazil a favourable place for the development of new solutions related to payments, crypto, foreign exchange, payments, credit, and finances in general. A strong example of innovation is the creation and evolution of the "digital Brazilian real" ("**DREX**"), which is the Central Bank Digital Currency ("**CBDC**"), in line with the increasing use of digital assets in financial transactions (tokenisation) around the world in recent years.

Attracting local and foreign investors, Brazil has a unique regulatory landscape in which one can clearly evidence the constant interaction between market players in the strong class associations and in the public segment itself. Through the years, the private sector and the class associations have reached the regulators to create an environment that considered the need for a solid regulatory environment that was at the same time open for innovation and competition. This has resulted in many legal advances, such as the enactment of Law No. 14,478 of December 21, 2022 ("**Crypto Law**"), specifically dealing with the regulation of the cryptoasset market, which became effective in June 2023. The Crypto Law provides for concepts, principles and guidelines that will rule the provision of services in the cryptoasset market, such as free competition, protection of personal data, protection of market economy, consumer protection, and money laundering prevention, among others.

Therefore, all of this has shaped Brazil's current financial and banking sector. The banking, finance, and payments sector is highly regulated with lots of different complexities, marked by a regulator who controls and delimits its activities, which is the Brazilian Central Bank ("**Central Bank**") and the National Monetary Council ("**CMN**").

Considering that, the regulators incentivise new entrants to the market, focus on solid regulation, and at the same time encourage and maintain controls already in place. The regulations in place tend to consider the size of the entity, the risk presented and the cost of observance, stimulating competition without bringing relevant systemic risk.

Regulatory architecture: Overview of banking regulators and key regulations

Brazil's financial and banking sectors comprise an environment marked by innovation. However, the pillars of the financial system were built through the enactment of Law No. 4,595 of 1964 ("**Brazilian Banking Law**"). Such law provides that the national financial system is composed of the CMN and the Central Bank, as well as public and private financial institutions. The Central Bank and the CMN have the power to oversee public and private financial institutions, laying out ground rules for players entering the financial system and those already in the financial system, and with the power to question their level of adherence to the rules established through Official Letters and to impose sanctions whenever the level of adherence is not within the expected range.

With its prerogatives granted by the Brazilian Banking Law, the CMN is the main regulatory body responsible for the monetary and financial policies and orientation of the investment of resources held by public and private financial institutions. It is also responsible for promoting the efficiency of the payment system, overseeing the liquidity of the financial institutions, and defining their capital requirements. As for the Central Bank, it is a federal autarchy, with attributions to issue currency within the limits established by the CMN, control the granting of credit and foreign capital, oversee the financial institutions, and apply penalties, when necessary, as well as grant authorisations to financial institutions to operate, merge, dissolve and open headquarters abroad. Brazil does not have state or municipal financial or banking regulators. Furthermore, the Securities Exchange Commission ("**CVM**") is responsible for overseeing and inspecting the securities market and its participants.

The Brazilian Banking Law remains the central pillar of the national financial system. However, there are other important dispositions scattered throughout the Brazilian legal framework as detailed below. The Federal Constitution, the hierarchically highest law of the country, establishes the principles that rule the economic system, and every other law and regulation issued is subject to such principles. Some laws are worthy of mention due to their importance and centrality in the daily activities of the banking system.

Law	Main Subject
Law No. 4,728/65	Capital Markets Law
Law No. 6,404/76 and Law No. 4,595/64	Corporations Law
Law No. 6,385/76	Securities Law
Law No. 7,492/86	White Collar Crime Law
Law No. 9,613/98	Anti-Money Laundering Law
Law No. 6,024/74	Liquidation Law
Decree-law No. 2,321/87	Special Administration Regime of Financial Institutions Law
Law No. 9,447/97	Joint-Liability Law
Complementary Law No. 105/2001	Bank Secrecy Law

Law	Main Subject
Law No. 13,506/17	Administrative Procedure Law
Law No. 14,286/21	Foreign Exchange and Foreign Capital Law
Law No. 14.478/22	Crypto Law

Even with a diverse range of laws in many subjects in the Brazilian legal framework, the majority of the regulatory burdens observed by financial institutions and other financial system stakeholders are the resolutions of the CMN and the Central Bank.

Brazilian legislation has been giving more freedoms to the Central Bank and the CMN because of their capacity to easily adapt to the necessities presented by the players and stakeholders of the financial market. One example of the adoption of such strategy was observed in the recently enacted Law No. 14,286 of 2021 ("**Foreign Exchange and Foreign Capital Law**"), to integrate the sparse rules and outline the general principles applicable to foreign exchange and foreign investment, transferring to the CMN and the Central Bank the statutory power to regulate such law. Among other elements, the Foreign Exchange and Foreign Capital Law sets out broad principles on how the foreign exchange market should work in Brazil and vests the Central Bank with powers to regulate this market by issuing specific rules and guidelines, particularly in technical and operational matters. Thus, the new legal framework brings greater flexibility to the Brazilian exchange market and reduces excessive bureaucracy, all of which are likely to attract new investments to Brazil.

Another example is the Crypto Law, which determined the basic guidelines and authorised the regulator, which is the Central Bank, to authorise, regulate, and supervise virtual asset service providers ("**VASPs**") within the scope of the new law. Therefore, virtual assets within the scope of the Crypto Law are subject to the Central Bank's regulation. On the other hand, virtual assets characterised as securities, as defined by the Securities Law, will remain subject to the regulations of the CVM.

The licensing processes for entry of new types of regulated entities in the financial sector have also been updated, making the process simpler and with a faster approval rate depending on the size and risk to the financial sector. This simplification included the elimination of obtaining a Presidential Decree for the entry of foreign investment in the financial sector. This shows a clear path toward attracting foreign investment by granting less burdensome treatment to foreign investors willing to enter the financial system. Much has been modified and much is yet to be modified regarding foreign investors willing to enter Brazil. The main modifications were brought by the Crypto Law and DREX. The Central Bank believes that the intelligent financial services – being automated and safely conducted within the DREX Platform – will also favour the entrance of new financial service providers and the emergence of innovative business models, supporting, ultimately, financial democratisation.

Recent regulatory themes and key regulatory developments in Brazil

Over the last few years, the Central Bank and the CMN have been working toward improving the regulatory environment to bring in more innovation and promote competition. Many major changes have been made and many are yet to come or are in their early development stages.

One of the major changes that has been made recently was the Central Bank's instant payment system ("**PIX**"). PIX is a government-owned, real-time 24/7 payment system that allows money held in deposit accounts and payment accounts (of e-wallets) to be sent or transferred in real time, at any time, including during non-business days. PIX has no cost (only participants can charge fees but at a very low transactional cost) and allows the

participation of several players, as long as they are connected to PIX as direct participants or connected to direct participants as indirect participants. Now, the Central Bank is creating new PIX products such as automatic PIX, guarantee PIX, and international PIX, which will mimic the credit card industry but with a lower cost. Recently, the Central Bank issued resolutions amending the regulation related to PIX, to address operational aspects of outsourcing PIX activities because of anti-money laundering concerns.

The development and implementation of PIX in Brazil represented a major innovation and breakthrough for the Brazilian payment system. As a result, market players are encouraged to be even more creative and explore new products and financial services that are more efficient and can be offered to customers in a world geared toward technology and security.

In the streamlining of the technology guideline followed by the Brazilian financial system, Brazil has passed the Crypto Law to govern the usage and trading of cryptoassets.

The Crypto Law also brings other regulatory changes that seek to strengthen security in the cryptoasset market, including: (i) the creation of a new specific felony for fraud using virtual assets; (ii) equating VASPs to financial institutions, specifically for Law No. 7,492/86, which deals with crimes against the financial system; (iii) expressly including such entities in the list of article 9 of Law No. 9,613/98, which deals with money laundering and other financial crimes; and (iv) applying the provisions of the Consumer Protection Code to operations conducted in the cryptoasset market.

With modern rules and products such as those mentioned above, the environment tends to become more favourable for foreign investments. The Brazilian legal and regulatory authorities, when streamlining the modernisation and attractiveness of foreign investment, reviewed the rules governing foreign exchange transactions and foreign capital entering Brazil. Since 2018, the Central Bank has worked with Congress to pass a new foreign exchange law, and more recently with the market to discuss the regulation of such law. The Central Bank was successful, and Congress passed the Foreign Exchange and Foreign Capital Law.

Such law revoked several out-of-date laws and regulations and concentrated in one legal document all the main principles of foreign exchange, while also delegating to the CMN and the Central Bank the power to regulate the law. The main purpose of this reform was to reduce the legal uncertainty that existed due to the excessive number of laws and decrees that were conflicting or would not fit the new market reality and to reduce the bureaucracy and transaction costs associated with foreign exchange transactions.

As a consequence, after discussing the draft regulation with the market, the Central Bank published Resolution No. 277 of December 31, 2022 to regulate the Foreign Exchange and Foreign Capital Law in relation to the aspects of competence of the Central Bank regarding the foreign exchange market. The new regulation eliminated several hurdles that existed under the older rules, such as imposition of specific models for exchange contracts, the obligation to classify each transaction under a very large number of codes, and the obligation to pre-register with the Central Bank equity investment, loan transactions and transactions in the stock exchange market. Notwithstanding this fact, foreign exchange transactions can only be carried out by institutions authorised to operate by the Central Bank and which operate as "gatekeepers" in order to check the origin of funds and the parties involved in the transaction and report suspicious transactions and eventual payment of related taxes.

The new regulation, however, has expanded the number of gatekeepers by allowing payment institutions (except payment initiation service providers) to also obtain a licence to operate in foreign exchange. With this change, the Central Bank is seeking to bring new business models and technology into the foreign exchange market, increasing competition and, as a

consequence, lowering the cost of transactions. It is now allowed for payment institutions to request a licence to also conduct foreign exchange transactions, in lower amounts and in an exclusively digital manner. At the regulatory level, the Central Bank issued Resolutions No. 278 and No. 281 on December 31, 2022, also introducing innovations intended to reduce the bureaucracy of foreign investments by simplifying the Central Bank's reporting requirements. For instance, reporting foreign direct investment and foreign credit transactions is only mandatory after reaching specific thresholds.

Combining the crypto world with the foreign exchange segment, and as part of the modernisation strategy, the Foreign Exchange and Foreign Capital Law also allows other Central Banks and international clearing systems to deposit local currency with the Central Bank in exchange for digital currency, such as CBDC. This demonstrates the intent of the regulation to transform the local currency (real) into a fully convertible currency over time. Most countries consider that CBDCs have the potential to improve the retail payments market and to promote competition and financial inclusion.

Following the tendency of launching CBDCs, the Central Bank has launched the DREX pilot project. The idea is that DREX will consist of a digital representation of the Brazilian real, linked to smart contracts, using the Distributed Ledger Technology. With the usage of DREX, transactions will be concluded when both parties comply with their obligations, and if one defaults, the payment in DREX can be "returned" to the original account. DREX is currently at an early development stage, but it is known that it will only be issued by the Central Bank, like the Brazilian real itself, and will depend on a bank or another regulated entity to be used by citizens.

In such a technological financial environment, it would be wise to keep in mind the evolution of fraud. Therefore, based on the increased number of digital transactions, the Central Bank and the CMN have issued Joint Resolution No. 6 of May 23, 2023 ("**Joint Resolution 6/2023**"). The purpose of the Joint Resolution is to create a shared database through which only authorised institutions can access and share information and cases of fraud to assist one another with fraud prevention.

Even in the context of fraud, the privacy of users of financial services is respected. Controversially, Joint Resolution 6/2023 provides that the privacy of data shared in this context must be respected. It also provides that the client with whom the institution maintains a relationship must consent beforehand to the sharing of their data.

Finally, data-sharing is a topic that the Central Bank has been exploring and developing since launching Open Banking (now called Open Finance) through which some financial institutions, payment institutions and other Central Bank-authorised entities are obliged to participate, and other regulated entities may opt to participate. The Central Bank established the scope of data and service with regard to Open Finance. The idea of Open Finance is to be implemented in phases and to ensure that users of financial services have the option of whether to share their data among the various financial and payment institutions in which they hold accounts.

In general terms, this new environment aims to integrate the financial system into different digital innovations and to reduce the informational asymmetry among financial service providers, providing an environment for new business models and for new relationships among the institutions themselves, as well as among the institutions and their clients and partners. Therefore, one of the goals of Open Finance is to facilitate access to information and to enhance transparency among the institutions and their customers.

The sharing of customer data is possible only upon the data subject's express consent. With Open Finance phases almost fully implemented, the Central Bank seeks to establish the "future of financial intermediation" by which innovation is compatible with financial stability and the ultimate goal is to enhance the efficiency in credit and payment markets by promoting a more inclusive and competitive business environment, while preserving the security of customers.

It is also important to highlight that there have been relevant changes concerning the regulation of revolving loans in Brazil, most recently by the amendment of CMN Resolution No. 4,549 of January 26, 2017 by CMN Resolution No. 5,112 of December 21, 2023 ("**Resolution 5,112/23**"). The main changes involved the granting of financings related to the outstanding balance of credit card and other post-paid payment instrument invoices and entered into effect immediately (with the limitations applying to credit transactions entered into beginning on January 1, 2024).

Additionally, Resolution 5,112/23 also amended matters related to portability of credit transactions and disclosure of information in the contracting of credit transactions provided for in other regulations, which will enter into effect on July 1, 2024.

Bank governance and internal controls

With few exceptions, financial institutions must be incorporated as *sociedade anônima*, which is the corporate regimen that most closely resembles a joint-stock company or corporation. The legal requirements of joint-stock companies are governed by the Corporations Law. The direct control of a financial institution in Brazil may only be held by: (i) individuals (of any nationality); (ii) other institutions authorised by the Central Bank; (iii) other financial institutions or similar regulated entities headquartered in Brazil or abroad; or (iv) a holding company headquartered in Brazil, with the exclusive corporate purpose of participating in financial institutions and other institutions authorised to operate by the Central Bank. The indirect control of financial institutions (and payment institutions as well) has no limitations except for venture capital or private equity funds since, in such funds, it is not possible to determine on an individual basis the final controlling shareholder.

Joint-stock companies are managed by an Executive Office (*Diretoria*) and, if applicable, a Board of Directors (*Conselho de Administração*) composed of at least three members. In addition, a Board of Auditors (*Conselho Fiscal*) may be instated provisionally or permanently to inspect the activities performed by the other management bodies. The Executive Office shall be composed of at least two members and the Board of Auditors shall be composed of at least three members and a maximum of five members (all of them shall be individuals residing in Brazil and must meet the requirements prescribed by law). All appointments to members of the Executive Office, Board of Directors and Board of Auditors of financial institutions will only be effective upon the Central Bank's discretionary approval, based on subjective and objective parameters.

In their corporate governance, all financial institutions must adopt policies and procedures to control: (i) their activities; (ii) their financial, operational and administrative information systems; and (iii) compliance with all regulations to which they are subject. According to this rule, without regard to the size of a given financial institution, its internal controls shall be effective and consistent with the nature, complexity, and risk of the institution's transactions.

The executive committee of the financial institution is responsible for implementing an effective internal control structure, defining responsibilities and control procedures and setting out the corresponding objectives at all levels of the institution. The executive

committee is also responsible for verifying compliance with internal procedures. Internal auditors report directly to the Board of Directors or management of the institution, as applicable, and external auditors are responsible for monitoring the internal control system.

Further to these general internal controls, financial institutions are also subject to specific, internal anti-money laundering controls and procedures. In terms of transaction monitoring, regulated entities must adopt systems that correspond to the risk presented by their activities. Regulated entities must adopt a risk-based approach, ensuring that their safety mechanisms correspond to the amount of risk they present to the financial system and based on their knowledge of their clients, service providers, and employees. This was established by Circular No. 3,978 of January 23, 2020, following the guidelines laid out in international treaties and by the Financial Action Task Force.

As indicated above, payment institutions are subject to the guidelines provided by Circular No. 3,978 of January 23, 2020. However, the rule that specifically establishes the compliance requirements is different for payment institutions and financial institutions. With payment institutions reaching a higher level of clients and a higher threshold of transactions settled every day, the Central Bank has created a resolution especially to govern the compliance requirements applicable to them. Financial institutions follow the guidelines of CMN Resolution No. 4,595 of August 28, 2017, while BCB Resolution No. 260 of November 22, 2022 ("**Resolution 260/22**") applies to payment institutions. In January 2023, Resolution 260/2022 came into force, establishing specific guidelines for compliance programmes of payment institutions. Starting on January 2024, payment institutions must also appoint a statutory officer responsible for observing compliance with the new rule.

Financial institutions should appoint an executive officer responsible for compliance with all regulations related to financial and auditing records. In addition to audit reports, financial institutions must also contract an independent auditor that should also report on: (i) the evaluation of internal controls and procedures for managing the risks exercised by the financial institution, including in relation to its electronic data processing system, presenting any potential failings verified; and (ii) a description of the financial institution's non-compliance with any applicable regulation that is material to its financial statements or activities.

Based on CMN and Central Bank regulations, financial institutions shall put in place operational, liquidity and credit risk management structures consistent with the type of activities performed, as well as to the degree of complexity of its products and services, and shall be commensurate with the level of exposure to such risks. Financial institutions must also have in place strict cybersecurity rules in order to prevent any breaches.

The Central Bank performs regular oversight of financial institutions in connection with this topic and may order the adoption of supplementary risk management actions, as well as set additional equity and liquidity limits and requirements if it believes that the actions taken by financial institutions are insufficient or inadequate. The constant oversight performed by the Central Bank may also result in the need to adopt stronger internal controls or compliance measures.

Bank capital requirements

In the case of financial institutions, at least 50% of the capital subscription must have been paid up in the subscription of the initial capital. Pending completion of all incorporation formalities, the paid-up capital must either be allocated to the purchase of government bonds or deposited before the Central Bank. The remaining balance of the capital must be paid up within one year from the subscription of the capital.

The minimum capital requirements for a financial institution depend upon the type of licences held. The minimum capital requirement for such institutions is composed of the sum of each licence, according to the below:

Financial Institution	Minimum Capital
Commercial banks and the corresponding licence of multiple service banks	R$ 17.5 million
Investment banks, development banks and the corresponding licence of multiple service banks and Caixa Econômica	R$ 12.5 million
Credit, finance and investment companies, real property credit companies, leasing companies and the corresponding licences of multiple service banks	R$ 7 million
Credit unions	R$ 10,000 up to R$ 6 million
Broker-dealer companies and securities dealership companies that deal with the management of investment funds	R$ 1.5 million
Direct credit companies (if the entity does not issue electronic currency) and peer-to-peer lending fintech companies	R$ 1 million
Broker-dealer companies and securities dealership companies that do not manage investment funds	R$ 550,000
Foreign exchange broker companies	R$ 300,000

In addition to initial capital requirements, as a member of G20 and signatory to Basel III, Brazil incorporated the Basel III rules mainly by the regulation issued by the CMN and the Central Bank. Communication No. 20,615, released by the Central Bank on February 17, 2011, introduced the preliminary guidelines on the implementation of Basel III in Brazil, and highlighted the concepts that would guide the new definitions of capital, liquidity and leverage ratios, following the referred macroprudential approach. Specifically, Basel III implementation in Brazil established that the calculus of the capital requirements should apply to financial institutions, taking into consideration the prudential conglomerate of which it was a part.

As part of the CMN's effort to incorporate the new recommendations from Basel III into the Brazilian regulatory framework, the CMN consolidated and amplified the Brazilian regulation on risk management for Brazilian financial institutions and other institutions authorised to operate by the Central Bank, which was previously regulated in a series of specific normative acts.

Prudential conglomerates in Brazil shall comply with capital requirements with a minimum Basel index of 10.5% to 15% depending on the risk profile of such financial institutions. Such calculations occur based on three types of risk: credit risk; market risk; and operational risk.

Said rules set forth that each financial institution must implement structures for continuous risk management as applicable, pursuant to their segmentation because of its risk profile. This means that a financial institution of smaller systemic importance can have a simplified risk management structure, while more complex financial institutions must follow stricter protocols.

Rules governing banks' relationships with their customers and other third parties

The Consumer Defence Code (*Código de Defesa do Consumidor* – "**CDC**") was promulgated to establish more stringent rules to govern consumer relations between the suppliers of products or services and consumers, to protect end-consumers. The Brazilian Supreme Court (*Supremo Tribunal Federal*) has already recognised that, in the Brazilian financial system, the CDC is also applicable to transactions between financial institutions and their customers.

Financial institutions shall also follow specific rules issued by the CMN and the Central Bank when contracting transactions and the provision of services to customers and the public. These regulations are typically very protective of consumers and prohibit, for instance, increasing the value of fees without fair reason, or charging them at a higher rate than that stipulated in current regulations and legislation, and automatically transferring demand deposit account and savings deposit account funds to any type of investment without prior authorisation from the customer.

To address customer complaints, financial institutions and other entities authorised to operate by the Central Bank shall have an ombudsman department and appoint an ombudsman officer who will be responsible for this office, according to CMN Resolution No. 4,860 of October 23, 2020, and establish an independent communication channel between the institutions and their customers. The guidelines applicable to payment institutions are provided in BCB Resolution No. 28 of October 23, 2020.

The ombudsman's office needs to observe strict compliance with consumer protection legislation and seek improvement and enhancement of products, consumer services and other services. The statutory officer responsible for the ombudsman's office (who can also be the ombudsman as long as they are not in charge of any other activity in the institution) must have technical capacity equivalent to the activities of the institution and the complexity of its operations. Institutions that are part of a financial conglomerate can implement a single ombudsman's office to assist the entire conglomerate.

Furthermore, the Central Bank has a specific channel where consumers may report that the services of financial institutions have not been carried out according to the required standards, i.e., the Registry of Citizens Demands System. The Central Bank analyses all complaints filed and decides whether or not to take action.

Additionally, the Central Bank has the legal obligation to keep a unified database of all clients of financial institutions and their attorneys-in-fact, provided in the Anti-Money Laundering Law. In order to comply with such obligation, the Central Bank has created the System of Registry of Clients of the Financial System (*Cadastro de Clientes do Sistema Financeiro* – "**CCS**"). The CCS is regulated by Central Bank Resolution No. 179 of January 19, 2022, which provides that it includes information about clients of financial institutions and other institutions authorised to operate by the Central Bank. "Client" is defined as an individual or legal entity, resident in the country or abroad, that has the ownership of accounts or financial assets under the form of assets, rights or goods kept or maintained in said institutions.

Institutions that do not maintain relationships with clients in the aforementioned manner, i.e., do not hold client assets in any way, may be exempted from remitting such information to the CCS as long as the institution requests exemption from the Central Bank. Institutions that wish to acquire such exemption must request this from the Central Bank within 10 business days of its expectation to provide such information.

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Canada

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Introduction

Banks in Canada have been continuously recognised as among the soundest and safest across the globe and well positioned for future challenges.

Regulatory architecture: Overview of banking regulators and key regulations

Banking in Canada falls under federal jurisdiction such that the Parliament of Canada has legislative authority over "Banking, Incorporation of Banks, and the Issue of Paper Money". The primary piece of legislation that governs banking in Canada is the *Bank Act*[1] and its regulations.

Banks in Canada are supervised by multiple regulators, with the Office of the Superintendent of Financial Institutions (OSFI) responsible for prudential regulation and financial stability, and the Financial Consumer Agency of Canada (FCAC) responsible for consumer protection and market conduct. OSFI regulates and supervises all banks under its supervisory framework, develops and interprets legislation, and issues guidelines. The FCAC ensures that federally regulated financial institutions (FRFIs) comply with consumer protection measures, and helps to keep consumers informed. The FCAC also supervises payment card network operators and external complaints bodies. The FCAC's Enforcement Division investigates and evaluates possible concerns, and has the power to enforce compliance.

Several other regulatory bodies are also involved in regulating banks in Canada. The Department of Finance Canada helps the Government develop and implement financial sector policy and legislation. The Bank of Canada, which is owned by the Federal Government, helps to keep inflation low, promotes efficient banking systems, is responsible for currency, and is a fiscal agent for the Government. The Canadian Payments Association (d.b.a. Payments Canada) (PC) runs the national clearing and settlement system in Canada. The Canada Deposit Insurance Corporation (CDIC) provides deposit insurance to all member institutions (which includes all major Canadian banks) against the loss of eligible deposits in the event of failure. The Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) helps to protect Canada's financial system by detecting and deterring money laundering and terrorist financing under the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act*[2] (Proceeds of Crime Act) and its regulations.

The Ombudsman for Banking Services and Investments is an independent and impartial body that resolves disputes between banks and their customers when a bank is unable to resolve the dispute internally. The Canadian Bankers Association (CBA) advocates for effective policies and works with banks and law enforcement to protect Canadians against financial crimes. Banks in Canada also need to ensure compliance with privacy legislation, which is enforced

by the Office of the Privacy Commissioner of Canada, who has the power to investigate complaints, conduct audits, and pursue court action. Finally, the Financial Institutions Supervisory Committee, whose membership consists of OSFI, the Bank of Canada, the Department of Finance Canada, CDIC and the FCAC, meets to discuss, coordinate, and advise the Federal Government on issues related to the Canadian financial system.

There are also three supranational regulatory bodies that are influential in Canadian banking. The Bank for International Settlements (BIS), of which the Bank of Canada is a member, leads global regulatory work on financial systems across the globe. The Basel Committee on Banking Supervision (Basel Committee) is made up of BIS members, and strengthens worldwide banking through the release of recommendations aimed at enhancing financial stability. Both the Bank of Canada and OSFI are Basel Committee members and are committed to implementing its recommendations. Lastly, the Financial Stability Board (FSB), which consists of G20 countries, monitors and makes recommendations related to the global financial system. The Bank of Canada, OSFI and the Department of Finance Canada are members of the FSB.

Restrictions on activities

The *Bank Act* imposes ownership requirements on banks in Canada. For instance, the *Bank Act* prohibits a person from being a major shareholder of a bank with equity of $12bn or more. Banks with equity of $2bn or more but less than $12bn must have at least 35% of their shares with voting rights listed and posted on a recognised stock exchange and they must not be owned by a major shareholder.

Pursuant to the *Bank Act*, banks are only permitted to carry on the "business of banking", which includes activities such as providing financial services, acting as a financial agent, providing investment counselling, issuing payment, credit, or charge cards, etc. Except when permitted by the *Bank Act*, banks may not "deal in goods, wares or merchandise or engage in any trade or other business".

The *Bank Act* also includes restrictions on undertaking fiduciary activities, guarantees of payment or repayment, dealing in securities, engaging in the insurance business, undertaking personal property leasing activities, and entering into partnerships. Moreover, banks have restrictions on the types of investments they can make and are prohibited from investing in an entity that carries on some of the activities listed above or entities that deal in securities, except in certain circumstances. Banks may invest in securities, but are restricted from making substantial investments (e.g. acquiring more than 10% interest in a non-bank entity) or in controlling certain types of entities. Under s. 468(1) of the *Bank Act*, banks may make a substantial investment in, or take control of, other banks, trust or loan companies, insurance companies, cooperative credit societies, and entities primarily engaged in dealing in securities. However, certain investments nonetheless require the approval of OSFI or the Minister of Finance.

Banks are prohibited from imposing any undue pressure or coercion on a person to obtain a product or service as a condition for obtaining another product or service. Subject to certain exceptions, a bank cannot make a loan to a natural person that contains conditions that prohibit the prepayment of the loan prior to the due date, or require a natural person to have an initial minimum deposit or maintain a minimum balance with respect to a retail account.

Banks are also prohibited from entering into related party transactions, except as otherwise permitted under the *Bank Act* (for instance, if the value is "nominal or immaterial to the bank").

Recent, impending or proposed changes to the regulatory architecture

The banking architecture in Canada continues to evolve to strengthen financial security and to incorporate international standards.

On November 21, 2023, the Government of Canada released its 2023 Fall Economic Statement.[3] The Economic Statement announced the Federal Government's intention to introduce legislation establishing an open banking framework (rebranded as "consumer-driven banking") that would regulate third-party access to consumers' financial data. Concurrently with the release of the Economic Statement, the Federal Government published a Policy Statement on Consumer-Driven Banking[4] to provide more insight and guidance for the implementation of the proposed framework. Through the Economic Statement and Policy Statement, the Government has committed itself to introducing legislation through Budget 2024 and fully implementing a consumer-driven banking framework by 2025.[5] In developing the open banking framework, the Government has been guided by three policy objectives: (1) safety and soundness; (2) consumer financial well-being and protection; and (3) economic growth and international competitiveness.

The proposed framework includes the ability of Canadians to securely access and share their financial data (without fees for doing so), as well as providing Canadians with safe access to innovative products and services that can help them manage their finances.[6]

On September 1, 2021, PC launched the first release of Lynx, Canada's new high-value payments system, which replaced the prior Large Value Transfer System. On March 21, 2023, PC launched the second release of Lynx, introducing the ISO 20022 financial messaging standard, which allows richer data to travel with each payment. As more financial institutions begin to send and receive ISO-enabled payments, Lynx participants will be able to leverage richer payments data to offer new products and services to their customers. For example, additional data such as purchase order details and invoice reference numbers travelling with each payment will allow for increased automation and the digitisation of manual and paper-based processes currently required to support payment reconciliation and exception handling. The implementation of the ISO 20022 standard will also simplify cross-border payments as the standard is adopted around the world, and helps align Canadian financial institutions with Swift's global implementation of ISO 20022.[7] The broader transfer to Lynx is a critical part of PC's ongoing plan to modernise the infrastructure, rules, and standards of Canada's national payments systems, a plan that also includes the expected implementation of a new real-time payments system, the Real-Time Rail.

The *Retail Payment Activities Act* (RPAA) was enacted on June 29, 2021 and creates a new regulatory regime for retail payment activities under the supervision of the Bank of Canada. The introduction of the RPAA is a significant milestone in the Canadian retail payments sector, which had previously been largely unregulated. The RPAA is intended to protect consumers by regulating payment service providers (PSPs) to safeguard funds and the financial system with operational risk requirements. PSPs will also be required to register with the Bank of Canada to operate under the RPAA. On November 22, 2023, the Government released final regulations under the RPAA.[8] Notably, the regulations provide clarity on when PSPs will be required to register with the Bank of Canada and establish risk management and end-user fund safeguarding frameworks.[9]

In November 2020, the Bank of Canada and OSFI launched a pilot project using climate change scenarios to better understand the risks that a transition to a low-carbon economy could pose to Canada's financial system. The scenarios developed by the Bank of Canada and OSFI demonstrated, among other things, that mispricing of transition risks could

expose financial institutions and investors to sudden and large losses and delay investments needed to help mitigate the impact of climate change. Following the results of the pilot project, OSFI published its Guideline B-15: *Climate Risk Management* on March 7, 2023.[10] The Guideline is aimed at ensuring a healthy and stable financial system in Canada by preparing FRFIs to face the increasingly severe impact of climate change. It outlines OSFI's expectations regarding governance and risk management, introduces expectations regarding climate scenario analysis and capital and liquidity adequacy, and introduces climate-related financial disclosure obligations. In regard to the climate-related disclosures, OSFI expects FRFIs to disclose relatively detailed information regarding the impact of climate-related risks on their business, markets, financial statements, investment strategy, or future cash flows. The disclosure requirements are expected to be implemented by FRFIs on or after fiscal periods ending October 1, 2024, 2025, and 2026, as applicable.

Recent regulatory themes and key regulatory developments in Canada

Canadian banks are subject to the regulatory oversight of OSFI. In 2022, OSFI released its 2022–2025 Strategic Plan, which outlines OSFI's plan to transform itself to fulfil its mandate in the face of new and challenging risks that face Canada's financial institutions.[11] The Strategic Plan is centred on refocusing the delivery of the mandate to further contribute to public confidence in the Canadian financial system, expanding risk management capabilities and risk appetite, and promoting corporate values to help individuals flourish within an operating environment of increasing insecurity.

Basel III reforms

OSFI has publicly affirmed its commitment to participating in the development of international financial standards, and has been proactive in the adoption and implementation of the Basel III framework of the Basel Committee. On January 31, 2022, OSFI announced revised capital, leverage liquidity and disclosure rules that incorporate the final Basel III banking reforms. The revised rules include a new *Capital Adequacy Requirements* Guideline (CAR Guideline), *Leverage Requirements* Guideline (LR Guideline), *Liquidity Adequacy Requirements* Guideline (LAR Guideline), *SMSB Capital and Liquidity Requirements* Guideline (SMSB Guideline), and separate revised Pillar 3 Disclosure requirements. The revised rules are intended to help ensure that deposit-taking institutions (DTIs) can effectively manage risks through adequate levels of capital and liquidity and bolster the resilience of the Canadian financial system. Most of the revised rules became effective in the second fiscal quarter of 2023, with the rules relating to market risk and credit valuation risk becoming effective in early 2024.[12]

Capital conservation buffer

To avoid breaches of minimum capital requirements, banks in Canada are required to hold a capital conservation buffer, the details of which are set out in OSFI's CAR Guideline.[13] The capital conservation buffer is equal to 2.5% of a bank's risk-weighted assets. Currently, banks in Canada are advised to maintain the minimum Common Equity Tier 1 (CET1) capital ratio, Tier 1 capital ratio and total capital adequacy plus the capital conservation buffer.

Countercyclical buffer

In certain instances, OSFI may implement a countercyclical capital buffer requirement that must be complied with by FRFIs. The purpose of the countercyclical buffer is to ensure that banking sector capital requirements account for the current state of the economy and financial system. The countercyclical capital buffer will be implemented by OSFI when it determines that credit growth is excessive and has led to a build-up of system-wide risk, and will be removed when such risks have dissipated or crystallised.[14]

Domestic Stability Buffer

Domestic systemically important banks (D-SIBs) are required to hold a Domestic Stability Buffer (DSB) intended to cover a range of Pillar 2 systemic vulnerabilities not adequately addressed in the other capital requirements described in the CAR Guideline. The level of the DSB is the same for all D-SIBs and is reviewed by OSFI on a semi-annual basis.[15]

Effective as of November 1, 2023, the DSB is equal to 3.5% of total risk-weighted assets (as calculated under the CAR Guideline).

Leverage requirements

In addition to the CAR Guideline, Canadian banks are expected to maintain a ratio of capital to exposure that meets or exceeds 3% at all times under OSFI's LR Guideline.[16] OSFI also prescribes authorised leverage ratio requirements for individual institutions, which are communicated to those institutions on a bilateral basis. The appropriateness of an authorised leverage ratio is assessed according to a number of factors, including: (a) the potential impact of the change in the leverage ratio on the institution's risk-based capital ratios compared to internal targets and OSFI targets; (b) the effectiveness of operational management and oversight functions; (c) the adequacy of capital and liquidity management processes and procedures; (d) the intervention history of the institution; (e) the institution's risk profile and business lines (including diversification of exposures); and (f) the institution's strategic and business plans.[17]

In addition to the 3.0% leverage ratio minimum and the authorised leverage ratio requirements, D-SIBs must also meet a leverage ratio buffer requirement.[18] The D-SIB leverage ratio buffer is set at 50% of a D-SIB's higher-loss absorbency risk-weighted requirements (as further detailed in the LR Guideline).[19]

Small and medium-sized deposit-taking institutions (SMSBs) falling into Category III (as defined in OSFI's SMSB Guideline) are not subject to OSFI's LR Guideline.[20] The leverage requirements for SMSBs are described in more detail below.

Common Equity Tier 1 surcharge

Consistent with the Basel Committee's Basel III framework,[21] OSFI has designated six Canadian institutions as D-SIBs: the Bank of Montreal; the Bank of Nova Scotia; the Canadian Imperial Bank of Commerce; the National Bank of Canada; the Royal Bank of Canada (RBC); and the Toronto-Dominion Bank (TD). These D-SIBs account for approximately 90% of the total assets of Canada's federally regulated DTIs and must comply with heightened regulatory requirements. The imposition of such requirements may offset the potential negative impact of any one D-SIB's failure.[22]

Pursuant to the CAR Guideline, D-SIBs are subject to a CET1 surcharge equivalent to 1% of the D-SIB's risk-weighted assets. The CET1 surcharge is periodically reviewed and adjusted as necessary in light of domestic and international developments in the financial sector. This CET1 surcharge is implemented through the extension of the capital conservation buffer. D-SIBs will be restricted in their ability to make distributions such as dividends in the event they do not satisfy their relevant capital conservation ratio.

RBC and TD are also global systemically important banks and, as such, are required to meet additional requirements.

Total Loss Absorbing Capacity

OSFI's *Total Loss Absorbing Capacity* (TLAC) Guideline (TLAC Guideline)[23] establishes a total loss-absorbing capacity ratio to ensure that a non-viable D-SIB has sufficient loss-absorbing capacity to support its recapitalisation. The minimum TLAC ratio is 21.5% of

risk-weighted assets of D-SIBs, and the minimum TLAC leverage ratio is 6.75%.[24] All D-SIBs are required to meet the requirements set out in the TLAC Guideline.

Small and medium-sized deposit-taking institutions

In April 2023, OSFI's SMSB Guideline became effective for all SMSBs.[25] The purpose of the SMSB Guideline is to act as a reference tool to clarify which parts of the CAR Guideline, LR Guideline, and LAR Guideline apply to SMSBs. The SMSB Guideline also aims to achieve greater proportionality for SMSBs by striking a balance between improving the risk sensitivity of the requirements for SMSBs and reducing the complexity of the capital and liquidity frameworks to reflect the nature, size and business activities of these smaller DTIs. Risk-based capital requirements, leverage requirements, and liquidity requirements will differ across SMSBs depending on whether they fall into Category I, Category II or Category III. An SMSB's category depends on the value of their total assets, the value of their total loans, whether they enter into interest rate or foreign exchange derivatives with a combined notional amount greater than 100% of total capital, have any other types of derivative exposure, and have exposure to other off-balance sheet items greater than 100% of total capital.[26]

Other recent developments

- On June 28, 2021, OSFI published its final Guideline E-4: *Foreign Entities Operating in Canada on a Branch Basis*, which replaces the existing Guideline E-4B: *Role of the Principal Officer and Record Keeping Requirements*. The new Guideline sets out OSFI's expectations of foreign banks that are authorised to carry on business in Canada on a branch basis, including in respect of branch management (i.e. the individuals who are responsible for overseeing the branch) and administration (e.g. record keeping), and underscores the responsibilities of the foreign entity and its management in overseeing the day-to-day operations of its business in Canada.[27]
- On February 28, 2023, OSFI published a draft *Culture and Behaviour Risk* Guideline (Culture Guideline), outlining the expectations for FRFIs' management of culture and behaviour risk to support their risk governance and resilience. The Culture Guideline is intended to be read in conjunction with other guidance such as the *Corporate Governance* Guideline, Guideline E-21: *Operational Risk and Management*, and Guideline E-13: *Regulatory Compliance Management*.[28]
- On April 17, 2023, OSFI and the Global Risk Institute released a joint report on the ethical, legal, and financial implications of artificial intelligence (AI) for financial institutions.[29] The report incorporates the outcomes of the Financial Industry Forum on Artificial Intelligence, which brought together experts from industry, government and academia to discuss safeguards and risk management for the use of AI in the Canadian financial industry. The report contemplates supporting safe AI development through four main principles aimed at ensuring that a balance is struck between setting robust regulations while ensuring innovation by allowing financial institutions to transform and remain competitive.[30]
- On April 21, 2023, OSFI released the Intelligence-led Cyber Resilience Testing (I-CRT) Framework, which outlines a methodology and provides a guide for FRFIs conducting I-CRT assessments. FRFIs are responsible for the overall testing of their measures to ensure resilience to technology and cyber risks consistent with Guideline B-13: *Technology and Cyber Risk Management* released in July 2022 (Technology Guideline). The Technology Guideline focuses on three key areas: (i) governance and risk management; (ii) technology operations and resilience; and (iii) cyber security. The I-CRT Framework is a supervisory tool that supplements the Technology Guideline with I-CRT assessments that allow FRFIs to proactively identify and address issues with their cyber resilience.[31]

- On July 26, 2023, OSFI announced proposed changes to its capital and liquidity approach to crypto assets. The new draft guidelines (one for federally regulated deposit-taking institutions and the other for insurers) will address the regulatory capital treatment of crypto assets and crypto-asset exposures. The guidelines are expected to come into effect in early 2025 and will replace the August 2022 interim advisory on the regulatory treatment of crypto-asset exposures.[32]
- On October 20, 2023, OSFI revised the CAR and *Mortgage Insurer Capital Adequacy Test* (MICAT) Guidelines to establish capital requirements for lenders and mortgage insurers that align with the risks of growing mortgage balances caused by increased interest rates. Along with CAR and MICAT, changes were also made to the *Life Insurance Capital* and *Minimum Capital Test* Guidelines to clarify how banks and insurers should apply capital guidelines.[33]
- On November 20, 2023, OSFI launched a consultation on the public disclosure of crypto-asset exposures by FRFIs in Canada. OSFI has stated that draft guidelines will be issued by fall 2024, with final guidelines intended to be implemented by Q4 2025.[34]
- On December 20, 2023, OSFI and the FCAC released a voluntary questionnaire related to how FRFIs are adopting AI/Machine Learning. Responses will be used to inform future policy and supervisory work.[35]

Bank governance and internal controls

The legislative requirements for the governance of banks are found in the *Bank Act*, which prescribes the form and degree of governance required. Canadian banks must have a minimum of seven directors: if the bank is a subsidiary of a foreign bank, at least half of its directors must be resident Canadians; and if the bank is a domestic bank, a majority of its directors must be resident Canadians. Banks are prohibited from having more than two-thirds of their directors qualifying as "affiliated" with the bank, which includes but is not limited to the following relationships with the bank: ownership of a significant interest in a class of shares; being a significant borrower; or acting as an officer.

Directors are legally obligated to discharge their duties honestly and in good faith with a view to the best interests of the bank, and are required to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. Directors must also establish an audit committee, a conduct review committee, a committee to monitor compliance with public disclosure requirements, and a committee to monitor the resolution of conflicts of interest. The Chief Executive Officer (CEO) of a Canadian bank must be a director of the bank as well as ordinarily resident in Canada. A significant feature of the *Bank Act* is the power of the shareholders to remove a bank's directors. A bank's board of directors (Board) is responsible for ensuring that the compensation of employees, senior management (Management) and the Board is aligned with the bank's long-term interests. Compensation for all employees is to be consistent with the FSB's *Principles for Sound Compensation* Guideline and related *Implementation Standards*.[36]

Corporate governance – the role of the Board and Management

Although the legislative regime of the *Bank Act* is fulsome, OSFI publishes guidance documents that detail the practical mechanisms of compliance in the Canadian banking industry. OSFI's *Corporate Governance* Guideline (Governance Guideline)[37] communicates OSFI's expectations with respect to corporate governance and complements the *Bank Act* and OSFI's Supervisory Framework and Assessment Criteria.[38] The Governance Guideline does not apply to the branch operations of foreign banks. It highlights the distinction

between the decision-making role of a bank's Board and the decision-implementing role of Management and highlights that the Board should be independent of Management. Apart from the critical separation of the roles of Board Chair and CEO, the Governance Guideline does not prescribe any single Board structure as guaranteeing independence. However, the Governance Guideline suggests that to ensure its effectiveness, a Board should be "diverse and, collectively, bring a balance of expertise, skills, experience, competencies and perspectives, taking into consideration the FRFI's strategy, risk profile, culture and overall operations".[39] Board members should also have expertise in the relevant financial industry and in risk management.

The Board plays a crucial role in the success of an FRFI through its approval of overall strategy and risk appetite, as well as oversight of Management and internal controls. Management is responsible for guidance related to significant operational, business, risk and crisis management policies, compensation policies, business and financial performance relative to the strategy and Risk Appetite Framework (RAF) approved by the Board, implementation and effectiveness of internal controls, implementing the Board's decisions and directing the operations of the FRFI.

Both the Board and Management have significant duties beyond those expressly found in the *Bank Act*. The structure of the bank itself may impose further duties on a Board. For example, a parent company's Board should implement sufficient oversight of a subsidiary's activities to ensure that the parent Board is able to discharge all of its responsibilities to the parent company. The interaction between Management and the Board should occur primarily through the CEO. The Board should supervise the oversight functions of the bank through the engagement of the relevant committees, such as the Audit Committee. The heads of the oversight functions should have sufficient authority and autonomy from Management and should have unfettered and direct access to the Board or the relevant Board committee for reporting purposes.

Risk governance

One focal element of the Governance Guideline is the concept of risk governance, which OSFI characterises as a distinct and crucial element of corporate governance in Canada. Banks should be in a position to identify the important risks they face, assess their potential impact, and have policies and controls in place to effectively manage them.

Measures endorsed in the Governance Guideline include the creation of a Board Risk Committee and the appointment of a Chief Risk Officer (CRO). The CRO should have the necessary stature and authority within the bank and be independent from operational management. The CRO should not be directly involved in revenue generation, and their compensation should not be linked to the bank's performance of specific business lines. The CRO should have unfettered access to, and a direct reporting line to, the Board or Risk Committee.

OSFI's *Enterprise-Wide Model Risk Management for Deposit-Taking Institutions* Guideline (Enterprise-Wide Guideline)[40] ensures that all DTIs have a baseline understanding of the minimum level of expectations with respect to their use of models that could have a material impact on their risk profile. Internal Models Approved Institutions are subject to all components of the Enterprise-Wide Guideline, whereas Standardised Institutions are only required to comply with the minimum expectations (but should strive to comply with the entire Enterprise-Wide Guideline).

OSFI's *Large Exposure Limits for Domestic Systemically Important Banks* Guideline (Large Exposure Guideline)[41] sets out a framework to limit the potential loss that would be suffered by a D-SIB as a result of a sudden failure of an individual counterparty or group of connected

counterparties. The Large Exposure Guideline includes reporting requirements for D-SIBs and requires them to create and implement procedures for identifying, correcting, and notifying OSFI of breaches of large exposure limits. In the Large Exposure Guideline, OSFI makes clear that D-SIBs should have a large exposure policy that is consistent with its RAF.

The role of the Audit Committee

The Governance Guideline also expands upon the relevant duties of the Audit Committee as mandated by the *Bank Act*. The Audit Committee, not Management, should recommend to the shareholders the appointment and removal of the external auditor for the bank. The Audit Committee should agree to the scope and terms of the audit engagement, review and recommend for approval by the Board the engagement letter and remuneration for the external auditor, and discuss with Management and the external auditor the overall results of the audit, the financial statements, and any related concerns raised by the external auditor.

The Audit Committee should satisfy itself that the financial statements fairly represent the financial positions, the results of operations, and the cash flow of the DTI. In order to do so, the Audit Committee should meet with the external auditor, the internal auditor, and other heads of the oversight function, as appropriate, with and without Management.

Consumer Protection Committee

The *Bank Act* requires that the directors of a bank establish a committee to monitor compliance with public disclosure requirements and complaint procedures (Consumer Protection Committee). On June 30, 2022, amendments to the *Bank Act* came into force, which provided further detail regarding the composition of the Consumer Protection Committee and the scope of its duties.[42] The Consumer Protection Committee must be composed of a minimum of three directors, a majority of which must not be affiliated with the bank. None of the members of the Consumer Protection Committee may be officers or employees of the bank or of a subsidiary of the bank. The Consumer Protection Committee must also require a bank's Management to establish procedures for complying with consumer protection provisions and to give annual reports on the implementation of consumer protection activities. The directors of a bank are required to report annually as to the activities of the Consumer Protection Committee during the previous financial year.

Whistleblowing

On June 30, 2022, a new whistleblower regime under the *Bank Act* became effective.[43] Under this new regime, banks must establish and implement policies and procedures to address wrongdoings that have been reported by an employee. Banks must also ensure that employees of any third parties dealing with the bank have access to the bank's whistleblower policies and procedures and can report wrongdoings to the bank or the relevant third party in the same manner. The bank's whistleblower policies and procedures must provide that employees have the choice of reporting any wrongdoing internally at the bank or directly to OSFI, the FCAC, any other government agency or body that regulates or supervises financial institutions or a law enforcement agency.[44]

Third-party arrangements

On April 24, 2023, OSFI released its highly anticipated new Guideline B-10: *Third-Party Risk Management* (B-10 Guideline) that comes into effect on May 1, 2024. The purpose of the B-10 Guideline is to set out OSFI's expectations for managing risks associated with third-party arrangements and it applies to all FRFIs (with the exception of foreign bank branches and foreign insurance branches). The FRFI and the applicable third party must establish and maintain appropriate measures to protect the confidentiality, integrity and

availability of records and data throughout the duration of the third-party arrangement. Additionally, the third-party arrangement must permit the FRFI timely access to accurate and comprehensive information to assist it in overseeing third-party performance and risks, and allow the FRFI to conduct or commission an independent audit of the third party. The FRFI is also expected to develop a Third-Party Risk Management Program. OSFI expects the FRFI to manage third-party risks in a manner that is proportionate to the level of risk and complexity of the FRFI's third-party ecosystem. All risks posed by third parties are to be assessed, managed and mitigated within the FRFI's RAF.

Bank capital requirements

Part X of the *Bank Act* requires Canadian banks to maintain adequate capital and adequate and appropriate forms of liquidity. OSFI is authorised under the *Bank Act* to establish guidelines respecting both the maintenance of adequate capital and adequate and appropriate forms of liquidity. The CAR Guideline supplements the *Bank Act* and implements the related Basel III capital rules without significant deviation.

A bail-in regime for D-SIBs has been in effect since September 2018 (mostly pursuant to the *Canadian Deposit Insurance Corporation Act* and its regulations) allowing the Government of Canada to convert certain debt of a failing D-SIB into common shares to recapitalise the bank. Only prescribed long-term debt is subject to the bail-in power, and deposits are excluded. The legislative regime defines the conditions for the conversion of instruments eligible for bail-in, outlines the terms that must be adhered to upon issuance of an eligible bail-in instrument, and establishes a framework to determine compensation for those entitled under the regulations.

The purpose of the TLAC Guideline (discussed above) is to provide a non-viable D-SIB with sufficient loss-absorbing capacity to support recapitalisation in the event of failure. This would facilitate an orderly resolution of the D-SIB while minimising adverse impacts on the stability of the financial sector and taxpayers' exposure to loss.

The TLAC Guideline, together with the CAR Guideline and the LR Guideline (each as discussed above), help to form the framework for the assessment of whether a D-SIB maintains its minimum capacity to absorb losses, in accordance with the *Bank Act*.

As part of compliance and monitoring requirements, DTIs (other than foreign bank branches) provide OSFI with quarterly Basel Capital Adequacy Reporting.[45] If reporting indicates deteriorating capital, the DTI may be subject to escalating stages of intervention, starting with additional reporting requirements and continuing to specific temporary restrictions on business lines. OSFI's *Net Stable Funding Ratio Disclosure Requirements* Guideline requires quarterly disclosure about key quantitative information relating to the Net Stable Funding Ratio of D-SIBs.

Additionally, OSFI has the authority to direct an FRFI to increase its capital if it determines that such FRFI is undercapitalised or, in severe cases, to take control of the assets of the FRFI or of the FRFI itself.

Rules governing banks' relationships with their customers and other third parties

The *Bank Act* and specific regulations thereunder have detailed provisions relating to consumer protection. Among other things, the *Bank Act* and related regulations contain requirements for the simplified disclosure to customers of the cost of borrowing and interest rates.

The FCAC has the mandate of administering consumer protection provisions of the *Bank Act*. Pursuant to the *Financial Consumer Agency of Canada Act*,[46] the FCAC's mandate includes: (i) supervision of FRFIs to ensure that they comply with federal consumer protection measures; (ii) promotion of the adoption of policies and procedures with respect to voluntary codes of conduct and FRFIs' public commitments designed to implement consumer protection measures; and (iii) supervision of payment card network operators and promotion of consumer financial awareness. The FCAC also promotes public awareness about the consumer protection obligations of FRFIs and payment card network operators. The FCAC has the power to, for example, impose monetary penalties and criminal sanctions. For minor oversights, the FCAC will work with the FRFI to rectify the issue. The FCAC's Supervision Framework describes the principles and processes applied by the FCAC to supervise FRFIs and ensure that financial consumers and merchants continue to benefit from applicable protections. In addition, the Consumer Framework has expanded the FCAC's mandate to, for example, enhance the scope of the FCAC's authority to impose increased monetary penalties on banks and to require quarterly complaints reporting.

The CBA's voluntary *Code of Conduct for the Delivery of Banking Services to Seniors* (Code) reinforces existing initiatives and resources used by banks and their staff to respond to the unique, evolving needs of senior customers.[47] The FCAC monitors compliance with the Code, which requires banks to, for instance, mitigate potential financial harm to seniors and account for market demographics and the needs of seniors when proceeding with branch closures. Banks began implementing requirements under the Code on January 1, 2021.[48]

CDIC is a statutory corporation funded through premiums charged to member institutions that provides deposit insurance on certain types of small deposits. CDIC insures up to $100,000 per customer, per financial institution, per insured category of deposits for certain eligible Canadian dollar-denominated deposits (including savings accounts, chequing accounts, and term deposits with an original term to maturity of five years or less). On April 30, 2022, the CDIC deposit protection regime was updated to, among other things, (i) add separate coverage for up to $100,000 in eligible deposits held in a Registered Education Savings Plan and a Registered Disability Savings Plan, (ii) remove separate coverage for deposits in mortgage tax accounts, and (iii) add new requirements for deposits held in trust that enhance CDIC's ability to extend protection to these deposits and reimburse quickly after a CDIC member failure.[49] The Government of Canada recently passed legislation to further expand the deposit insurance framework. Effective April 1, 2023, eligible deposits held in the First Home Savings Account (FHSA) will be separately protected for up to $100,000.[50]

With respect to customer information and privacy, Canadian banks must comply with the *Personal Information Protection and Electronic Documents Act* (PIPEDA). In addition, all banks in Canada have a common law duty of confidentiality in their dealings with customers and in customer identification. PIPEDA provides a regulatory regime in respect of the collection, use and sharing of personal information in the context of commercial activities, and requires that institutions obtain an individual's consent prior to using such personal information. Canadian banks have a positive duty to safeguard personal information that has been collected, and to abide by the limits on the retention of personal information, as set out in PIPEDA.

On August 13, 2021, OSFI released an updated Cyber Security Self-Assessment to assist FRFIs in improving their readiness for emerging and expanding cyber threats.[51] At the same time, OSFI also released updated guidance on how FRFIs should report and disclose technology and cyber incidents to OSFI in the *Technology and Cyber Security Incident*

Advisory (Technology Advisory). Under the Technology Advisory, FRFIs must report a technology or cyber security incident to OSFI's Technology Risk Division and its lead supervisor within 24 hours. The Technology Advisory also indicates that where an FRFI fails to report a cyber incident, it could be subject to increased oversight by OSFI, put on a watch list, or assigned to one of the stages of OSFI's supervisory intervention approach.[52]

Banks are also required to comply with Canada's Anti-Spam Legislation (CASL), which regulates unsolicited commercial electronic communications sent by commercial enterprises to individuals. CASL applies to all electronic messages and requires the prior consent (express or implied) of the recipient before any such message can be sent, and includes mechanisms for civil recourse as well as monetary penalties and criminal charges for non-compliance.

* * *

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Chile

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Introduction

According to the Central Bank of Chile's ("**Central Bank**") December 2023 Monetary Policy Report, inflation in Chile continued to recede during 2023 and the forecast is that further decreases will be observed in 2024, by an estimated 3% in the second half of this year. In line with this decline, the Central Bank's monetary policy interest rate shows an aggregate reduction of 300 basis points since July 2023 and stood, as of December 2023, at 8.25%. In order to reach the estimated inflation rate, the Central Bank considers that further cuts to the monetary policy interest rate will be required in 2024, the extent and timing of which will take into consideration the evolution of the macroeconomic scenario and the potential consequences for the course of the inflation rate. A continued reduction in the inflation rate, together with lower interest rates, will likely see a moderate increase in economic growth and in banks' and other financial institutions' lending activities and general financial operations.

In keeping with the expected recovery in economic growth, lower interest rates and increase in banking activity, Chilean Congress and regulatory entities kept busy during 2023 in banking and financial matters, discussing and enacting regulations aimed at keeping up with international requirements and standards, expanding competition and innovation and generally protecting investors and clients, even in the climate of uncertainty implied by the second constitutional reform process carried out in Chile last year and rejected by citizens in the December 2023 referendum. As a result of such rejection, the 1980 constitution will remain in force, with the Chilean government announcing that the process for creating a new constitution was closed and that no actions on this issue would be presented for the rest of the current presidential term, which ends on March 11, 2026.

An example of recent new banking regulations is the activation by the Central Bank of the countercyclical capital requirement by 0.5% of the risk-weighted assets as a preventive measure against external financial uncertainty. The deadline for Chilean banks for meeting the capital requirement is May 2024 and is intended to allow banks to accumulate a capital buffer that will be available in case of severe stress scenarios.

On the other hand, the CMF (as defined below) has moved forward with the gradual entry into force of Law No. 21,521, known as the "**Fintech Law**", by enacting General Rule No. 502, to become effective on February 3, 2024, which establishes the requirements generally applicable to the registration, authorisation, and obligations of financial service providers under the Fintech Law. The Fintech Law, enacted in January 2023, promotes competition and financial inclusion through innovation and technology in the provision of financial services by establishing a regulatory framework for services based on fintech technologies

and creating an open banking system that allows the exchange of customer information between different financial or related service providers.

All in all, these new regulations, along with some other legislative and regulatory developments discussed below, generally aim to improve the Chilean banking system to maintain the country's status as one of the best and more reliable investment destinations in the region.

Regulatory architecture: Overview of banking regulators and key regulations

Regulators and key regulations

The Central Bank is an autonomous entity, whose main purpose is to safeguard currency stability and proper functioning of internal and external payments. In the exercise of its constitutional mandate, it is vested broad regulatory powers regarding foreign exchange transactions, and monetary, lending and financing matters.

Furthermore, working closely with the Central Bank and supervising proper fulfilment of some of its regulations, the Financial Market Commission or "**CMF**" is the main regulator of the banking industry.

The CMF was incorporated on February 23, 2017 by Law No. 21,000, and on June 1, 2019 it replaced and assumed, among others, the authorities of the former banking regulator: the Superintendence of Banks and Financial Institutions.

The CMF's main mission (which is the basis for its regulations) is to supervise proper operation, development, and stability of the Chilean financial market (including banks), and to ensure that entities under its supervision comply with the laws, rules, bylaws, and applicable regulations.

The Central Bank's main mission is to oversee the currency's stability and proper operation of internal and external payments.

The Chilean banking system is based on the General Banking Act of 1997. The General Banking Act was materially amended in January 2019, introducing several innovations on supervision, and adjusting banks' capital requirements and other obligations to the standards set out in Basel III.

Since banks must be incorporated as special corporations, Law No. 18,046 (the Corporations Act) also applies to banks (with certain exceptions), mainly regarding corporate governance.

In addition to the above, both regulators have enacted several regulations, of which the most important are:
- CMF: Updated Compilation of Rules (*Recopilación Actualizada de Normas*), mainly issued by its predecessor (i.e., the Superintendence of Banks and Financial Institutions).
- Central Bank: Compendium of Financial Regulations and Compendium of Foreign Exchange Regulations.

Restrictions on the activities of banks

Only entities authorised under the General Banking Act can perform core banking activities in Chile. Financial activities that are not regarded as core banking activities are permitted without a banking licence (for example, lending, financial advice (not intermediation) and derivative transactions). However, financial advice has been increasingly regulated, as per the Fintech Law.

Banking services are understood generally as receiving, in a customary manner, money or funds from the public, to use it to grant loans, discount documents, make investments and

perform financial intermediation, while obtaining revenue out of this money and performing related activities permitted by law.

Article 69 of the General Banking Act lists the operations that banks can engage in, which include (among others):

1. Deposit-taking and accepting other repayable funds from the public.
2. Issuing bonds or debentures.
3. Lending (in its various forms).
4. Money brokerage, intermediation or brokerage of trading and debt instruments.
5. Issuing letters of credit and performance bonds.
6. Entering into derivative transactions, money collection, payment and transmission services.
7. Trading money market instruments, foreign exchange, financial futures and options, exchange, and interest instruments.
8. Acquisition, sale and trading of debt or fixed-income instruments, and providing underwriting services related to the issue and placement of such securities and acting as a placement agent and underwriter relating to offerings of newly issued shares of the stock of public corporations.

Under Article 70 *et seq*. of the General Banking Act, banks are authorised to incorporate subsidiaries to perform the following operations or activities:

- Stockbrokerage, broker-dealers, management of mutual funds, investment funds or foreign capital investment funds, securitisation, and insurance brokerage.
- Leasing, factoring, financial advice, custody and transport of securities services, credit collection services and other financial services that the CMF, by a general ruling, deems ancillary to the banking business. Banks are also authorised to set up subsidiaries in the real estate business and managers of housing funds.

Additionally, banks are allowed, with prior CMF authorisation, to be shareholders or participate in banking support companies (*sociedades de apoyo al giro bancario*). These are companies whose sole objective is to provide services to facilitate compliance with bank purposes, and/or carry out banking activity other than raising money. Once the CMF has granted authorisation to a bank to incorporate or participate in a banking support company, the CMF cannot deny the same authorisation to another bank.

Recent regulatory themes and key regulatory developments

Fintech Law

One of the most important legislative changes is the passing of the Fintech Law, which was published in the Official Gazette on January 4, 2023. The Fintech Law seeks to establish a regulatory perimeter for certain services that are based on fintech technologies, such as crowdfunding platforms, alternative transaction systems, credit rating services, investment advice, custody of financial instruments, order routers and financial instrument intermediaries, which were not regulated or supervised by the CMF. In addition, the Fintech Law has created an open banking system that will enable the exchange of client information directly and securely between different financial or related service providers, through remote and automated access interfaces, provided express consent by the clients has been obtained.

The Fintech Law generally regulates alternative transaction systems, in some cases for the first time in Chile, such as the offer, quote and trade in cryptocurrencies and crowdfunding or crowdfunding platforms, and in other cases providing a more in-depth regulatory framework, such as advisory services for credit and investment, custody of financial instruments, order

routers and intermediaries of financial instruments. In any case, the focus of the law is on the regulation of services rather than on the regulation of the entities themselves.

The CMF plays a relevant role within the Fintech Law, as it is the governmental authority in charge of supervising the services regulated by law and is entrusted with issuing the regulations for the application and compliance of its provisions. Also, the CMF is required by law to issue regulations for the operation of the open finance system, to oversee compliance with the obligations of its participants, and monitor the operation of this system.

As a general rule, the Fintech Law provides that companies providing these services must have an exclusive line of business and comply with certain requirements in order to obtain authorisation to operate from the CMF, including, among others: (a) continuing reporting obligations to clients and the general public; (b) corporate governance and risk management obligations; (c) establishment of minimum permanent assets; and (d) conditions of suitability for the provision of credit and investment advisory services. These requirements apply in a differentiated manner among the different financial service providers.

Finally, in order to operate, companies providing fintech services must be authorised by the CMF and be registered in the corresponding registries.

As a general rule, the provisions of the Fintech Law entered into force on February 3, 2023 (i.e., 30 days after its publication in the Official Gazette), except for the provisions related to technology-based financial services and the open finance system, as well as other provisions that modify other regulatory bodies, which have their own rules of deferred entry into force.

In compliance with the mandate of the Fintech Law, on January 12, 2024, the CMF completed the first stage of implementation of said law, with the issuance of General Rule No. 502, which becomes effective on February 3, 2024. This regulation establishes in a single regulatory body the registration requirements, authorisation process and obligations applicable to all fintech service providers, including crowdfunding platforms, alternative transaction systems, intermediation of financial instruments, order routing, credit rating services, investment advice and custody of financial instruments. In line with the above, existing fintech service providers will have a period of 12 months from the issuance of the regulation (i.e., until February 3, 2025) to submit their respective applications for registration and authorisation before the CMF, except in the case of providers of investment advisory services, which must submit their registration and authorisation applications before February 3 of the current year. If fintech service providers do not comply with the above requirement, they must refrain from continuing to provide their services and will be allowed to perform only acts aimed at concluding their operations. The main topics covered by General Rule No. 502 are: registration with the CMF; requirements to obtain authorisation from the CMF to operate as a provider of fintech services; information and reporting obligations; corporate governance and risk management; minimum capital and required collateral; and operational capacity, among others.

The Fintech Law mandates the CMF to issue regulations for the implementation of the open finance system within 18 months from the publication of the Fintech Law, and such regulations must include a gradual implementation schedule for all participants. This regulation is still pending issue by the CMF.

Other regulatory themes and key regulatory developments

In August 2023, the CMF published the so-called "Guidelines for a Financial Conglomerates Law in Chile", which would aim to place financial conglomerates under its supervision. The

document, although not yet binding, contemplates a definition of "financial conglomerate", the obligation to follow a certain corporate structure and to report periodically to the CMF, and the requirement of transaction and corporate governance policies.

On August 29, 2023, the CMF published for consultation a regulatory proposal for a new chapter for its Updated Compilation of Rules, regarding the early regularisation of banks. The purpose of the regulatory proposal is to determine: (i) the form and deadline that banks will have to report to the CMF the occurrence of an event indicative of financial instability; (ii) the requirements to be met by the delegated inspectors or provisional managers; and (iii) requirements of suitability or technical capacity of the liquidator in case of mandatory liquidation.

On November 30, 2023, the CMF issued Exempt Resolution No. 9077, whereby it modified the category of transactions "expressed" in foreign currency to also include those "in" foreign currency (i.e., payable in foreign currency), which will be renamed as "transactions in foreign currency and expressed in foreign currency". The foregoing is for purposes of determining the common interest rate and the maximum interest rate for both types of transactions. Prior to such resolution, the CMF only published the common interest rate and the maximum interest rate for operations expressed in foreign currency but payable in Chilean pesos. However, as a result of a Supreme Court resolution, the new category of "transactions in foreign currency and expressed in foreign currency" will be subject to the provisions of Law No. 18,010, on money lending operations, including rules on maximum interest rate. It is worth mentioning that, notwithstanding the provisions of the resolution, money lending transactions indicated in Article 5 of Law No. 18,010, including those that are agreed with a foreign or international banking or financial institution or those in which the borrower is a banking or financial entity, will continue to be exempt from the maximum interest rate.

Finally, Law No. 21.641, which strengthens the resilience of the financial system and its structures, was published in the Official Gazette on December 30, 2023. Among other things, this law improves the repurchase agreement ("**REPO**") market and allows for a netting of obligations between the parties and gives them the status of "related obligations" (*obligaciones conexas*) for purposes of the bankruptcy reorganisation resolution.

Bank governance and internal controls

Governance and risk management

Banks in Chile must be incorporated as corporations, following the specific requirements in the General Banking Act and the Corporations Act. Every bank in Chile must be a special corporation (*sociedad anónima especial*) under the specific requirements of the General Banking Act.

Under the General Banking Act, the main body is the board of directors, entrusted with the direction of the bank and proper risk management. Directors cannot be both directors and employees of the bank.

The internal organisation of banks is mostly carried out by the board of directors, which must provide necessary governance of the banking entity through the senior management, committees, and policies.

All directors must fulfil several honourability and solvency requirements to be appointed as such. These requirements include: not being convicted of serious crimes described in the General Banking Act; not being sanctioned by infringements to market regulations;

and not being involved in serious conduct that may risk the bank's stability or the safety of its depositors. It is forbidden by law to set special requirements based on nationality or profession in order to be appointed as bank director, and notwithstanding the fulfilment of the abovementioned conditions, there are neither specific approvals from regulators nor certifications required in this regard.

The board must adopt necessary measures to remain informed of the management and general situation of the bank. The board must have at least five members and a maximum of 11 and must always be composed of an odd number of directors. The directors remain in office for three years and can be re-elected. The board must meet once a month.

Sound internal governance is measured in accordance with the CMF's Guide to the Banking Supervision Process. Pursuant to this Guide, the main objective of banking supervision is assessing the quality of risk management used by banks. This approach, according to the CMF, corresponds to a Supervision Based on Risks ("**SBR**") approach, which reflects the maturity of the banking industry in Chile.

According to the Guide to the Banking Supervision Process, the SBR approach is based on the following pillars that set standards for choosing persons with control functions, based on the levels of technical knowledge required:

- Government and supervision. The board of directors and the banks' committees must strongly promote the risk policy, requiring and receiving information to correctly assess the risks and apply agreements reached.
- Risk management framework. A clear demarcation of the policies and procedures decided by the board, which must be consistent with the bank's volume of business.
- Measurement and continuous monitoring of risk. This in turn includes:
  - risk quantification: review and evaluation of the bank's risk assessment methodologies, to determine whether these are duly documented, updated and consistent with the business depth and volume;
  - timely follow-up of risk: early warnings (constantly reviewed under established protocols) for risk detection and boundaries that limit the risks, with necessary analysis and bases for it;
  - risk information system: involving a management report structure, this must address the needs of the bank's different levels; and
  - independent review: internal independent and qualified auditing, with adequate depth and coverage. Its analysis approach should consider risk, compliance with internal policies and regulations, obtaining a recognised and validated opinion by different levels of the bank, and appropriate technological tools for developing their work.

Internal control

Chapter 1-13 of the Updated Compilation of Rules of the CMF defines corporate governance as a set of institutional instances, guidelines and practices that influence the bank's decision-making process, contributing, among other things, to the sustainable creation of value, within a framework of transparency and adequate management and control of risk. It classifies the banks according to their organisational rules as level A, B or C, with A being the most compliant with management proceedings.

The following aspects, among others, are considered by the CMF as inherent to good corporate governance and criteria for evaluating a bank's management:

i. Establishing strategic objectives, corporate values, lines of responsibility, monitoring, and accountability.

ii. Verifying the performance of senior management and compliance with policies established by the board of directors.
iii. Promoting sound internal controls and effective audit.
iv. Establishing proper disclosure mechanisms.

Outsourcing of functions

Banks in Chile are allowed to outsource certain functions, provided the requirements set forth by the CMF are complied with. Chapter 20-7 of the Updated Compilation of Rules of the CMF contains the rules applicable to outsourcing of functions. Certain activities of banks may under no circumstances be outsourced, such as: those related to raising funds from third parties outside the bank's offices; the opening of bank accounts; and functions related to internal controls of the banks.

Banks are required to assess all the risks associated with outsourcing functions and establish an outsourcing policy that appropriately addresses those risks, including a proper governance structure, a sound framework of applicable regulations and procedures, and an environment that allows the identification, control, mitigation, monitoring and reporting of such risks.

Any outsourcing policy should consider, in general, the following elements: (i) general conditions approved by the board of directors regulating the activities or functions that may be outsourced; (ii) continuity of business; (iii) safety of the bank's own information and its clients; (iv) observance of banking secrecy; (v) access to the information by the CMF; and (vi) the political risk (*riesgo país*) of the country where the service provider is located (with banks not being allowed, except under certain exceptions, to outsource services to companies located in a country that does not have investment grade).

The abovementioned Chapter 20-7 also sets additional regulatory requirements applicable to the outsourcing of data processing services and reinforced due diligence obligations when contracting cloud computing services.

Bank capital requirements

Following the recommendations of Basel III, the current regulations on capital requirements were updated by Law No. 21,130, which increased such requirements from both a quantitative and qualitative point of view to address the risks currently associated with banking activity. Main innovations in this regard can be summarised as follows:

1. **Capital requirement**. The minimum required level of effective equity is 8% of risk-weighted assets. The Tier 1 minimum capital requirement, corresponding to the composition of assets with the best loss-absorbing capacity, was increased from 4.5% to 6% of risk-weighted assets. This increase is achieved by incorporating an additional Tier 1 capital requirement equivalent to 1.5% of risk-weighted assets. Additional Tier 1 capital can be made up of preferred shares or bonds with no maturity (perpetual).
2. **Conservation buffer**. A conservation buffer of 2.5% of risk-weighted assets above the established minimum must be set, which must be made up of basic capital.
3. **Additional basic capital**. Supplementing this conservation buffer, the law incorporates an additional basic capital requirement of a countercyclical nature, which will be generally applicable to all banking companies incorporated or authorised to operate in the country, by means of which it seeks to mitigate the development of systemic risks. The Central Bank, depending on the phase of the economic cycle, can set this reserve at up to 2.5% of the risk-weighted assets, subject to the consent of the CMF. As indicated above, in 2023, the Central Bank activated this additional basic capital by 0.5% of the risk-weighted assets, to be implemented by banks within one year (i.e., up until May 2024).

4. **CMF authorities**. Additionally, the CMF is granted the authority to require basic capital or additional effective equity for up to 4% of the risk-weighted assets in those cases in which the legal requirements are not sufficient to cover the specific risks faced by a determined entity.

Banking liquidity requirements

Article 35 No. 6 of Law No. 18,840, the organic constitutional law of the Central Bank, empowers it to enact regulations and set restrictions applicable to the relationships between active and passive banking activities.

Based on the above, the Central Bank enacted Chapter III.B.2.1 of its Compendium of Financial Regulations, which sets rules on management and measuring of banks' liquidity positions. Even though local banks solidly endured the global financial crisis, the Central Bank introduced this rule to prevent future liquidity shocks.

In this regulation, the Central Bank has established minimum standards and requirements that shall be observed by banks, with the purpose of maintaining an adequate liquidity position, in both local and foreign currency, and that allow banks to properly fulfil their payment obligations in both regular conditions and in exceptional stress scenarios whose occurrence can be considered plausible.

Chapter III.B.2.1 states that the board of directors is responsible for setting the bank's liquidity risk tolerance, understood as the liquidity risk level that the relevant bank is willing to assume as a result of both the risk/return assessment of its global policies, and the manner as to which such risks are managed. For these purposes, the board of directors must adopt, lead, and oversee the implementation of a liquidity management policy (*Política de Administración de Liquidez*, or "**PAL**"). The bank's senior management is responsible for proposing to the board the PAL compatible with the nature, scale and complexity of the business and risk tolerance of the bank, enforcing and updating the PAL.

The PAL must contain stress tests, which must be performed at least quarterly, considering the structure of the bank's assets and liabilities, the scale and complexity of its operations, and possible effects on its cash flow and liquidity position. The PAL must also establish a formal contingency plan, setting the strategies to be adopted when facing a liquidity deficit in stress scenarios.

Under Chapter III.B.2.1 of the Central Bank's Compendium of Financial Regulations, the liquidity position is measured through the difference between expenses and income flows in and out of the balance sheet for a given period. This difference is called a term mismatch.

Banks must observe the following limits regarding term mismatches:

- The sum of all term mismatches for up to 30 days cannot exceed the basic capital.
- The same requirement must be met considering only flows in foreign currency.
- The sum of the term mismatches of up to 90 days cannot exceed twice the basic capital.
- Therefore, projected net cash outflows in 30 days cannot be higher than the equity capital of the bank, and projected net outflows in 90 days cannot surpass twice that amount.

The PAL shall be available at all times for CMF review and term mismatches, if any, must be reported by the bank to the CMF.

In 2020, the Central Bank's council introduced an amendment to these rules, by means of which it will be entitled to suspend or increase flexibility on the abovementioned limits, to the extent the term mismatches occurred during a national emergency or due to other serious exceptional cases.

Rules governing banks' relationships with their customers and other third parties

In their relationship with clients, the general rules applicable to each type of banking activity will apply. Therefore, banks need to follow the rules contained in the Money Lending Operations Act, which governs the lending business in Chile, setting out what is understood as a money-lending transaction, the rules governing accrual of interests and other matters (including a maximum interest rate (*interés máximo convencional*), applicable, as of November 30, 2023, also to money lending operations "in" foreign currency (i.e., operations payable in foreign currency)), the Consumer Protection Act (Law No. 19,496), and the Data Protection Act.

In addition, there are specific rules that govern the relationships of banks with their customers. Most of these specific rules are contained in sectorial regulations enacted by the CMF, such as those regarding bank hours, bank accounts, leasing and factoring operations, other banking operations, issuance of subordinated loans, etc. Banks are also required to observe lending limit regulations when dealing with customers.

Anti-money laundering regulations are also applicable in the relationship between banks and their customers. In fact, banks need to follow Law No. 19,913 (the Anti-Money Laundering Act), which sets forth the general framework on anti-money laundering. In particular, banks are required to report to the Financial Analysis Unit (*Unidad de Análisis Financiero*):

1. "Suspicious transactions" they are aware of.
2. Cash transactions exceeding US$10,000, on a semi-annual basis.
3. Documents and antecedents required to examine a previously reported suspicious transaction, or one it has detected.

Law No. 20,393 extends to legal entities liability for criminal wrongdoings related to money laundering, financing of terrorism and bribery of civil servants. It is worth mentioning that on May 15, 2023, Chilean Congress approved the bill that systematises economic crimes and offences against the environment and innovates in a series of matters, including: (i) the systematisation of offences related to business activity under four major categories of crimes that correspond to so-called "Economic Crimes"; (ii) the creation of new offences (e.g., a new title has been incorporated into the Criminal Code called "Offenses against the environment", among others); (iii) the inclusion of new offences based on the crime of money laundering typified in Article 27 of Law No. 19,913; (iv) the establishment of new penalties and sanctions, as well as the strengthening of existing ones, seeking that custodial sentences are effectively complied with by those who are involved in the commission of an Economic Crime; and (v) the exponential growth of the number of predicate offences for which legal entities (including banks) may be criminally liable under Law No. 20,393. Regarding the growth of offences that may trigger criminal liability of legal entities, the new law renders companies – regardless of their size – liable for all offences included in the so-called "Economic Crimes" referred to above, even when they do not meet the requirements to be considered "Economic Crimes". This means that the legal entity will be liable for more than 200 new offences. In addition, the new law changes the conditions for holding legal entities liable, by no longer requiring that the offence be committed in the interest or for the benefit of the legal entity: according to the new law, it is sufficient that the offence is committed by someone inside the company, or third parties that manage services for it, with or without its representation, and that the perpetration of the act is favoured or facilitated by the lack of an adequate crime prevention model.

The CMF requires banks, in addition to following the rules set forth in Law No. 19,913, to have specific anti-money laundering systems in place, which are based on the "know-your-

customer" system. Chapter 1-14 of the Updated Compilation of Rules of the CMF lists the main features that every bank's "know-your-customer" system should contain.

Finally, with respect to sanctions applicable to banks in Chile, the Banking Law establishes that those banking entities that do not comply with the law, regulations and other norms that govern them, may be sanctioned in accordance with Law 21,000 mentioned above, without prejudice to the sanctions established in other legal bodies.

In line with the above, Law No. 21,000 establishes three sanctions for banks:

1. Censorship.
2. Fine for fiscal benefit, which may be, depending on the case, (i) twice the amount of the benefit obtained from the illegal transaction, (ii) 30% of the amount of the illegal transaction, or (iii) 15,000 UF (*Unidad de Fomento*), which corresponds to approximately US$600,000 as of January 12, 2024.
3. Revocation of the company's authorisation of existence.

The sanctions above are applied by the CMF, taking into consideration the seriousness of the infraction, the economic benefit obtained, the damage caused to the financial market, recidivism, the economic power of the offender and the collaboration provided by the offender in the investigation.

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Congo – D.R.

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Introduction

Despite the banking crisis of the 1990s and the current global financial tensions, it is clear that economic development in the Democratic Republic of the Congo ("DRC") is being accompanied by a spread of banks and a strengthening of the banking system, with a view to creating a competitive market capable of meeting the challenges facing the country.

Faced with the war in the eastern part of the country, with the involvement of negative forces supported by a neighbouring state, and the political challenges of stabilising the country, the wealth of resources, the presence of foreign and local investors, and the competition in the market from numerous companies in different sectors certainly represent a pole of attraction for the banking system.

Recently, as will be discussed in more detail below, legislative interventions have been made in the financial and banking system, with more effective regulation of the banking system and the fight against money laundering and the financing of terrorism.

The response of the banking and financial system, characterised by modernisation and digitalisation as well as by credit and micro-credit offers, shows that state intervention is perceived as favouring rather than discouraging the market and competition, through the creation of common conditions and clear standards for monitoring the activity of institutions and consumer protection.

The DRC's banking and financial system

As explained in our chapter in the previous edition of this book, the authorities have embarked on courageous reforms in the economic sector in general, in particular with the DRC's membership of the Organization for the Harmonization of Business Law in Africa ("OHADA"), the mining code, the hydrocarbons code, and, in particular, the finance and banking sector with the insurance code, the law on leasing, the reform of the Central Bank and the modernisation of payment systems.

Regulatory bodies

In the current architecture of the financial landscape, there is the supervisory body, which is the Central Bank, the *Association Congolaise des Banques* ("ACB") (the representative body, which is the association of banks in the DRC) and the insurance regulatory and supervisory authority.

Here, our attention will be focused on the Central Bank and the ACB, which cover the banking sector.

The Central Bank

The Central Bank is the sole authority in charge of controlling the financial sector and banks in the DRC, and is the only authority in charge of the supervision of the financial and banking sector in the DRC. It is responsible for defining and implementing the country's monetary policy, the main objective of which is the stability of the general price level. It has the legal power to approve banking institutions, to control them and to ensure that they respect the law. It also has the power to take corrective measures to remedy problems of safety and soundness of the financial system and to establish regulatory and prudential rules for financial activities. It is therefore the disciplinary body for banks.

The Central Bank's mandate covers, in addition to banks, all non-bank credit and savings cooperatives, specialised financial institutions, finance companies and microfinance institutions and other financial intermediaries (money transfer institutions and financial messaging services).

In addition, in return, the Central Bank has the power to regulate all transfers of tangible and intangible assets between the DRC and foreign countries by requiring notification actions at the origin of such transfers and by imposing formalities and conditions for their execution. It also has the power to establish rules and regulations on foreign exchange transactions and to promote the proper functioning of clearing and payment systems.

The Central Bank is headed by a Governor, a position currently held by a woman who prepares and executes the acts issued by the Board of Governors. The Board of Governors is the supreme body that has the most extensive powers to design and direct the policy of the Central Bank and its management control.

The ACB

Congolese commercial banks are grouped in the ACB, which is a professional association. The main objective of this association, representing the collective interests of its members to the authorities, is to analyse all issues of mutual interest and to make recommendations to promote the network of cooperation, organisation and management of services of common interest to banks. It is a representative body.

These two bodies, the Central Bank and the ACB, work in partnership to ensure the secure development of the Congolese banking sector.

Regulation

Influence of supranational regulatory regimes or regional bodies

In its legal system, the DRC has adopted a principle according to which, when it adheres to an international treaty, the latter supplants its internal law in its application. In addition to being part of the international community, the DRC has acceded to international and regional organisations.

Thus, the DRC has adhered to the treaty against money laundering, and has committed itself to respecting the provisions of Article VII of the Constitution of the International Monetary Fund ("IMF") on restrictions on the non-use of current payments and of the General Agreement on Tariffs and Trade of 1994.

At the regional level, the DRC is a member of the Common Market for Eastern and Southern Africa ("COMESA") and of the Southern African Development Community ("SADC"), and in April 2022, it became a member of the East African Community ("EAC"). With its membership of the SADC, the DRC implemented Law No. 13/025 of 7 July 2013, authorising the ratification of the Protocol on Finance and Investment in the SADC.

This treaty aims to promote the harmonisation of the policies of state parties in the areas of finance and investment in order to comply with the objectives of the SADC and to facilitate regional integration, cooperation and coordination in these areas in order to diversify and expand the productive sectors of the economy, and increase intra-regional trade in order to achieve development, sustainable economic growth and poverty eradication.

The SADC's objectives are focused on financial and monetary integration, good governance and peacekeeping.

Consequently, at the internal level, the DRC, through its Constitution, lays down the principles of public finance management. Thus, it has established the Central Bank as the main body for the regulation of financial institutions and banks.

Within this framework, specific laws have been passed and instructions issued by the Central Bank to regulate and control banking operations.

Some of the laws and instructions governing the DRC's banking sector are the following (non-exhaustive list):

1. Law No. 005 on the establishment, organisation and functioning of the Central Bank of the Congo (7 May 2002).
2. Law No. 04/016 concerning the fight against money laundering and terrorist financing (19 July 2004).
3. Law No. 020/2002 concerning the regime of exemptions for the restructuring of the Central Bank of the Congo (16 October 2002).
4. Law No. 022/2002 concerning the special scheme for the restructuring of credit institutions (30 October 2002).

Material exchange

1. The regulation of exchange in the DRC, February 2014.
2. Instruction No. 1 to Micro Finance Institutions.
3. Administrative Instruction No. 006 regulating the activity of financial messaging (Amendment No. 1).
4. Administrative Instruction No. 007 regulating the activity of currency exchange (Amendment No. 1).

We also note the Central Bank's modification of the instruction that allows commercial banks to constitute compulsory reserves in the currency of foreign currency deposits, the updating of instructions on governance and internal control (Instruction No. 21 on corporate governance in credit institutions and Instruction No. 17 on prudential rules for internal control in credit institutions), the modernisation of the national payment system and the effective issue of Treasury bills on the public securities market.

Recent legislative interventions in the banking sector

Among the most important legislative interventions concerning credit institutions and banking activity, the following should certainly be mentioned:

- Law No. 22/069 of 27 December 2022 on the activity and control of credit institutions, which came into force in the second half of 2023.
- Law No. 22/068 of 27 December 2022 on the fight against money laundering and the financing of terrorism and the proliferation of weapons of mass destruction, which came into force in February 2023.
- Law No. 23/010 of 13 March 2023 on Digital Code.

These legislative developments will be briefly examined below, as they allow us to observe the attitude of the legislator to the current challenges of the banking and financial sector.

Law No. 22/069 of 27 December 2022 on the activity and control of credit institutions

When examining the reasons for the adoption of this law, it is possible to understand its purpose and spirit; that is, on the one hand, the need to go beyond the previous legislation (Law No. 003/2002 of 2 February 2002), now considered inadequate to deal with the financial and economic crisis that followed 2008, and on the other hand, to modernise Congolese law in light of the increasing technological innovations in the banking world in terms of harmonising the system.

The first novelty of the law in question is therefore the introduction of the prior agreement, that is to say that credit institutions, before carrying out their activity on national territory, must obtain the agreement under the conditions provided for by said law and by the instructions of the Central Bank of the Congo.

Here, it should be noted how the centrality and strengthening of the role of the Central Bank of the Congo aim at the harmonisation of the banking system, through the assessment by a competent third party of the minimum and effective conditions of an institution to operate in the banking and financial system (including minimum capital, legal form, etc.).

The aspect of professionalism is also reflected in the requirements for holders of the capital stock of credit institutions, among which it is required that they own a shareholder, partner or member of reference, legal or natural person, providing all the guarantees of reputation, ethics, financial surface and/or professionalism in the banking, financial or any other sector.

Thus, while it is true that any control or limit initially appears as a limitation of economic freedom, it is clear that such a provision can only create greater confidence among investors and savers (consumers) in the choice of the banking institution to which they apply.

Additional requirements are also laid down concerning the organisational structure, aimed at ensuring a high level of management, with a precise distinction between the executive body and the supervisory bodies: identification and reporting procedures; an integrity policy; control and security mechanisms; and an adequate warning system, etc.

In order to give effect to this internal control and to encourage credit institutions to exercise sound overall administrative management, it is envisaged that credit institutions will be required to set up an audit committee and a risk committee within their deliberative bodies.

The audit committee is responsible for, among other things: the financial reporting process; monitoring the effectiveness of internal control and risk management systems; monitoring the audit and its activities; and monitoring the statutory audit of the annual accounts, etc.

The risk committee, in short, advises the deliberating body on aspects concerning the strategy and level of risk tolerance, both current and future.

Another obligation of credit institutions is to appoint an auditor, whose appointment is subject to prior authorisation from the Central Bank of the Congo.

Finally, the following can be noted as regards the strengthening of the Central Bank of the Congo in the control of the activity of credit institutions:

- the obligations of credit institutions to the Central Bank of the Congo regarding the appointment of members of the deliberative bodies and the executive body in terms of good repute, competence and professional experience in the banking field;
- control and review of the preventive recovery plan, a plan to be drawn up by each credit institution within six months of the start of its activities and concerning the measures likely to be implemented in order to restore its financial and/or organisational situation following a significant deterioration in those areas;
- the periodic preparation of a preventive resolution plan for the systemically important credit management system;

- the central role, in terms of declaration and designation of professionals in charge of the procedure, of the Central Bank of the Congo in the preventive, curative and liability clearance procedures applicable to credit institutions in difficulty; that is, adjustments, resolution, liquidation; and
- the power to sanction violations of the provisions of the law in question.

In this sense, the Central Bank has taken administrative instructions such as:

1. Administrative Instruction No. 006 regulating the activity of financial couriers, the purpose of which is to define the conditions required for the exercise of money transfer activity by financial couriers (Article 1). This instruction has the particularity of requiring any company or natural person wishing to engage in this activity to incorporate as a legal person, in the legal form of SARL with the sole purpose of said company, the sole activity of transfer of funds. Moreover, this requirement is also made for foreign companies (Article 3 *et seq*.).
2. Administrative Instruction No. 007 regulating manual exchange activity (Amendment No. 3), which defines the conditions and procedures for exercising such activity (Article 1).

These two instructions have the advantage of reinforcing the requirements in the exercise of financial activity in the sense of not only cleaning up the economic and financial environment but fighting against fraud and money laundering and providing a guarantee of consumer protection.

Law No. 22/068 on the fight against money laundering and the financing of terrorism and the proliferation of weapons of mass destruction

This law represents an important intervention to amend and strengthen the previous law on the same subject, Law No. 04/016 of 19 July 2004.

In particular, as can also be read in the explanation of the reasons for the adoption of Law No. 22/068, the DRC has shown a strong commitment to the fight against money laundering and capital financing, as evidenced by the promulgation of Law No. 04/016, as well as the admission of the DRC on 5 and 9 September 2017 as an associate member of the Action Group against Money Laundering in Central Africa (“GABAC”), and as an observer member of the Anti-Money Laundering Group Money in Eastern and Southern Africa (“GABAOA”).

However, the legislator has recognised that the DRC’s non-membership of the Financial Action Task Force (“FATF”), the intergovernmental body created in 1989 by the Ministers of States belonging to the G7, as well as the failure to update its legal framework in accordance with the changes to the FATF recommendations, so far constitute major obstacles to the effectiveness of the system against money laundering and the financing of terrorism and proliferation weapons of mass destruction in the DRC and its contribution to the international community’s fight against organised crime.

In this sense, the objective of Law No. 22/068 is to reform the framework with regard to:

- Article 122 point 6 and Article 215 of the Constitution of 18 February 2006 as amended by Law No. 11/002 of January 2011 revising certain articles of the Constitution of the DRC.
- Relevant Resolution Nos 1267, 1988, 1989 and 1373 of the United Nations Security Council.
- 40 FATF recommendations and their subsequent updates.
- Actions recommended in the DRC mutual evaluation report, following the second cycle methodology, by GABAC.

It is clear that the law in question affects the banking system (as well as other market sectors and companies in general) and it is therefore worth briefly highlighting the most relevant aspects.

First, as regards structures, the National Financial Intelligence Unit ("CENAREF") has been established, an institution endowed with administrative and financial autonomy and placed under the supervision of the Minister of Finance. Its mission is to collect and process financial intelligence on money laundering and terrorist financing and proliferation of weapons of mass destruction.

The CENAREF prepares a quarterly report and an annual report that analyse the evolution of activities to combat money laundering and the financing of terrorism and the proliferation of weapons of mass destruction at the national and international levels, and then assess the suspicious activity reports collected. These reports are sent to the Minister of Finance.

An Interministerial Committee on Combating Money Laundering and the Financing of Terrorism and Proliferation ("CILB") has also been established, headed by the Minister of Finance and seconded by the Minister of Justice, responsible for defining, facilitating and coordinating government policy in this area.

Finally, an Advisory Committee on the Fight Against Money Laundering and the Financing of Terrorism and the Proliferation of Weapons of Mass Destruction ("COLUB") has been established, under the authority of the Minister of Finance, which is responsible for assisting the Government in the definition and implementation of national policy in the matter in question.

That said, this law has strengthened certain preventive measures from the previous law and introduced others through the introduction of obligations for constant monitoring, including:

- The provision that any transaction in Congolese francs or other currency in an amount generally equal to or greater than US$10,000 may not be paid in cash or by bearer security.
- The obligation for any person of a third state, who enters or leaves the territory of the DRC, to complete, in good faith, at the time of entry and exit, a statement of cash and negotiable instrument to bear a sum in Congolese francs or other estimate, generally equal to or greater than US$10,000.
- The obligation of constant vigilance for all taxable persons (the Central Bank of the Congo, financial institutions, financial intermediators, lottery companies, casinos, notaries, lawyers, bailiffs, judicial administrators, real estate agents, accountants, etc.) as well as the obligation to inform the CENAREF of any suspicion regarding money laundering, terrorist financing, etc.
- The obligation to identify the beneficial owners of operations, which cannot be prevented by professional secrecy.
- The obligation of custodians for 10 years from the closing of its accounts or the termination of its relations with its usual or occasional client, their beneficial owner or their economic beneficiaries, documents and documents relating to their identity, including the books of accounts, business correspondence and the results of any analysis.

As for the sanctions regime, in order to make the prevention rules effective, conservative measures (freezing and seizure) are envisaged on the one hand against the perpetrators of money laundering, financing of terrorism and proliferation of weapons of mass destruction, and on the other hand a tightening of the sentencing regime.

Similarly, penalties are provided for taxable persons who violate the monitoring, identification and information obligations established by the law in question.

Fintech

As mentioned above, another element that shows the interest in the permanence and diffusion of credit institutions in the DRC is the increasing diffusion of internet banking services, the creation of e-wallets and other such digital tools that encourage people to rely on the banking system.

In general, in the DRC, there is an interest in the dissemination of technological and computer innovations, starting from the development and publication in September 2019 of the National Digital Plan ("PNN") – Horizon 2025, which proposes, among the objective of initiating projects in artificial intelligence, augmented reality, robotics, home automation, nanotechnology, and bionics (intelligent prosthesis, augmented humans), that the current achievements of artificial intelligence can be grouped into different areas, such as:

- Expert systems.
- Machine learning.
- Automatic language processing.
- Recognition of shapes, faces and vision in general.

In addition, the introduction to the above-mentioned document states: "The future of Digital is all the more promising as it announces the popularization of artificial intelligence, connected objects, the Internet of Things, 5G technology, cloud computing (cloud computing), big and open data (Big Data and Open Data), blockchain, electronic money, uberization of the economy (utility applications), genomics, nanotechnology."

In this sense, we are witnessing a process of regulation of the matter, represented by the recent adoption of Law No. 23/010 of 13 March 2023 on Digital Code, by which the institutional framework of the digitally enabled services sector is defined as follows by the Minister of Digital, the Digital Regulatory Authority, the National Authority for Electronic Certification, the National Cybersecurity Agency, and the National Digital Council:

- preventive verification systems are established (authorisation, declaration, approval); and
- the general principles and obligations applicable to the sector are defined (equal treatment, transparency, non-discrimination, free competition, technological neutrality), and rules are introduced for the regulation of electronic commerce, electronic advertising, electronic identification, processing of personal data, data controllers, etc.

Finally, there has recently been a commitment from local credit institutions to digitise and use functional IT tools to address global technological development.

Conclusion

State intervention in financial and banking matters demonstrates the need for control to avoid anomalies in the system, such as the persistence in the market of credit institutions in economic difficulty or, in general, the prevention of all dangers arising from the infiltration of organised crime into the economy of the country, creating common surveillance obligations.

In addition, as mentioned above, the creation of common minimum standards of supervision for credit institutions also aims to harmonise the banking system, ensuring the presence of reliable entities in the market, financial inclusion and consumer protection.

The response of credit institutions and market operators, consisting of growth of the market in question in terms of offers and competitiveness, shows that legislative interventions aim to ensure the efficient and secure functioning of the market. However, it must be admitted that continuous technological innovations, challenges in terms of banking security and solvency of credit institutions require constant observation of the system capable of creating solutions, whether they are legislative or free market practices, which can keep the Congolese banking and financial system capable of following these ongoing developments at the international level. Thus, revisions, adaptations and new laws will be taken; it is a continuous adaptation.

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Germany

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Introduction

The financial sector in Germany and in Europe has undergone significant changes in recent years and the regulatory environment continues to evolve. Recent developments can be attributed to a multitude of economic, pandemic, political and technological factors. In the aftermath of the financial crisis in 2008, the regulatory regime applicable to banks, investment firms and financial markets in general has tightened globally, resulting in stricter capital, liquidity and prudential requirements. This trend of tightening the financial regulatory regime has continued in recent years and is expected to continue. In this regard, financial regulation in Germany is significantly influenced and shaped by the law of the European Union (***EU***), which actively participates in the development and implementation of international regulatory standards for credit institutions within the Basel Committee on Banking Supervision (***BCBS***) accounting for a significant part of the global regulatory framework.

Recent legislative initiatives that significantly impact the regulatory environment of the financial sector include digitalisation with digital operational resilience and crypto, sustainability as well as anti-money laundering/combatting the financing of terrorism (***AML/CFT***). Increased digitalisation in the financial sector has been mirrored in several fundamental legal acts at the EU level, including those on digital operational resilience and crypto-assets that will apply directly in the EU Member States. The EU sustainable finance strategy and related legislative packages aim to support the financing of the transition to a sustainable economy and reduce the greenwashing phenomenon in the EU, while institutions from the financial sector have to implement challenging environmental, social and governance (***ESG***) standards in their processes and products. Increased risks in the AML/CFT sphere led to the proposal of a comprehensive EU AML/CFT legislative package. Further, the Russian invasion of Ukraine in 2022 has induced the legislator to adjust the German sanctions regime particularly with the objective of improving the enforcement of sanctions and prevention of money laundering. Other current issues include inflation and the risk of price corrections on financial markets and in real estate.

Regulatory architecture: Overview of banking regulators and key regulations

Banks and other financial institutions operating in Germany are subject to financial supervision at an EU and/or a national level. At the EU level, the competent regulators are the European Central Bank (***ECB***) and the European supervisory authorities including the European Banking Authority (***EBA***), the European Securities and Markets Authority (***ESMA***) and the European Insurance and Occupational Pensions Authority (***EIOPA***) (together, the European Supervisory Authorities, or ***ESAs***), each with specific competences. Even though the ESAs have only under very exceptional circumstances

direct supervisory powers *vis-à-vis* financial institutions, they significantly influence financial regulation by developing technical and implementation standards, guidelines and recommendations applied by supervisory authorities and the financial institutions that are subject to supervision. At the national level, the banking regulators in Germany are the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*, ***BaFin***) and the German Central Bank (*Deutsche Bundesbank*, ***Bundesbank***), which closely cooperate for the supervision of financial institutions in Germany.

The Single Supervisory Mechanism

The allocation of competences among the ECB and the national competent authorities (***NCAs***, i.e. BaFin and Bundesbank in Germany) results from the rules of the Single Supervisory Mechanism (***SSM***) established for the European Economic Area (***EEA***) (i.e. not necessarily for all EU Member States – which do, however, have an opt-in right) in 2014. Those rules have been set out in two key EU regulations: ECB Regulation (EU) No. 468/2014 (***SSM Framework Regulation***); and Council Regulation (EU) No. 1024/2013 (***SSM Regulation***). The SSM, however, provides for the allocation of responsibilities only with respect to the supervision of credit institutions within the meaning of Regulation (EU) No. 575/2013 (***CRR***, as amended). Such credit institutions include institutions engaged in the lending and deposit-taking business and, since 26 June 2021, investment firms dealing on own account, engaged in the underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis, whereby, in the case of the investment firms, an additional quantitative pre-requisite applies: the investment firms engaged in the aforesaid businesses are considered CRR credit institutions if the total value of their assets on a solo basis or, subject to further conditions, on a group consolidated basis is equal to or exceeds €30 billion. Otherwise, NCAs are responsible for the supervision in any event.

Within the SSM, significant institutions and less significant institutions must be distinguished between. Institutions are only captured by the SSM if they meet the criteria specified in the SSM Regulation. Institutions are significant if they meet, in particular, any of the following criteria:

- they have a total value of assets over €30 billion or over 20% of the GDP of the EU Member State of establishment, but not less than €5 billion;
- upon a decision of the ECB based on an NCA's notification (in Germany: BaFin);
- they are one of the three most significant credit institutions in an EU Member State of the euro area; and/or
- public financial assistance has been requested or received directly from the European Financial Stability Facility or the European Stability Mechanism.

Significant institutions are subject to the direct supervision of the ECB insofar as they perform the duties that an NCA would otherwise have to fulfil. The relevant NCA, however, is as involved in the daily supervision as the ECB by allocating members to the Joint Supervisory Team that is formed for each significant institution.

With respect to less significant institutions, ECB supervision is primarily of an indirect nature, as such institutions are generally supervised by NCAs. The ECB's part in the supervisory process for less significant institutions is therefore generally limited to the issuance of regulations, directions and guidance for NCAs (such as BaFin) as well as monitoring the national supervisory practice. However, there are a few exceptions from this general rule. In particular, within the SSM, the ECB has the exclusive competence to grant and withdraw banking licences, and to object to the acquisition of a qualifying holding, in each case with regard to significant and less significant institutions. Matters such as consumer protection or money laundering do not fall within the competence of the SSM.

BaFin and Bundesbank

BaFin supervises not only less significant credit institutions but also other financial institutions providing financially regulated services such as, for instance, banks conducting lending business but not taking deposits from the public, investment firms that are not significant credit institutions, factoring and leasing firms, payment services institutions, insurance companies, and asset management firms. In addition, BaFin is responsible for combatting money laundering and terrorism financing as well as collective consumer protection in the financial sector. Bundesbank closely cooperates with BaFin in performing the supervisory function, which is effectively a joint task.

Key regulations

The core regulations applicable to banks and investment firms in Germany are laid down in the following laws and rules: the Banking Act (***KWG***); the Securities Institutions Act (***WpIG***) implementing Directive (EU) No. 2019/2034 on the prudential supervision of investment firms (***IFD***); CRR; Directive (EU) No. 2013/36/EU, as amended (***CRD***) and as implemented into German law; Regulation (EU) No. 2019/2033 on the prudential requirements of investment firms (***IFR***); the Securities Trading Act (***WpHG***); and Directive No. 2014/65/EU on markets in financial instruments, as implemented into German law, as well as various EU regulations implementing this Directive (together, ***MiFID II***). Further regulations that are also key for financial institutions but address rather specific topics can be found in so many German acts that only a few of them are highlighted in the following.

KWG and WpIG

Authorisation requirements for banking business, investment services and other financial services in Germany are included in KWG and WpIG. As a general rule, anyone who intends to conduct banking business or provide investment or financial services in Germany, commercially or on a scale that requires commercially organised business operations, needs written authorisation from the supervisory authority. Thus, the definition of banking business and of investment and financial services is of the utmost importance to determine whether a certain activity is subject to a licence requirement under German law.

KWG defines various types of banking businesses and other financial services, whereas investment services are defined both in KWG and in WpIG. Banking business includes, for instance, credit, deposit, guarantee, principal broking, securities custody and underwriting business. Investment services comprise, in particular: investment broking; investment advice; trading in financial instruments as a service for others as well as by using high-frequency algorithmic trading techniques; the operation of a multilateral trading facility; and portfolio management. Other financial services include leasing, factoring and, since 2020 and 2021, respectively, crypto custody business and crypto securities registration services. Trading in financial instruments on one's own account and behalf may also be subject to a licence requirement if it is performed in addition to banking and/or financial services, or – subject to certain exceptions that are particularly relevant for firms having their seat outside of Germany – if such proprietary trading is being conducted as a member or participant of an organised market or multilateral trading facility, or with direct electronic access to such trading venues. Further, proprietary trading in commodity derivatives and emission allowances might also be subject to a licence requirement, unless one of the available exceptions applies. As regards the relation between the provisions of KWG and WpIG, investment services, including the respective authorisation requirements for their conduct, are regulated by WpIG, unless the investment firm, on a solo or on a consolidated basis and subject to certain conditions, exceeds the monthly average of the total assets of €30 billion and engages in underwriting, dealing on own account or proprietary trading.

Generally speaking, all banks, financial institutions and investment firms operating on the German market may be subject to a licence requirement under KWG or WpIG. However, credit institutions, investment firms and other financial institutions from other EU/EEA Member States may provide cross-border services or establish branches in Germany without an additional licence from BaFin within the framework of the EU passporting regime. This applies to the extent that: an institution holds a valid licence in its home Member State; an institution is supervised by the competent supervisory authority in line with the EU requirements; the relevant business operations are covered by the licence obtained in the home Member State; and entering the German market was preceded with a notification procedure informing BaFin of the contemplated market access. The licensing requirement does not necessarily require that a service provider has a physical presence in Germany. It is sufficient that a service provider targets the German market in order to offer banking products or investment and/or financial services repeatedly and on a commercial basis to companies and/or persons having their registered office or ordinary residence in Germany. Consequently, a licence requirement is not triggered if a foreign financial institution provides a regulated service so long as the service was requested by a German client with no solicitation or targeting by the foreign bank (i.e. no directed marketing or setting up of a German language website) – the so-called reverse solicitation exemption or reverse enquiry regime. In certain exceptional cases, BaFin may exempt a foreign bank from the licensing requirement in Germany if such a bank is effectively supervised in its home country in line with appropriate international standards, and the competent supervisory authority effectively cooperates with BaFin.

A further exception from the general licence requirements has been introduced by MiFID II but has not yet become relevant in practice. Under Regulation (EU) No. 600/2014 (***MiFIR***), firms in a non-EEA Member State may offer investment services on a cross-border basis to certain categories of customers that do not appear to need a high level of protection (i.e. professional customers and eligible counterparties), provided that the firm has been registered in a special EU register maintained by ESMA. Such registration depends on an equivalence decision of the EU Commission determining that the firms authorised in that third country comply with legally binding prudential and business conduct requirements that have equivalent effect to the requirements under EU law and that the legal framework of that third country provides for an effective, equivalent system for the recognition of investment firms authorised under third-country legal regimes. The IFR has further extended the scope of requirements applicable to this special exemption regime under MiFIR; among others, the requirements for the adoption by the EU Commission of the equivalence decision have been extended so that third-country firms shall comply with prudential, organisational and business conduct requirements, which have an equivalent effect to those set out in CRR, CRD, IFD and IFR. At the same time, Member States may allow third-country firms to provide investment services for eligible counterparties and professional clients where no aforesaid equivalence decision by the EU Commission has been adopted or where such a decision has been adopted but is either no longer in effect or does not cover the services or activities concerned.

The process of obtaining a licence in Germany requires an application and the submission of numerous documents, such as: a viable business plan; evidence of meeting capital adequacy requirements; detailed information on liquidity and risk management, organisational structure and internal control procedures; adequate staffing and technical resources; and an adequate contingency plan, in particular for IT systems. Further, the application for a licence must also include information and documents indicating that the members of the management board and the supervisory board (Germany follows the two-tier system for

corporate governance purposes) are eligible for such positions, as well as information and documents on qualified holdings (i.e. at least 10% of capital and/or votes held directly or indirectly, or exerting significant influence by other means).

Aside from the licence requirement, a recent amendment to KWG following the implementation of a CRD amendment into German law introduced a requirement to obtain a written approval by (EU) (mixed) parent financial companies to ensure compliance with prudential requirements on a consolidated and semi-consolidated basis.

In addition, KWG and WpIG include general requirements on the business organisation and constitute the legal basis for various supervisory actions that BaFin and Bundesbank may take.

CRR/IFR

CRR include, in particular, capital and liquidity requirements for credit institutions, limitations on large exposures and rules on the leverage ratio, i.e. the limitation of indebtedness. Prudential requirements under CRR apply also to larger systemic investment firms. These include investment firms dealing on own account and/or engaged in underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis if its consolidated assets are equal to or exceed €15 billion or if the investment firm is part of a group in which the total value of the consolidated assets of all undertakings in the group that engage in the relevant activities is equal to or exceeds €15 billion. In addition, following the implementation of IFD, BaFin may decide to apply the CRR prudential regime to an investment firm, dealing on own account and/or engaged in underwriting of financial instruments, whose total value of the consolidated assets is equal to or exceeds €5 billion provided that certain further conditions are met, such as the investment firm carries out those activities on such a scale that the failure or the distress of the investment firm could lead to systemic risk. IFR provides for various prudential requirements, including in relation to own funds, capital, concentration risk, liquidity and related reporting applicable to the investment firms, unless the CRR regime applies. In addition, small and non-interconnected investment firms that do not meet specific thresholds defined in IFR benefit from simplified requirements.

WpHG/MiFID II

WpHG includes, in particular, rules of conduct and organisational requirements for the offering of investment services. Due to the implementation of MiFID II into German law, WpHG was completely revised and does not contain all these rules and requirements in detail, but refers partly to various delegated regulations promulgated under MiFID II at the EU level. WpHG/MiFID II include, for instance, rules on inducement in connection with the provision of investment services, cost transparency, requirements on the recording of correspondence with customers, product governance rules, etc. Further, WpHG contains a licence requirement for certain markets in financial instruments from outside the EEA that allow traders in Germany direct electronic access to the trading venue. Finally, WpHG contains various capital market rules such as, for instance, the voting rights notification regime, restrictions on short selling, and certain disclosure obligations.

Other key regulations

Other key regulations affecting the financial sector in Germany include:

- The Capital Investment Code (***KAGB***): Particularly addressing the licensing requirements applicable to investment fund managers (including passporting options), categorising various types of funds and setting out the requirements on their asset allocation and their investors as well as including restrictions for the distribution of fund units.

- The Payment Services Supervision Act (***ZAG***): Particularly addressing the licensing requirements in connection with providing payment services and issuing e-money, including organisational requirements and rules of conduct for payment institutions as well as for other institutions providing payment services (e.g. obligation to grant access to an account via an API, strong customer authentication, IT security requirements).
- The Money Laundering Act (***GwG***): Including the obligations aimed at combatting money laundering and terrorism financing.
- The Recovery and Resolution Act (***SAG***): Implementing the EU Banking Recovery and Resolution Directives (EU) No. 2014/59/EU (***BRRD***) and (EU) No. 2019/879 (***BRRD II***) and which includes, for instance, the requirement to prepare recovery and resolution plans and the instruments of the regulators in case of a default of a systemically important credit institution.
- The Remuneration Regulation for Institutions (***InstitutsVergV***): Providing for transparent remuneration systems and adequate remuneration in banks and other financial institutions.
- Legislative acts applicable to specific areas of banking business such as, for instance: the Safe Custody Act (***DepotG***), addressing the requirements for the safe custody of securities; the Stock Exchange Act (***BörsG***), including rules for stock exchanges and their market participants; and Regulation (EU) No. 648/2012 of 4 July 2012, as amended, on over-the-counter derivatives, central counterparties and trade repositories, which contains directly applicable rules, particularly for trades in derivatives like clearing or notification obligations, and specific requirements for central counterparties.
- The newly promulgated Secondary Credit Market Act (***KrZwMG***), implementing Directive (EU) No. 2021/2167 on credit servicers and credit purchasers and introducing requirements for the provision of credit servicing activities in respect of non-performing credit receivables and agreements, including authorisation requirements, as well as obligations of credit institutions as sellers of non-performing credit agreements, obligations of purchasers of such credit agreements and the supervision of credit services institutions (the KrZwMG provides for a transitionary period of six months, which lapses on 29 June 2024).
- Numerous BaFin circulars and guidance notices issued by BaFin or Bundesbank that specify the regulatory obligations, e.g. the Minimum Requirements on Risk Management (***MaRisk***).
- Numerous guidelines, recommendations, implementation and technical standards of EBA and ESMA.

Recent regulatory themes and key regulatory developments

Recent EU banking packages

Recent EU banking packages, including a proposal that is currently in the legislative procedure, are together aimed to finalise the implementation of the international Basel III agreement and the reforms agreed at an international level by the BCBS and the Financial Stability Board as regards a regulatory framework for credit institutions.

The EU banking package 2019 brought about the revision of key EU legislation applicable to credit institutions, including CRR, CRD, BRRD and the Single Resolution Mechanism Regulation 806/2014 (***SRM***). It included amendments of CRR, CRD, SRM and BRRD. CRR and SRM are directly applicable in the EU Member States, whereas the amendments of CRD and BRRD had to be implemented into national laws. In Germany, the EU banking package has been implemented by the Risk Reduction Act (***RIG***), in force since December 2020.

Key amendments included strengthening the financial stability of credit institutions by introducing a binding leverage ratio requirement of 3% of Tier 1 capital (with an option to impose additional leverage ratio requirements at the discretion of the supervisory authorities), an additional leverage ratio requirement applicable to global systemically important institutions (***G-SIIs***) equal to 50% of the risk-based G-SIIs capital buffer ratio, a reporting requirement concerning the BCBS Fundamental Review of the Trading Book standards including large exposures, exposures to central counterparties, collective investment undertakings, counterparty credit risk and interest rate risk, as well as changes to the large exposures regime. Also, a binding net stable funding ratio (***NSFR***) of at least 100% and a more risk-sensitive approach to trading in securities and derivatives have been introduced. Small and non-complex institutions benefit from the rules of increased proportionality and have less stringent reporting obligations, including a simplified, less granular version of the NSFR.

In line with a corresponding amendment of CRD, German law implemented the amendments to the supervisory review and evaluation process (***SREP***), whereby the additional own funds requirements imposed by BaFin do not have to be met exclusively with Common Equity Tier 1 (***CET1***) capital. Also, BaFin may provide additional Pillar 2 Guidance (***P2G***) aimed at strengthening an institution's resilience in covering its losses in stress periods.

To ensure that prudential requirements are met at the group level on a consolidated basis, the RIG implemented the CRD requirement of a written approval for (EU) (mixed) parent financial holding companies. BaFin (and other NCAs accordingly) are responsible for ongoing supervision of a group on a consolidated basis if it supervises the relevant parent institution. Further, large financial groups conducting significant activities in Germany (and other EU Member States accordingly) are obliged to set up an intermediate EU parent undertaking if they have two or more CRR credit institutions or investment firms established in the EU with the same ultimate parent undertaking in a third country unless the total value of assets in the EU of the third-country group is not more than €40 billion.

In the area of banking resolution, the EU banking package 2019 introduced new standards on the total loss-absorbing capacity (***TLAC***) aligned with the minimum requirement for own funds and eligible liabilities (***MREL***). As such, G-SIIs shall have more loss-absorbing and recapitalisation capacity. The relevant parameters include the risk-based ratio based on risk-weighted assets and the non-risk-based ratio based on the leverage ratio exposure. In addition, a new category of "top-tier" banks has been introduced, generally comprising non-G-SIIs with total assets exceeding €100 billion. Top-tier banks will also be subject to TLAC/MREL requirements. In addition, from 2024, G-SIIs and top-tier banks are subject to an additional requirement of 8% of total liabilities and own funds to facilitate the bail-in resolution.

The EU banking package 2021, adopted by the EU Commission in October 2021, includes two legislative proposals to further amend CRR and CRD; in addition, it included a separate legislative proposal concerning amendments to CRR in the field of resolution (the so-called "daisy chain" proposal), which in the meantime was finally adopted and entered into force in the form of Regulation (EU) No. 2022/2036. This so-called daisy chain regulation addresses the prudential treatment of G-SIIs with a multiple-point-of-entry resolution strategy as well as methods for the indirect subscription of instruments eligible for meeting the minimum requirement for own funds and eligible liabilities.

The other proposed changes within the EU banking package 2021 concern CRR requirements for credit, credit valuation adjustment, operational and market risks and risks resulting from the use of banks' internal models, the latter by means of introducing the so-called output

floor. Amendments to CRD include provisions on supervisory powers, sanctions, third-country branches as well as ESG risks. After the political agreement reached in June 2023, the EU banking package 2021 was endorsed by the preparatory bodies in December 2023 and has been submitted for adoption by the Council and the European Parliament.

Investment firms package

The regulatory regime for investment firms introduced by IFD and IFR, implemented into German law by WpIG applicable since 26 June 2021, revised the regulatory framework in CRD, CRR, MiFID II and MiFIR. The revised regime differentiates the prudential regime according to the size, nature and complexity of investment firms. Larger, systemic investment firms are now subject to the same prudential regime as CRR credit institutions. Generally speaking, any investment firm that is dealing on own account or engaged in underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis has to comply with the CRR rules if its consolidated assets are equal to or exceed €15 billion or if the investment firm is part of a group in which the total value of the consolidated assets of all undertakings in the group that engage in the relevant activities is equal to or exceeds €15 billion. Non-systemic investment firms are split into two groups. The capital requirements for small and non-interconnected and thus least risky investment firms are set in a new tailored regime, with simpler requirements. For larger firms, a new modus of measuring their risks has been introduced that is based on their business models.

Digitalisation, digital operational resilience, crypto *et al.*

The financial sector and its regulatory framework are changing dynamically as a result of digitalisation of banking and financial services and the new risks involved. Recent months and years have brought a multitude of regulatory changes, and further changes are on their way.

In January 2025, the Digital Operational Resilience Act, i.e. Regulation (EU) No. 2022/2554 (***DORA***), will start to apply. DORA is an EU-wide regulation that introduces, among others, requirements for financial entities to prevent and mitigate cyber threats and enhance digital operational resilience. This includes requirements on information and communication technology (***ICT***) risk management, incident reporting, digital operational resilience testing, information and intelligence sharing and measures for the sound management of ICT third-party risk. Further, DORA contains requirements in respect of contractual arrangements between financial entities and ICT third-party service providers, and the oversight framework for critical ICT third-party service providers. In January 2024, the ESAs published the first set of final draft technical standards under DORA and, in December 2023, public consultation on the second batch of the Level 2 and Level 3 measures under DORA was launched. DORA will play a key role in the financial sector, including in the context of outsourcing.

In June 2023, a directly applicable EU-wide regulation on Markets in Crypto-Assets, Regulation (EU) No. 2023/1114 (***MiCAR***), entered into force and will apply in full from December 2024 (and in part from June 2024). MiCAR provides for a full harmonisation of crypto-asset services, including a unified regime on transparency, authorisation and disclosure requirements. In-scope services include providing custody and administration of crypto-assets on behalf of clients, operation of a trading platform for crypto-assets, exchange of crypto-assets for funds and for other crypto-assets, execution of orders for crypto-assets on behalf of clients, placing of crypto-assets, reception and transmission of orders for crypto-assets on behalf of clients, providing advice on crypto-assets, providing portfolio management on crypto-assets and providing transfer services for crypto-assets on behalf of clients. MiCAR also includes provisions on the prevention and prohibition of market abuse involving crypto-assets.

Other EU-wide legislative acts in the context of digitalisation include:

- Regulation (EU) No. 2022/858 on a pilot regime for market infrastructures based on distributed ledger technology (***DLT***) (***DLT Regulation***) that has applied since March 2023 (and partly even before). The DLT Regulation lays down requirements in relation to DLT market infrastructures and their operators concerning granting and withdrawing specific permissions to operate DLT market infrastructures along with exemptions and conditions attached to such exemptions, the operation and supervision of DLT market infrastructures as well as cooperation between operators of DLT market infrastructures, competent authorities and ESMA.
- Regulation (EU) No. 2020/1503 on European crowdfunding services providers for business (***ECSPR***), in force since November 2021 with a transitional period that elapsed in November 2023. ECSPR provides a unified EU standard for lending- and equity-based crowdfunding. It defines "crowdfunding service" as matching of business funding interests of investors and project owners through the use of a crowdfunding platform and which consists of the facilitation of granting loans or placing without a firm commitment basis, as referred to MiFID II, of transferable securities and admitted instruments for crowdfunding purposes issued by project owners or a special purpose vehicle, and the reception and transmission of client orders in relation to those transferable securities and admitted instruments for crowdfunding purposes. Crowdfunding services providers need to obtain an authorisation from the national supervisory authority (in Germany: BaFin) and shall be registered by ESMA in an EU register of all operating crowdfunding platforms.

Further, in June 2023, the EU Commission published a financial data access and payments package, which includes a proposal for a directive on payment services and electronic money services (***Draft PSD3***) (repealing, among others, Directive No. 2015/2366/EU (***PSD2***)), a proposal for a regulation on payment services (***Draft PSR***) and a proposal for a regulation on a framework for Financial Data Access (***Draft FIDA***). The authorisation requirements shall, as before, remain regulated in a directive to be implemented by EU Member States, whereas a directly applicable EU-wide regulation shall provide uniform requirements on the provision of payment services and electronic money services. The Draft FIDA shall in particular extend the rules on the access, sharing and use of certain categories of customer data in financial services ("open finance"). The legislative procedure is pending and the proposals are at the stage of the first reading.

Also in June 2023, the EU Commission published a Single Currency Package, including a legislative proposal on the legal tender of euro cash and a legislative proposal establishing the legal framework for a possible digital euro as a complement to euro banknotes and coins. The legislative procedure is pending and the proposals are at the stage of the first reading.

In April 2021, the EU Commission proposed new rules and actions for excellence and trust in artificial intelligence (***AI***), including a proposal for a regulation laying down harmonised rules on AI (***Draft AI Act***). AI systems provided or used by regulated credit institutions will need to be addressed and documented in such institutions' internal governance, arrangements, processes and mechanisms set forth in CRD and the competent supervisory authorities will need to consider these aspects in prudential supervision. The legislative procedure on the Draft AI Act is pending and is at the stage of the first reading.

As far as digitalisation from the German law perspective is concerned, crypto values already qualify as financial instruments for financial licencing purposes. Since January 2020, conducting crypto custody business falls within the scope of financial services under KWG,

and requires written authorisation from BaFin if it is conducted in Germany, commercially or on a scale that requires commercially organised business operations. Crypto custody business is defined in KWG as the custody, management and safeguarding of crypto values or private cryptographic keys used to hold, store or transfer crypto values as a service for others. Cryptographic values are digital representations of a value that is not issued or guaranteed by a central bank or a public authority and does not possess a statutory status of currency or money, but is accepted by natural or legal persons as a means of exchange or payment, or that serves investment purposes and can be transferred, stored, and traded electronically. As such, cryptographic values encompass both cryptocurrencies, such as Bitcoin, and investment tokens. Other than the licence requirement, as mentioned above, German-based institutions and branches engaged in conducting crypto-asset transfers are subject to requirements and duties of care.

In 2021, German securities law was fundamentally modernised by the Act on Electronic Securities (***eWpG***), which introduced optional dematerialisation of instruments such as bearer bonds and certain shares in special assets funds. In December 2023, a novelisation of eWpG by the Financing for the Future Act (***ZuFinG***) came into force, which provides for optional dematerialisation of both company registered shares and bearer shares. Pursuant to eWpG, electronic securities are property objects subject of a right *in rem* under property laws. Under eWpG, the issuers may choose whether to issue securities in the form of a certificate or electronically. Under certain conditions, traditional securities in the form of a physical certificate can be subsequently digitised and *vice versa*. eWpG provides for two types of electronic securities registers, i.e. central securities registers and decentralised crypto securities registers, the latter being typically based on DLT. Company bearer shares, if dematerialised, have to be registered in the central securities registers (registration of dematerialised company bearer shares in crypto securities registers is not permitted). Central securities registers can be maintained by a central securities depository within the meaning of Regulation (EU) No. 909/2014 (in Germany: Clearstream Banking AG) or, if authorised by the issuer, by a custodian bank. Crypto securities registries can be maintained by the issuers themselves or by other entities, which requires obtaining a licence from BaFin and is subject to regulatory supervision. In June 2022, the Regulation on Crypto Funds Units (***KryptoFAV***) came into force, allowing units in investment funds or in individual fund classes to be issued in whole or in part as crypto fund units. Crypto fund units are defined as electronic unit certificates that are entered in a crypto securities register. The latter may be kept either by the depositary or by another entity appointed by the depositary and holding the BaFin licence for the maintenance of a crypto securities register. Further specific requirements were outlined in the Regulation on the Requirements as regards the Electronic Securities Registers (***eWpRV***) in force since October 2022.

To adapt the domestic laws to the EU-wide regulations, including DORA and MiCAR, in December 2023, a draft bill by the German government of the Financial Market Digitalisation Act (***FinmadiG-E***) was published. FinmadiG-E includes, among others, a draft Crypto Market Supervision Act (***KMAG-E***), a separate draft legal act, in particular bundling various supervisory powers of BaFin in respect of crypto-assets and crypto-asset services providers. FinmadiG-E further proposes changes in a number of domestic laws aimed to align existing domestic provisions with EU-wide regulations.

Sustainable finance

ESG and sustainable finance are key trends in the current EU regulatory and supervisory framework. This follows the EU sustainable finance strategy aimed to support the financing of the transition to a sustainable economy. In July 2020, Regulation (EU) No. 2020/852

on the establishment of a framework to facilitate sustainable investment (***Taxonomy***) entered into force providing for environmental objectives as well as conditions allowing for economic activity to qualify as environmentally sustainable. In 2021, the Sustainable Finance Disclosure Regulation (EU) No. 2019/2088 (***SFDR***) introduced a definition for "sustainable investment" including investments in economic activities that contribute to an environmental objective (e.g. key resource efficiency indicators on the use of energy, renewable energy, raw materials, water and land, on the production of waste, and greenhouse gas emissions), a social objective (e.g. tackling inequality, fostering social cohesion, integration, and labour relations) or an investment in human capital or economically or socially disadvantaged communities, provided that such investments do not significantly harm any of those objectives and that the investee companies follow good governance practices (i.e. sound management structures, employee relations, remuneration of staff and tax compliance, etc.). SFDR introduced the principle of "do no significant harm" and imposed related transparency requirements on financial market participants on their websites, in pre-contractual disclosures and marketing communications. January 2023 marked the start of applicability of the last provisions of the Taxonomy and SFDR in respect of the environmental objectives, the start of the applicability of the regulatory and technical standards of SFDR as well as the entry into force of the Corporate Sustainability Reporting Directive, Directive (EU) No. 2022/2464 (***CSRD***). The CSRD shall be implemented by EU Member States by 6 July 2024. The new measures under the CSRD shall apply generally to financial years starting on or after 1 January 2024, 2025 or 2026, depending essentially on the size of the undertaking, and 2028 for reporting concerning third-country undertakings.

Since the entry into force of the Taxonomy and SFDR, a number of Level 2 measures and drafts thereof have been published and partly entered into force to integrate sustainability factors, risks, preferences and screening criteria into financial products, governance, operating and organisation, business conduct and investment advice, including as part of the EU Commission's Sustainable Finance Package 2021. In February 2022, an EU Commission's proposal for a Directive on Corporate Sustainability Due Diligence was published, currently in the legislative procedure at the stage of the first reading.

In June 2023, the EU Commission published a new Sustainable Finance Package 2023, which includes amendments to existing regulations of Taxonomy delegated acts and a proposal for an EU-wide regulation on the transparency and integrity of ESG rating agencies, including authorisation and supervision by ESMA of ESG rating providers.

In November 2023, an EU-wide Regulation (EU) No. 2023/2631 on European Green Bonds and optional disclosures for bonds marketed as environmentally sustainable and for sustainability-linked bonds (***EU Green Bond Regulation***) was published. The EU Green Bond Regulation in particular provides for a uniform set of specific requirements for bonds that may be optionally issued by financial and non-financial undertakings and sovereigns that intend to use the designation "European Green Bond" or "EuGB" for such bonds. The EU Green Bond Regulation shall apply from 21 December 2024, but some provisions already started to apply in December 2023.

Furthermore, the EU banking package 2021 provides for explicit regulations concerning management and supervision of ESG risks, including within climate stress tests and supervisory reviews.

In Germany, in June 2023, BaFin included ESG risks in the scope of the minimum requirements on risk management by credit and financial institutions outlined in the novelisation of the MaRisk (before, ESG risks were mainly discussed in a non-binding

guidance notice). It can therefore be expected that the ESG aspects will be included in the SREP. Sustainability criteria for financial investment products have also been included in the German Financial Investment Brokerage Regulation (***FinVermV***).

Further changes and developments on ESG topics are pending and to be expected.

AML/CFT

The AML/CFT regime has undergone significant changes in recent years and further crucial changes are coming soon. In the past few years, Directive (EU) No. 2015/849 (***AMLD***) and subsequent amendments, particularly by Directive (EU) No. 2018/843, have been transposed into German law, which resulted in a complete revision of the GwG. First, the AMLD strengthened a holistic, risk-based approach in line with the international recommendations of the Financial Action Task Force (***FATF***) and brought about a number of changes concerning the customer due diligence process and internal safeguard measures. The revised GwG also introduced an electronic transparency register as a central database on ultimate beneficial owners (***UBOs***) of companies, trusts and similar entities. Further changes were required to implement amendments of the AMLD, including the revision of the transparency register, which has become publicly accessible and shall be fully comprehensive, i.e. directly include all the required information even if such information is retrievable from other publicly accessible, e.g. commercial, registers. Also, entities engaged in the crypto custody business have effectively become AML obliged entities.

In July 2021, the EU Commission proposed a full AML/CFT package consisting of four legislative proposals, including three regulations and one directive. The package includes a proposal for an EU regulation establishing an EU AML/CFT authority in the form of a decentralised EU regulatory agency with direct supervisory powers over some of the riskiest cross-border financial sector obliged entities. Further, an EU regulation has been proposed that is aimed as a single rulebook on matters currently regulated by the EU AML/CFT directives and respective national implementing provisions. The proposed regulation includes more detailed and granular provisions as well as new requirements, e.g. ensuring the inclusion of various types of crypto-asset services providers, crowdfunding services providers, mortgage credit intermediaries and consumer credit providers, that are not financial institutions, among the AML obliged entities subject to the AML/CFT rules. The proposed directive will repeal the current AMLD and will include only the provisions that, given their nature, are not appropriate for a directly applicable regulation and instead require national transposition. Further, the package provides for a recast of Regulation (EU) No. 2015/847 on information accompanying transfers of funds (Wire Transfer Regulation, ***WTR***) (***WTR Recast***) so that the WTR requirements shall apply also to transfers of crypto-assets. The WTR Recast was in the meantime adopted, entered into force and will start to apply from 30 December 2024. In this regard, to ensure the traceability of crypto-asset transfers by the time the WTR Recast starts to apply, the German Federal Ministry of Finance has issued a German crypto-asset transfer regulation that entered into force in October 2021 (***CATR***) and that provides for duties of care for German-based institutions and German branches of foreign institutions engaged in conducting crypto-asset transfers. The CATR will cease to apply once the WTR Recast starts to apply. The other legislative proposals as part of the EU Commission's AML/CFT package are in the legislative procedure at the stage of the first reading.

Further changes to the German AML/CFT regime have been introduced to the GwG with the entry into force of the new sanctions regime.

New sanctions regime

The Russian invasion of Ukraine in February 2022 brought about changes in the sanctions regime both at the international level and the domestic level in Germany. Aside from several

sets of international sanctions adopted against Russia, Germany adopted two Sanctions Enforcement Acts (***SDG I*** and ***SDG II***) in May and December 2022 aimed to improve the effective enforcement of sanctions and prevention of money laundering. The new measures include the formation of a central federal agency for sanctions enforcement, direct applicability of UN sanctions lists in Germany, the introduction of various administrative measures in respect of investigating and registering the assets of sanctioned persons and partnerships, enhancement of information exchange between authorities involved and data retrieval as well as creation of a whistleblowing agency. Measures concerning holdings in real properties located in Germany include linking detailed information on real properties with the German AML transparency register, the ban on payment in cash, cryptocurrencies, gold, platinum or precious stones in transactions over real properties located in Germany, the obligation for foreign entities to report their holdings in real properties located in Germany to the transparency register as well as, as from 1 January 2026, the obligation for AML obliged entities and notaries to report discrepancies in respect of the allocation of real properties.

At the EU level, in December 2022, the EU Commission published a proposal for a directive on the definition of criminal offences and penalties for the violation of EU restrictive measures. The legislative procedure is pending and is at the stage of the first reading.

Financial market integrity

In the aftermath of the Wirecard insolvency, which is considered to be the result of extensive fraud, financial market integrity has become one of the priorities of the German government. In 2021 and partly in 2022, the Act on Strengthening the Financial Market Integrity (***FISG***) led to the amendment of several German laws. Key amendments provide for a stricter liability regime for auditors such as increased liability caps; e.g., in the case of auditing capital companies that are credit institutions but are not capital market oriented, €4 million for simple carelessness and €32 million for gross negligence. The liability for intent is not limited. The FISG also introduces a maximum term of 10 years for audit mandates and significantly extends BaFin's supervisory duties and powers including in respect of regulated companies' balance sheets. As regards collective consumer protection, BaFin is allowed to make use of "mystery shopping" *vis-à-vis* regulated entities and engage trained fieldwork customers in order to identify infringements. Further, the FISG introduced stricter regulatory requirements on outsourcing. Outsourcing of critical or important functions is subject to prior notification to BaFin and Bundesbank. This notification requirement applies also to significant changes and serious incidents concerning such outsourcing. Institutions are obliged to maintain registers of all outsourcings of critical and non-critical functions. In the case of outsourcings to third-country firms, the institutions have to contractually ensure that the third-country firm appoints a local agent for the service of process. BaFin is explicitly allowed to issue orders directly *vis-à-vis* outsourcing firms that are necessary and suitable to remedy infringements. The stricter provisions on outsourcing reflect the EBA guidelines on outsourcing arrangements (EBA/GL/2019/02), which have in the meantime been implemented in BaFin's published administrative.

Secondary credit market

On 30 December 2023, the KrZwMG, implementing Directive (EU) No. 2021/2167 on credit servicers and credit purchasers, was promulgated in Germany. In general, the KrZwMG sets out the obligations of credit institutions as sellers of non-performing credit agreements, obligations of purchasers of such credit agreements, requirements for the provision of credit servicing activities for such purchasers and the supervision of credit services institutions. Non-performing credit agreements in scope of the KrZwMG are those classified as a non-performing exposure in accordance with Art. 47a CRR. However, the KrZwMG does not

apply in respect of credit agreements issued by lenders established in third countries, nor in respect of credit purchases that originally occurred before 30 December 2023. The KrZwMG introduces the obligation to obtain a licence from BaFin for anyone who intends to conduct credit servicing activities, unless an exemption applies. Credit servicing activities include, in respect of non-performing credit agreements, enforcement of due payment claims and other claims of the lender, certain renegotiations with the borrower, processing of complaints and certain information activities towards the borrower. The KrZwMG subjects entities that conduct credit servicing activities to a qualitative financial supervisory regime. Further, the KrZwMG introduces obligations for credit purchasers, including the obligation to engage a credit servicer in respect of a purchased non-performing credit agreement if the latter has been entered into with a natural person or a micro, small or medium-sized enterprise and the obligation to notify BaFin and Bundesbank of the credit servicer engaged. The KrZwMG provides for a transitionary period of six months, which lapses on 29 June 2024.

Bank governance and internal controls

As a general rule, institutions must appoint at least two management board members. Management board members and supervisory board members are subject to a fit and proper assessment. Board members are required to be adequately qualified, trustworthy and in a position to dedicate sufficient time to performing their functions properly. To ensure the latter, KWG limits the number of mandates that can be held simultaneously by board members. If no exception (e.g. group privilege) applies, BaFin may consent to one additional mandate to be held in excess of the statutory limits.

Institutions must ensure proper business organisation, in particular, appropriate and effective risk management, including:

- strategies, in particular business strategy aimed at an institution's sustainable development, and a consistent risk strategy along with processes for planning, implementing, assessing and revising such strategies;
- processes for determining and safeguarding capital adequacy and risk-bearing capacity;
- an internal control system and an internal audit function with rules on the organisational and operational structure, including a clear determination and division of tasks and competences;
- processes for identification, assessment, management and monitoring of risks, a risk-control function and a compliance function;
- an internal audit function;
- adequate staffing and technical and organisational resources;
- an adequate contingency plan, especially for IT systems; and
- suitable and transparent remuneration systems for board members and employees.

Regulatory requirements in connection with governance and internal controls are further specified in various BaFin circulars and guidance notices, in particular the MaRisk and BaFin's circular no. 10/2017 on Banking Supervisory Requirements for IT (***BAIT***).

Further regulatory requirements as regards business organisation may arise if a financial institution intends to offer investment services (e.g. investment broking or investment advice). In such a case, the additional organisational requirements and rules of conduct set forth, in particular, in WpHG, the delegated regulations promulgated under MiFID II, and BaFin's circular no. 05/2018 on minimum requirements for the compliance function and further conduct, organisation and transparency obligations (***MaComp***), may apply.

Bank capital requirements

Capital requirements for credit institutions under German law are based on CRR and KWG and, as such, are in line with the final measures of the BCBS – Basel III framework. To that extent, credit institutions operating in Germany have to comply with requirements on capital adequacy, liquidity and leverage ratio.

Capital adequacy

The own funds of an institution may not fall below the amount of initial capital required at the time of its authorisation. Own funds consist of the sum of its Tier 1 and Tier 2 capital. As a rule, CRR require institutions to maintain adequate amounts of own funds consisting of CET1 capital ratio (4.5%), a Tier 1 capital ratio (6%) and a total capital ratio (8%). CRR specify the requirements for own funds to qualify as eligible capital. CET1 capital includes, in particular, share/stock capital, capital surplus/agio, retained profits, other accumulated income, and reserves.

Requirements for the Additional Tier 1 capital are less stringent than in the case of CET1 capital, but more stringent than for Tier 2 capital. Further details on own funds are set forth in CRR and Commission Delegated Regulation (EU) No. 241/2014, supplementing CRR with regard to regulatory technical standards for own funds requirements for institutions. As part of the SREP of the institution's individual capital adequacy, supervisory authorities (BaFin) may ask the institution to hold additional own funds in excess of the default rules under CRR. The SREP decision is issued annually and is based on factors such as the institution's business model, governance, risk, capital, and liquidity.

KWG requires credit institutions to maintain a capital conservation buffer (***CCB***) of CET1 capital equal to 2.5% of the total risk exposure amount and an institution-specific countercyclical capital buffer (***CCyB***). The latter is calculated with the use of domestic CCyB of between 0% and 2.5%. In Germany, the domestic CCyB has been determined by BaFin at 0.75% with effect from 1 February 2022 and, on 30 January 2024, that percentage was confirmed by BaFin as appropriate for the first quarter of 2024 based on the current risk situation.

Liquidity

CRR provide for a liquidity coverage requirement (***LCR***), according to which institutions shall hold adequate liquidity buffers to face any possible imbalance in liquidity flows over a period of 30 days. All institutions must invest their funds in such a way as to ensure that adequate funds for payment outflows (liquidity) are available at all times. In addition, amendments to CRR introduced a binding NSFR of at least 100% (with a possibility of a simplified NSFR with the prior permission of the competent authority in the case of small and non-complex institutions) along with related reporting requirements. Detailed liquidity adequacy requirements are set forth in Commission Delegated Regulation (EU) No. 2015/61 with regard to LCRs for credit institutions.

Leverage ratio

Institutions are required to monitor the level and changes in the leverage ratio as well as leverage risk as part of the internal capital adequacy assessment process. As mentioned, amendments to CRR introduced a binding leverage ratio requirement of 3% of Tier 1 capital. For G-SIIs, an additional leverage ratio requirement, equal to 50% of the risk-based G-SIIs capital buffer ratio, applies. The leverage ratio is subject to reporting to the supervisory authorities and taken into account during the SREP. Details on calculating the leverage ratio are included in CRR and Commission Implementing Regulation (EU) No. 2021/451 laying down implementing technical standards for the application of CRR with regard to supervisory reporting of institutions.

Rules governing banks' relationships with their customers and other third parties

Deposit protection schemes

German law provides for a statutory deposit protection scheme under the Deposit Protection Act (***EinSiG***) that secures deposits of up to €100,000 per institution and customer, and in certain cases up to €500,000. A compensation event is determined by BaFin if an institution, due to its financial situation, is not in a position to repay due deposits and there is no prospect that it will be able to do so.

In addition to mandatory participation in the statutory deposit protection scheme, many private banks are members of the voluntary deposit protection fund of private banks kept by the Association of German Banks (*Bundesverband deutscher Banken*), which provides for a higher level of protection than the statutory deposit protection scheme.

Regulatory obligations

Regulatory obligations of credit institutions, financial services institutions and investment institutions are set forth in a number of EU and German laws (KWG, WpIG, WpHG, etc.) and are specified in technical standards, recommendations, circulars and guidance notices of supervisory authorities (e.g. BaFin and the ESAs). Institutions are subject to extensive reporting obligations *vis-à-vis* supervisory authorities and information obligations towards their customers. Compliance with regulations must be duly documented and evidenced (e.g. that the recommended securities transaction was suitable for a given customer or, in case of payment services providers, that the payment transaction was authenticated).

Institutions are subject to various regulations in connection with customers' complaints and must maintain and document internal processes for handling such complaints. At the same time, customers are required to comply with various information obligations towards the institutions so that the latter may fulfil the regulatory requirements imposed on them. Institutions must conduct know-your-customer checks and comply with AML/CFT provisions under the GwG, which require them to conduct customer due diligence, identify the UBO and provide information such as name, date of birth, place of residence, nature and scope of ownership interests (including details on shareholding and control) to the transparency register, as well as to monitor the business relationship.

Contractual relationships

Depending on the product or service offered, the rights and obligations of a bank's customers are regulated in the relevant contract (e.g. loan agreement) and are subject to various provisions of the German Civil Code (***BGB***) and the Introductory Act to the Civil Code (***EGBGB***). In addition, banks use various general terms and conditions to define the contractual relationship with their customers. To that extent, the general terms and conditions template provided by the Association of German Banks serves as a point of reference for German banks.

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Indonesia

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Nusantara DFDL Partnership

Introduction

The functioning of Indonesian banking is based on the principle of prudence. Its main role is to act as a collector and distributor of public funds, with the aim of supporting the implementation of national development. This, in turn, contributes to fostering equitable development, economic growth, and national stability, ultimately improving the lives of many people.

Since early 2020, the global community, including Indonesia, has faced the challenges posed by the COVID-19 pandemic. The Indonesian banking sector, in particular, has also felt its impact. The enforcement of social restriction policies has exerted pressure on debtor performance, leading to the need for restructuring credit for debtors affected by the COVID-19 pandemic.

Another significant sector that needs to be considered is the current development of financial technology ("**Fintech**") in Indonesia. According to the press release from the Financial Services Authority ("**OJK**") dated 10 November 2023, the performance of the Fintech peer-to-peer lending ("**P2P Lending**") industry has shown robust growth. Outstanding financing disbursed by Fintech P2P Lending grew by 14.28% year on year, reaching a nominal financing amount of IDR 55.7 trillion.

On 12 January 2023, the Indonesian Government issued Law No. 4 of 2023 on Financial Sector Development and Strengthening ("**Law 4/2023**"). This law aims to support and realise efforts in developing and strengthening the financial sector in Indonesia, given the increasingly complex and diverse nature of the financial services industry. Law 4/2023 regulates various aspects of the financial sector ecosystem, including banking, financing services, pension funds, and others.

Regulatory architecture: Overview of banking regulators and key regulations

Banking in Indonesia is primarily regulated by Law No. 7 of 1992 on Banking, as last amended by Law 4/2023 ("**Banking Laws**"). In Indonesia, two institutions have authority over banking matters: Bank Indonesia ("**BI**") and OJK. BI serves as the central bank of the Republic of Indonesia and is an independent state institution, free from interference by the Government or other parties, except for matters expressly regulated in Law No. 23 of 1999 on Bank Indonesia, as last amended by Law 4/2023. BI aims to achieve and maintain the stability of the rupiah value in Indonesia, including determining and implementing monetary policy, and regulating and maintaining a smooth payment system.

OJK functions to organise an integrated system of regulation and supervision for all activities in the financial services sector, actively maintaining financial stability in accordance with its authority, and providing protection to consumers and the public.

Based on Law 4/2023, additions have been made to OJK's authority related to regulatory and supervisory duties. Previously, these duties only covered financial services in sectors such as banking, capital markets, insurance, pension funds, financing institutions, and other financial service institutions. Now, the regulatory and supervisory duties of OJK also extend to sectors including financial derivatives, carbon exchanges, technological innovation in the financial sector (such as digital financial assets and crypto assets), the behaviour of financial services business actors, the implementation of consumer education and protection, and the integrated management of the financial sector. Additionally, OJK is tasked with conducting systemic impact assessments of financial conglomerates.

In relation to the banking sector, OJK generally has the authority for:

1. Regulation and supervision of bank institutions:
   a. Licensing for bank establishment, bank office opening, articles of association, work plans, ownership, management, and human resources, as well as bank merger, consolidation, and acquisition, are within the scope of regulatory oversight. Additionally, the revocation of a bank business licence is subject to regulatory processes.
   b. Bank business activities, including the funding sources, provision of funds, hybrid products, and service activities, are essential components of its operations.
2. Regulation and supervision of bank health:
   a. Liquidity, profitability, solvency, asset quality, minimum capital adequacy ratio, maximum credit limit, loan-to-deposit ratio, and bank reserves are key factors in assessing the financial health of a bank.
   b. Bank reports related to bank health and performance.
   c. Debtor information system.
   d. Credit application.
   e. Bank accounting standards.
3. Regulation and supervision of the bank prudential aspects:
   a. Risk management.
   b. Bank governance.
   c. Know-your-customer ("**KYC**") and anti-money laundering principles.
   d. Prevention of terrorism financing and banking crimes.
4. Bank inspection.

Types of banks in Indonesia

In addition to BI, which serves as the central bank in Indonesia, Indonesia also recognises two types of banks, namely:

1. Commercial Banks

   Commercial Banks are financial institutions that engage in conventional and/or *Sharia*-based business activities, providing services in payment transactions as part of their operations.

   Commercial Bank business activities include, among others:
   a. collecting of funds from the public in the form of deposits, such as savings, current accounts, time deposits, certificates of deposit, and/or other equivalent forms;
   b. distributing funds in the form of credit or financing based on *Sharia* principles;
   c. performing activities in the field of payment;
   d. conducting business activities in foreign exchange; and
   e. performing receivables transfer activities.

   Given the advancement of technology, Commercial Banks can leverage information technology in conducting their business activities. This capability can be actualised by operating as a Digital Bank, defined as a bank that primarily provides and conducts

business activities through electronic channels, without physical offices other than the head office or with limited physical offices.

2. Rural Banks (*Bank Perekonomian Rakyat* or "**BPRs**")
   BPRs carry out business activities conventionally or based on *Sharia* principles, and in its operations does not provide services in payment transactions directly. Similar to Commercial Banks, BPRs also engage in various business activities, including:
   a. collecting funds from the public in the form of savings, time deposits, and/or other equivalent forms;
   b. distributing funds in the form of credit or financing based on *Sharia* principles, which is a key practice for Islamic financial institutions;
   c. conducting business activities in foreign exchange; and
   d. performing receivables transfer activities.

Shareholding in Commercial Banks

Commercial Banks may be established by Indonesian citizens, Indonesian legal entities, or a partnership of Indonesian citizens and/or legal entities with foreign citizens and/or legal entities. It is important to note that ownership by foreign nationals and/or foreign legal entities in Commercial Banks is limited to a maximum of 99% of the paid-up capital.

Pursuant to OJK Regulation No. 56/POJK.03/2016 on Share Ownership of Commercial Banks ("**POJK 56/2016**"), the maximum limit of share ownership in Commercial Banks for each category of shareholders is set as follows:

a. Legal entities of bank financial institutions and non-bank financial institutions are allowed to own up to 40% of the bank's capital. However, shareholders in the form of legal entities of bank financial institutions may own this percentage only upon obtaining OJK approval and meeting the criteria specified in POJK 56/2016.
b. Shareholders in the form of legal entities that are not financial institutions are permitted to own up to 30% of the bank's capital.
c. Individual shareholders are allowed to own up to 20% of the bank's capital.

In the event that a shareholder of a Commercial Bank already owns more than the maximum share limit as stipulated above, they are obliged to adjust to the maximum share ownership limit within a maximum period of five years after the last valuation period or sale of shares owned if certain conditions are met:

a. Commercial Banks experience a downgrading of the bank's health rating and/or governance rating to rating 3, rating 4, or rating 5 for three consecutive assessment periods if certain conditions are met. This triggers specific regulatory actions and requirements; or
b. the shareholders voluntarily sell the shares they own.

Prohibition for Commercial Banks

In general, Commercial Banks are prohibited from:

a. Conducting equity participation outside financial service institutions, except for equity participation activities in financial service institutions and/or other companies that support the banking industry in accordance with OJK regulations. Temporary equity participation activities outside financial service institutions to overcome credit failure or *Sharia* principle financing are allowed, provided that they withdraw their participation.
b. Engaging in insurance business, except for marketing insurance products in the context of cooperation with other financial service institutions and collaboration with entities other than financial service institutions in providing financial services to customers.
c. Undertaking other businesses beyond the activities specified for Commercial Banks as mentioned above.

Sole proprietorship provisions

Pursuant to OJK Regulation No. 39/POJK.03/2017 of 2017 on Sole Ownership in Indonesian Banking ("**POJK 39/2017**"), each party may only become a sole shareholder in one Commercial Bank. However, this provision is exempted in the event of a party becoming a sole shareholder in: (i) two Commercial Banks, each conducting business activities with different principles, namely conventionally and based on *Sharia* principles; and (ii) two Commercial Banks, one of which is a joint venture bank.

Please note that if a party purchases shares of another Commercial Bank, thereby becoming a controlling shareholder in more than one Commercial Bank, the following actions must be taken:

a. The merger or consolidation of controlled Commercial Banks and the establishment of a bank holding company in the form of a limited liability company must be completed within a maximum of one year after the purchase of shares.
b. Establishing a holding function, i.e., consolidating and directly controlling all activities of Commercial Banks that become its subsidiaries, must be fulfilled within a maximum period of six months after the purchase of shares.

Failure to comply with the provisions mentioned above may result in a written warning from OJK. Furthermore, controlling shareholders who fail to comply with the provisions in POJK 39/2017 may face administrative sanctions, including the prohibition of being a controlling shareholder in all banks in Indonesia for a period of 20 years.

Recent regulatory themes and key regulatory developments

Implementation of Governance for Commercial Banks

In 2023, OJK issued OJK Regulation No. 17 of 2023 on the Implementation of Governance for Commercial Banks ("**POJK 17/2023**"), replacing Regulation No. 55/POJK.03/2016 ("**POJK 55/2016**") with the same title. The issuance of POJK 17/2023 aims to enhance the stability of Commercial Banks and ensure their sustainable growth. Several aspects that were not previously regulated in POJK 55/2016 are now addressed in POJK 17/2023 and detailed below.

*Dismissal or replacement of the board of directors ("**BOD**") or board of commissioners ("**BOC**")*

In POJK 17/2023, the dismissal or replacement of members of the BOD and/or BOC of a Commercial Bank must prioritise the main interests of the Commercial Bank. The following factors must be considered when dismissal or replacement of members of the BOD and/or BOC is carried out before the end of their term of office:

a. Such members are deemed incapable of fulfilling their duties and responsibilities in managing and implementing a healthy Commercial Bank strategy.
b. The dismissal or replacement is not based on the subjective assessment of shareholders but rather on an objective evaluation of the management of the Commercial Bank.
c. The dismissal or replacement follows established planning and mechanisms, including an assessment by the nomination committee, and is scheduled during the General Meeting of Shareholders ("**GMS**").
d. The dismissal or replacement does not disrupt the organisation and business activities of the Commercial Bank.
e. The implementation of the dismissal or replacement prioritises effective communication patterns with various related parties.
f. The dismissal or replacement is carried out by prioritising the implementation of good governance in Commercial Banks and focusing on prudential aspects.

Prior approval must be obtained from OJK before a decision is made in the GMS for the dismissal or replacement of: (i) the president director and/or the director in charge of the compliance function; and (ii) the independent commissioner, before the end of their term of office.

BOD and BOC committee

BOD and BOC committees were not previously regulated in POJK 55/2016; however, now, POJK 17/2023 includes provisions for these committees. As a result, the committees currently include: (i) a BOD committee; (ii) a BOC committee; (iii) an audit committee; (iv) a risk monitoring committee; (v) a remuneration and nomination committee; and (vi) other BOC committees.

BOD committees consist of, at least: (a) a risk management committee; (b) a credit or financing policy committee; (c) a credit or financing committee; and (d) an information technology steering committee. Meanwhile, BOC committees consist of, at least: (a) an audit committee; (b) a risk monitoring committee; and (c) a remuneration and nomination committee (which can also be separated into a remuneration committee and a nomination committee).

Implementation of internal audit function

Currently, Commercial Banks are required to communicate with OJK regarding the implementation of the internal audit function at least once a year. Commercial Banks must submit a report to OJK on the implementation, comprising:

a. a report on the appointment or dismissal of the head of the internal audit work unit;
b. a special report on any internal audit findings that are considered to jeopardise the continuity of the Commercial Bank's business;
c. an independent external review report;
d. a report on the implementation and main points of internal audit results; and
e. other reports at the request of OJK.

*Implementation of governance, risk management, and compliance ("**GRC**")*

Commercial Banks are now required to take additional actions as part of GRC implementation. These actions include, among others: (i) establishing internal control systems; (ii) formulating remuneration policies; (iii) preparing and publishing sustainability reports, structured reports, and unstructured reports; (iv) developing, submitting, and implementing recovery action plans; (v) formulating dividend policies; (vi) implementing anti-fraud and sustainable finance strategies; and (vii) coordinating and evaluating bank governance with members of the bank's business group.

Report submission mechanism

The submission of the governance implementation report to OJK ("**Report**") is conducted online through OJK's reporting system (https://sipenaojk.ojk.go.id) or other addresses specified by OJK. The Report is directed to the Bank Supervision Department or Regional Office/OJK Authority for Commercial Banks headquartered outside DKI Jakarta or Banten.

Money market and foreign exchange market

As previously explained, BI is authorised to regulate, develop, and supervise the money market and foreign exchange market, currently governed by BI Regulation No. 6 of 2023 on Money Market and Foreign Exchange Market ("**BI Reg 6/2023**"). The aim of BI Reg 6/2023 is to establish a modern and internationally standardised money market and foreign exchange market. It supports the transformation of integrated monetary management with the money market and foreign exchange market and promotes socioeconomic financing.

Furthermore, BI Reg 6/2023 covers, among others:

a. money market transactions;
b. interest rate derivative transactions;
c. foreign exchange market transactions;
d. exchange rate derivative transactions; and
e. transaction execution, clearing and reporting.

Parties subject to BI Reg 6/2023 include Commercial Banks and other financial service institutions. It is important to note that Commercial Banks intending to engage in activities related to the money market and foreign exchange market, including derivative transactions, must obtain a licence from BI.

Development of information technology/cyber-security

At the end of 2022, Indonesia finally enacted a law addressing the regulation of personal data protection, namely Law No. 27 of 2022 on Personal Data Protection ("**PDP Law**"). The introduction of the PDP Law is a significant step toward enhancing personal data security in Indonesia, addressing an issue that has long needed attention.

In relation to the banking sector, OJK has regulated the implementation of information technology by Commercial Banks in OJK Regulation No. 11/POJK.03/2022 of 2022 on the Implementation of Information Technology by Commercial Banks. Commercial Banks are required to effectively manage data in the processing of their data to support the achievement of business objectives, paying attention to at least: (i) data ownership and control; (ii) data quality; (iii) data management systems; and (iv) data management support resources. Additionally, Commercial Banks are obligated to implement principles of personal data protection in processing personal data and conduct an impact assessment on the implementation of these principles.

In connection with data exchange activities, in addition to considering the consent of customers and/or prospective customers as stipulated in the PDP Law, Commercial Banks are also required to establish, at a minimum:

a. classification of data that is personal data;
b. rights and obligations of parties involved in the exchange of personal data;
c. a personal data exchange agreement;
d. a facility for the exchange of personal data; and
e. security of personal data.

OJK also regulates violations committed by Commercial Banks in connection with the protection of personal data. This includes administrative sanctions such as a prohibition on issuing new bank products, suspension of certain business activities, and/or a reduction in the assessment of the governance factor when evaluating the health level of the Commercial Bank.

Fintech development

In connection with the advanced development of Fintech, OJK issued OJK Regulation No. 10/POJK.05/2022 of 2022 on Information Technology-Based Joint Funding Services ("**POJK 10/2022**") as a replacement for the previous regulations governing Fintech P2P Lending. Currently, the capital requirement for Fintech P2P Lending is IDR 25 billion at the time of establishment, which was previously only IDR 1 billion at the time of registration and IDR 2.5 billion at the time of licence application. The capital must fulfil the following requirements:

a. The capital must be paid in full in cash and deposited in a time deposit under the name of the P2P Lending organiser. The deposit can be held in a Commercial Bank, either conventional or *Sharia* principle, or in a *Sharia* business unit, depending on the business principles adhered to by the P2P Lending organiser (whether conventional or *Sharia* principle).

b. The capital must not originate from financial crimes (e.g., money laundering, terrorism financing) or be sourced from loans, ensuring the legitimacy and ethical sourcing of funds for the operation of the P2P Lending organiser.

Based on POJK 10/2022, regarding share ownership of Fintech P2P Lending:

a. Indonesian citizens and/or Indonesian legal entities are eligible to own share ownership, excluding legal entities in the form of cooperatives; or
b. Indonesian citizens and/or Indonesian legal entities may hold share ownership together with foreign legal entities and/or foreign citizens, provided that:
    i. Foreign nationals can only become owners of Fintech P2P Lending by purchasing shares through the stock exchange, ensuring compliance with regulatory requirements and transparency in ownership acquisition.
    ii. Foreign ownership, whether direct or indirect, is limited to 85% of the total paid-up capital of the Fintech P2P Lender unless it has become a publicly listed company trading its shares on the stock exchange, in which case the ownership structure is subject to market dynamics.

Bank governance and internal controls

Matters related to BOD and BOC are also regulated in POJK 17/2023, where Commercial Banks are required to meet specific requirements in the appointment or designation of their BOD and BOC.

BOD

Currently, Commercial Banks are required to have at least three BOD members, all of whom must be domiciled in Indonesia. The majority of the BOD members must possess a minimum of five years of experience in the operational field as bank executive officers. Commercial Banks stipulate in their articles of association that the term of office for BOD members is a maximum of five years for one term of office, starting from the effective date of their appointment by the GMS.

Furthermore, a managing director of a Commercial Bank must come from a party that is independent of the controlling shareholder. Additionally, BOD members are prohibited from holding concurrent positions:

a. as a member of the BOD, member of the BOC, member of the *Sharia* supervisory board, or executive officer at a bank, company, and/or other institution;
b. in the field of functional duties at bank financial institutions and/or non-bank financial institutions, whether domiciled at home or abroad;
c. in other positions that may cause a conflict of interest in the performance of duties as a member of the BOD; and/or
d. in other positions in accordance with the provisions of laws and regulations.

BOC

Unlike the provisions regarding the BOD, members of the BOC in a Commercial Bank are not required to have at least five years of experience in the field of operations as an executive officer of a bank, and they are not all required to be domiciled in Indonesia. Commercial Banks are mandated to have a minimum of three BOC members and a maximum number equal to the number of BOD members. The term of office for BOC members in the articles of association is also a maximum of five years for one period, consistent with the provisions for the term of office of the BOD.

BOC members consist of independent commissioners and non-independent commissioners. Independent commissioner candidates must have sufficient and relevant banking knowledge and experience in banking and/or finance, ensuring their capability to contribute effectively to the oversight and governance of the Commercial Bank.

In connection with violations committed by Commercial Banks regarding the provisions of the BOD and BOC, OJK may impose administrative sanctions. These sanctions include written warnings, prohibitions on issuing new bank products, suspension of business activities, prohibitions on expanding business activities, and other forms as stipulated in POJK 17/2023. In addition to administrative sanctions, there is also the possibility of fines ranging from at least IDR 2 billion to a maximum of IDR 50 billion for each violation committed.

Remuneration

Commercial Banks are required to implement governance in the provision of remuneration. In certain circumstances, OJK is authorised to:

a. review the amount of variable remuneration for the BOD, BOC, *Sharia* supervisory board, and/or Commercial Bank employees;
b. evaluate the payment of variable remuneration that is not in accordance with the principles of fairness and justice; and/or
c. order Commercial Banks to adjust their variable remuneration policies.

Internal and external audit functions

Commercial Banks are required to establish an internal audit function conducted by an independent and objective internal audit work unit. The implementation of the internal audit function encompasses the structure, authority, and main tasks of the internal audit work unit. In terms of external audit, Commercial Banks engage external audit functions through public accountants and/or public accounting firms.

Bank capital requirements

In 2021, OJK issued OJK Regulation No. 12/POJK.03/2021 on Commercial Banks ("**POJK 12/2021**"). Previously, Commercial Banks were grouped based on business activities, commonly referred to as "**BUKU**". However, with the issuance of POJK 12/2021, the categorisation shifted to bank groups based on core capital, known as "**KBMI**". OJK classifies KBMI into four groups, namely:

a. KBMI 1 refers to a bank with a core capital of up to IDR 6 trillion;
b. KBMI 2 refers to a bank with a core capital exceeding IDR 6 trillion up to IDR 14 trillion;
c. KBMI 3 refers to a bank with a core capital exceeding IDR 14 trillion up to IDR 70 trillion; and
d. KBMI 4 refers to a bank with a core capital exceeding IDR 70 trillion.

In relation to the minimum provision, the applicable provisions still refer to OJK Regulation No. 11/POJK.03/2016 of 2016 on Minimum Capital Adequacy of Commercial Banks, as amended by OJK Regulation No. 34/POJK.03/2016 of 2016 ("**POJK 11/2016**"). According to POJK 11/2016, the minimum capital requirement is set at the lowest of:

a. 8% of risk-weighted assets for Commercial Banks with risk profile rating 1;
b. 9% to less than 10% of risk-weighted assets for Commercial Banks with risk profile rating 2;
c. 10% to less than 11% of risk-weighted assets for Commercial Banks with risk profile rating 3; or
d. 11% to 14% of risk-weighted assets for Commercial Banks with risk profile rating 4 or 5.

Regulatory capital requirements derive from national law and align with international standards (Basel III)

Based on POJK 12/2021, all banking institutions have an equal opportunity to develop similar products without specific restrictions. The primary focus is on risk mitigation efforts related to the resulting products. Therefore, POJK 12/2021 represents the implementation of banking regulations established by the national financial supervisory authority, namely OJK.

However, OJK also issued OJK Regulation No. 27 of 2022 on the Second Amendment to OJK Regulation No. 11/POJK.03/2016 on the Minimum Capital Adequacy Requirements of Commercial Banks. This amendment aims to make adjustments to the calculation of banking capital that are more sensitive to risk, strengthening risk management in line with international standards, specifically Basel III: Finalising post-crisis reforms. The adjustment to Basel III mandates the calculation of market risk-weighted assets for all banks, effective since 1 January 2024.

Rules governing banks' relationships with their customers and other third parties

In carrying out its function as a collector and distributor of funds, banks must establish cooperation with various parties, particularly with customers. The Banking Laws have legally regulated the relationship between banks and customers, defining customers as parties who use bank services. The Banking Laws further distinguish customers into two types:

a. depositing customers are individuals who place funds in the bank through deposit agreements; and
b. a debtor customer is an individual who obtains credit or financing based on *Sharia* principles or equivalent, as stipulated in the bank's agreement with the customer.

Based on the aforementioned, the legal relationship between banks and customers can be formalised through an agreement, either in the form of an informal deed or an authentic one. Customers, as consumers, are entitled to legal protection for utilising the service products offered by banks. According to the provisions of Law No. 8 of 1999 on Consumer Protection, customers have the right to receive comfortable, safe, and secure services when consuming goods and/or services.

Regulations that apply to banks' dealings with third parties

Under OJK Regulation No. 9/POJK.03/2016, which addresses Prudential Principles for Commercial Banks Engaging in Partial Assignment of Work to Other Parties, OJK permits banks to outsource supporting tasks within the flow of banking business activities and in activities supporting banking business. However, certain criteria for these supporting tasks must be specified in the bank's outsourcing policy. These criteria include:

a. low risk;
b. does not require high competency qualifications in banking; and
c. not directly related to the decision-making process that affects bank operations.

Regulatory on customer complaints

OJK requires banks to protect consumers through OJK Regulation No. 22 of 2023 concerning Consumer and Public Protection in the Financial Services Sector ("**POJK 22/2023**"). Consumer protection is all efforts to ensure legal certainty to provide protection to consumers, including:

a. adequate education;
b. openness and transparency of product and/or service information;
c. fair treatment and responsible business conduct;

d. protecting consumer assets, privacy and data;
e. handling complaints and resolving disputes effectively and efficiently;
f. compliance enforcement; and
g. healthy competition.

Furthermore, there is an obligation for the Commercial Bank to provide a 24-hour consumer complaint service, which includes receiving complaints, handling complaints, and resolving complaints. In the event that an agreement cannot be reached regarding the resolution undertaken by the bank in handling complaints, then the consumers may:

a. submit complaints to OJK for complaint handling in accordance with the authority of OJK; or
b. submit a dispute to the Financial Services Sector Alternative Settlement Institution that has approval from OJK or to the court.

If a consumer submits a dispute as described above, the Commercial Bank has the right to defend itself by providing evidence. In the event of a claim for compensation based on an unlawful act, it is the responsibility of the Commercial Bank to prove whether or not there is an element of error.

Compensation schemes that cover bank customers in the case of bank failure

Through POJK 22/2023, OJK stipulates the obligation of Commercial Banks to cover consumer losses arising from errors, negligence, or unlawful actions in the financial services sector, as well as agreements made by related parties such as directors, the BOC, employees, or Commercial Bank representatives. However, Commercial Banks will not be responsible for consumer losses if the bank can prove that the consumer was personally involved in an error, negligence, or unlawful act in the financial services sector.

Restrictions on inbound cross-border banking activities

BI provides prohibitions and limits on transactions by banks through BI Regulation No. 24/7/PBI/2022 of 2022 on Transactions in the Foreign Exchange Market. These transaction prohibitions include certain restrictions and limitations, such as:

a. transferring rupiah abroad;
b. non-deliverable forward foreign currency transactions against rupiah abroad;
c. providing overdrafts as well as credit and/or financing for foreign exchange transactions against rupiah;
d. providing overdrafts as well as credit and/or financing in rupiah or foreign currency to non-residents (persons, legal entities or other entities who are not domiciled in Indonesia or have been domiciled in Indonesia for less than one year);
e. purchasing securities in rupiah issued by non-residents;
f. making investments in rupiah to non-residents; and
g. other transactions determined by BI.

However, from the prohibition above, there are exceptions for:

a. certain activities to settle transactions using local currency (local currency settlement);
b. intraday overdraft for foreign exchange transactions against rupiah;
c. providing credit or financing to non-residents with certain economic activity requirements in Indonesia;
d. purchase of securities related to certain economic activities in Indonesia; and
e. other transactions determined by BI.

In addition, banks receiving rupiah transfers must ensure that transfers to accounts in Indonesia, which belong to non-residents or non-residents and residents in the form of

joint accounts and exceed a certain amount, have underlying transactions. Underlying transactions are activities that underlie foreign currency transactions against rupiah. There is an exception to the obligations related to underlying transactions for rupiah transfers that:

a. originate from exchange rate derivative transactions or hedging transactions based on *Sharia* principles for foreign exchange transactions against the rupiah; or
b. are transfers of rupiah between accounts held by the same non-resident in rupiah accounts.

Regulatory framework on anti-money laundering

Commercial Banks are institutions that rely on public funds, and they also bear the burden of public trust in managing funds to prevent causing losses to society. Consequently, Commercial Banks must adhere to the principle of prudence in their business operations. This precautionary principle is regulated by the Banking Laws, specifically the KYC or customer identification policy, which serves as the standard for each financial institution. There are two ways to implement KYC, as regulated in OJK Regulation No. 8 of 2023 on the Implementation of Anti-Money Laundering Programs, Prevention of Terrorism Financing, and Prevention of Funding for the Proliferation of Weapons of Mass Destruction in the Financial Services Sector:

a. Customer Due Diligence ("**CDD**")
   CDD is an activity involving identification, verification, and monitoring conducted by banks to ensure that transactions align with the profile, characteristics, and/or transaction patterns of prospective customers, existing customers, or walk-in customers. CDD procedures are mandatory when:
   a. business relationships are carried out with prospective customers;
   b. there are financial transactions in rupiah and/or foreign currency whose value is at least or equivalent to IDR 100 million;
   c. there is a fund transfer transaction;
   d. there are indications of suspicious financial transactions related to money laundering crimes, terrorism financing crimes, and/or funding the proliferation of weapons of mass destruction; or
   e. the bank doubts the veracity of the information provided by prospective customers, clients, walk-in customers, proxy recipients, and/or beneficial owners.
b. Enhanced Due Diligence ("**EDD**")
   EDD is a more in-depth CDD action conducted by banks on prospective customers, walk-in customers, or customers at high risk, including politically exposed persons and/or those in high-risk areas.

Regulatory framework on sanctions

If a Commercial Bank fails to comply with applicable laws in carrying out its business activities, it will face serious consequences. For instance, non-compliance with consumer protection principles mandated by OJK through POJK 22/2023 may lead to administrative sanctions, including written warnings, fines, or revocation of business permits.

These sanctions not only have the potential to harm the reputation of banks but can also impact their operational performance and business sustainability. It is imperative for banks to prioritise regulatory compliance to maintain the trust and confidence of their customers. Adhering to established regulations enables Commercial Banks to recognise risks and ensures the integrity and stability of their operations.

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Ireland

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Introduction

The banking sector in Ireland benefits from an open economy with direct access to the EU labour market, EU regulatory passporting and a skilled, English-speaking talent pool. The Irish banking ecosystem consists of retail banks that primarily offer services to the domestic economy, and international banks that operate on a wider multi-jurisdictional basis.

The banking sector has evolved significantly in recent years. As a result of Brexit, certain international banks have expanded their operations in Ireland with a view to establishing European hubs. The Central Bank of Ireland (the "**CBI**") has noted that cross-border assets held by third-country subsidiaries is a factor in the growth of banks' aggregate balance sheets in Ireland.

Ireland's domestic retail banking sector has reduced in size in recent years. The number of domestic banks serving the sector now stands at three. This follows the exits of KBC and Ulster Bank (NatWest) from the Irish market, which both ceased domestic operations in 2023.

The shrinking of the domestic retail banking sector prompted the Government to carry out a retail banking review in 2022, a process that culminated in the publication of 34 separate recommendations across the themes of access to cash, consumer protection, lending to SMEs, and relaxing remuneration restrictions on the remaining retail banks – Bank of Ireland, Allied Irish Banks (AIB) and PTSB.

Those recommendations now form part of Government policy. Over the course of 2023, work commenced on their implementation. Notably, the Credit Union (Amendment) Act 2023 was enacted, expanding the services that credit unions can provide, thus enabling credit unions to play a greater role in the provision of banking services.

A further key trend that accelerated during COVID and continues apace is the wider adoption of digital and mobile banking. Challenger banks, such as Bunq and Revolut, provide digital-only offerings and operate with low-cost bases, and have increased in popularity. EU banks also offer deposit products in Ireland on a passported basis, sometimes using intermediaries such as Raisin Bank. Incumbent Irish banks are now required to substantially invest in technology to keep pace with new market entrants.

Despite technological advancements, there remains an enduring demand for cash. According to a recent survey by BearingPoint, cash is the most frequently used payment method in Ireland. To safeguard the role of cash in the economy, the Government is progressing "Access to Cash" legislation, which will, amongst other matters, empower the Minister for Finance to set "regional criteria" stipulating the minimum number of ATMs required per

100,000 people. Over the coming months, the Department of Finance will also finalise the National Payments Strategy, establishing a roadmap for the future evolution of Ireland's payments system, particularly in the context of digitalisation.

A key factor in anticipating future banking-related developments in Ireland, for 2024 and beyond, will be the trajectory of the economic environment in Europe. The European Central Bank (the "**ECB**") recently published its supervisory priorities for 2024–26. Supervised institutions, including those based in Ireland, are asked to: (i) strengthen resilience to immediate macro-financial and geopolitical shocks; (ii) accelerate the effective remediation of shortcomings in governance and the management of ESG-related risks; and (iii) make further progress in relation to digital transformation and building operational resilience frameworks.

Additionally, in July 2023, the European Banking Authority (the "**EBA**") issued the results of its EU-wide stress test, which was stated to have used the most severe adverse scenario to date. The stress test showed European banks remaining resilient in a hypothetical adverse scenario. According to the exercise, Ireland's two largest retail banks hold enough capital to withstand a severe adverse economic shock scenario.

The CBI has noted that economic context is crucial to determining regulatory focus. In 2024, the CBI can be expected to continue safeguarding financial stability, ensuring that firms operate in the interests of consumers. To this end, the CBI will conduct a comprehensive review of its Consumer Protection Code 2012. The review is centred on certain themes, including two broad discussion themes of "Availability and Choice" and "Acting in Consumers' Best Interests", and eight more-focused themes, including "Innovation & Disruption", "Digitalisation" and "Climate Matters".

Regulatory architecture: Overview of banking regulators and key regulations

As an EU Member State, banking regulation Ireland is fundamentally interlinked with the EU regulatory architecture.

The European Single Supervisory Mechanism (the "**SSM**") established in 2014 designated the ECB as the competent authority for banking supervision in the EU. Banks are divided into two categories: significant institutions ("**SIs**"); and less significant institutions ("**LSIs**").

The ECB supervises SIs based in Ireland, while the CBI supervises LSIs (in close cooperation with and with oversight from the ECB). The CBI uses a risk-based supervision approach entitled "PRISM". The CBI states that this approach delivers value by focusing the regulator's energies on the firms that are most significant and on the risks that pose the greatest threat to financial stability and consumers.

The CBI is the competent authority in respect of anti-money laundering and countering the financing of terrorism ("**AML/CFT**") obligations for all banks. The CBI is also solely responsible for conduct of business supervision for banks.

The Financial Services and Pensions Ombudsman (the "**FSPO**") is responsible for the resolution of individual complaints against banks. The Competition and Consumer Protection Commission (the "**CCPC**") enforces competition and consumer protection laws, enhances consumer welfare, and promotes competition and financial education.

The key regulations applying to banks in Ireland are as follows:

<u>The SSM Framework Regulation and the SSM Regulation</u>

Regulation (EU) 468/2014 (the "**SSM Framework Regulation**") and Regulation (EU) 1024/2013 (the "**SSM Regulation**") establish the framework for banking supervision in the EU. Those Regulations confer the task of banking supervision on the ECB and allocate responsibilities between the ECB and the CBI.

The Capital Requirements Framework

Regulation (EU) 575/2013 (the "**CRR**") and Directive 2013/36/EU ("**CRD IV**") apply to banks in Ireland. The CRR is directly effective in Ireland. CRD IV was transposed into Irish law by the European Union (Capital Requirements) Regulations 2014. The CRR and CRD IV govern authorisation requirements, the supervisory framework, prudential rules, governance, and reporting requirements, amongst other aspects.

Pursuant to Part 5 of the European Union (Capital Requirements) Regulations 2014, a bank may passport into Ireland by establishing a branch in Ireland (subject to notifying the CBI or the ECB, as applicable) or providing services in Ireland (subject to notifying the CBI or the ECB, as applicable).

The Central Bank Acts

The Central Bank Acts 1942 to 2023, as amended, also apply to banks. Key provisions of the regime include: (i) Section 9 of the Central Bank Act 1971, which applies to the granting of bank licences; (ii) Part IIIC of the Central Bank Act 1942, which provides the CBI with enforcement powers in respect of regulated firms; and (iii) the Central Bank Reform Act 2010 (the "**2010 Act**"), which sets out a fitness and probity regime.

In 2023, the Central Bank (Individual Accountability Framework) Act 2023 was signed into law. The new Individual Accountability Framework (the "**IAF**") confers powers on the CBI to strengthen and enhance individual accountability in the management and operation of regulated financial service providers ("**RFSPs**"). Core provisions of the IAF have since come into operation (including a modified fitness and probity regime, new conduct standards applicable to individuals in RFSPs, and enhancements to CBI enforcement capabilities). The Senior Executive Accountability Regime ("**SEAR**"), an accountability regime broadly comparable to the UK's Senior Managers and Certification Regime ("**SMCR**"), is the only pillar of the IAF that has yet to come into operation. SEAR will begin to apply to in-scope firms from July 2024, but with a deferral in relation to (independent) non-executive directors until July 2025.

AML/CFT

The CBI is the competent authority in Ireland for the monitoring and supervision of compliance with AML/CFT obligations under the Criminal Justice (Money Laundering and Terrorist Financing) Act 2010 (the "**CJA 2010**"), as amended. The CBI is empowered to take measures "reasonably necessary" to ensure that institutions comply with the provisions of the CJA 2010.

Notably, an AML/CFT package is being progressed at the EU level, which includes a Sixth Anti-Money Laundering Directive, a new Anti-Money Laundering Regulation and a Regulation establishing an EU Anti-Money Laundering Authority ("**AMLA**"). Ireland has submitted a bid to host the new Authority, once in operation.

Conduct of business

The CBI is the competent authority in Ireland for the supervision of financial conduct of business regulation for RFSPs. The CBI supervises conduct through primary legislation and codes of conduct, including the Consumer Protection Code 2012, the Code of Conduct on Mortgage Arrears 2013, and the Central Bank (Supervision and Enforcement) Act 2013 (Section 48) (Lending to Small and Medium-Sized Enterprises) Regulations 2015.

In 2024, the CBI intends to introduce a revised and modernised Consumer Protection Code, which involves, amongst other matters, consolidating existing rules with the Code of Conduct on Mortgage Arrears.

Credit reporting

The CBI administers a statutory credit register known as the Central Credit Register (the "**CCR**"), pursuant to the Credit Reporting Act 2013 (the "**CRA**"). The purpose of the CCR is to enable better quality lending by providing a "single borrower view" of all loans, deferred payments, and other forms of financial accommodation provided by creditors to the borrower. Regulated entities that provide credit are within scope, including banks (domestic and EEA passporting), retail credit firms, credit unions, payment institutions, investment firms, and certain investment funds. In addition, unregulated providers of credit, such as corporate lenders, SPVs, and purchasers of loan portfolios are within scope of the CRA. In-scope firms must: (i) register with the CBI as "credit information providers"; (ii) categorise customers (consumers *vs* non-consumers) and guarantors; (iii) submit detailed data about existing and new credit agreements of €500 or more in a prescribed format to the CCR; (iv) check the CCR before advancing new credit of €2,000 or more; and (v) ensure that processes and procedures are compliant with the CRA.

Recovery planning

Directive 2014/59/EU (the "**BRRD**") was transposed into Irish law by the European Union (Bank Recovery and Resolution) Regulations 2015. The BRRD was introduced to provide resolution authorities with effective powers to manage failing banks. The BRRD is intended to enhance the resilience of banks to ensure that they are better prepared for and able to recover in the event of a significant financial deterioration. The Regulations transposing the BRRD include, amongst other requirements, the requirement that banks prepare recovery plans identifying appropriate actions in the event of a significant financial deterioration to reduce the likelihood of a bank failure. In addition, the CBI is given early intervention powers to execute recovery options, remove management, and modify the structure of an institution.

EMIR

Regulation (EU) 648/2012 ("**EMIR**") implements increased transparency requirements regarding derivatives, by imposing requirements concerning the reporting of derivative contracts, clearing derivatives subject to the mandatory clearing obligation, risk mitigation techniques for non-centrally cleared derivatives, and setting out requirements for central counterparties and trade repositories.

The CBI is the designated competent authority in Ireland for the purposes of EMIR. In November 2023, the CBI announced that it had fined a UCITS investment fund, for the first time, for breaching the reporting obligation under Article 9(1) of EMIR. The fine was imposed pursuant to Ireland's European Union (European Markets Infrastructure) Regulations 2014, as amended, which were made to give full effect to EMIR.

Operational resilience

Due to the increased use of technology and outsourcing in financial services, regulators are increasingly focused on outsourcing-related risks and on promoting operational resilience. Banks are subject to the CBI's cross-industry guidance on outsourcing and on operational resilience. The CBI's guidance on operational resilience was issued in December 2021, communicating to industry how to prepare for, and respond to, operational disruptions affecting the delivery of critical or important business services.

Cross-industry guidance on outsourcing was issued by the CBI in December 2021, highlighting the potential of outsourcing to threaten the operational resilience of regulated firms. The CBI expects all regulated firms to demonstrate that they have appropriate measures in place to effectively manage outsourcing risk and to ensure compliance with the sectoral legislation, regulations, and guidance applicable to their businesses.

In December 2022, Regulation (EU) 2022/2554 ("**DORA**") was published in the Official Journal. DORA applies to banks, imposing requirements relating to ICT risk management frameworks, relationships with third-party providers, digital operational resilience testing and incident reporting. DORA will apply from 17 January 2025. Over the course of 2023, the European Supervisory Authorities (the "**ESAs**") published for consultation draft technical standards under DORA, which they hope to submit to the European Commission in 2024.

Additional guidance

Banks in Ireland are subject to additional guidelines, codes and other regulatory measures issued by the EBA, the ECB and the CBI.

Recent regulatory themes and key regulatory developments in Ireland

Governance

A significant regulatory topic in 2023 was the promotion of sound governance practices in regulated firms, evidenced most clearly by the introduction of the IAF.

Individual Accountability Framework

The Central Bank (Individual Accountability Framework) Act 2023 was signed into Irish law on 9 March 2023. The IAF confers powers on the CBI to strengthen and enhance individual accountability in the management and operation of RFSPs.

Core pillars of the IAF came into operation in 2023. Those include:

- conduct standards for individuals performing controlled function ("**CF**") and pre-approval controlled function ("**PCF**") roles at RFSPs;
- an enhanced fitness and probity regime, with updated certification, due diligence, and reporting requirements; and
- enhanced CBI enforcement powers, including an amended Administrative Sanctions Procedure ("**ASP**") removing the so-called "participation link", whereby the CBI could only bring enforcement action against individuals at a firm if it had first found that the firm had committed a breach.

SEAR is the only IAF pillar yet to come into operation. SEAR will begin to apply to in-scope firms from July 2024, and in relation to (independent) non-executive directors at in-scope firms from July 2025. Banks (but not credit unions) will be included in the first implementation phase of SEAR.

Key themes permeating the IAF are obligations:

- to act honestly, ethically and with integrity;
- to act with due skill, care and diligence;
- to act in the best interest of the customer;
- to avoid conflicts of interest;
- to maintain and follow adequate controls and procedures;
- to engage with the regulator openly and in good faith; and
- to disclose to the CBI any information of which it would reasonably expect notice.

Credit markets

2023 saw continued regulatory interventions, both domestically and at an EU level, in relation to credit markets, particularly in the context of changes accelerated by digitalisation. This continued a key 2022 trend, a year that saw the passage of Irish legislation expanding the regulatory parameters for lending to include non-traditional financial products, such as buy-now-pay-later ("**BNPL**") and high-cost credit loans.

New EU credit servicing regime

In December 2023, the Minister for Finance signed the European Union (Credit Servicers and Credit Purchasers) Regulations 2023, transposing the provisions of the EU Credit Servicing Directive. The EU-based regime for credit servicing, transposed via the Irish Regulations, applies only to non-performing loans ("**NPLs**") originated by EU credit institutions, and transferred on or after 30 December 2023 (the date of coming into operation). The primary goal of the EU Directive is to assist EU credit institutions in efficiently selling NPLs so that those credit institutions are not hampered in discharging their key role of providing finance to EU businesses. As part of that overarching goal, the Directive contemplates the standardisation of information for potential credit purchasers as well as the creation of a new authorisation regime for credit servicers, which can be passported throughout the EU.

Significantly, the new EU-based regime will operate alongside Ireland's existing domestic credit servicing regime under the Central Bank Act 1997. The 2023 Regulations provide that existing credit servicing firms authorised under the domestic Irish regime before 30 December 2023 are automatically deemed to be authorised to act as a credit servicer under the new EU regime.

Consumer Credit Directive

In October 2023, Directive (EU) 2023/2225 ("**CCD II**") was published in the Official Journal. CCD II, which will repeal and replace Directive 2008/48/EC, following the date of entry into application of 20 November 2026, is considerably broader in scope compared to its precursor. Significantly, CCD II extends consumer protections to financial products such as BNPL, which have become more common in recent years due to changes that have occurred across EU markets.

Distance Marketing of Financial Services Directive

In November 2023, Directive (EU) 2023/2673 concerning distance financial services contracts was published in the Official Journal. The Directive revises the framework for distance financial services contracts, in the context of rapid technological development. According to the EU, the Directive will bolster online consumer protection and provide traders with clarity. The Directive acts as a "safety net", meaning that all financial services not covered by specific sectoral legislation will be covered by the new rules, once they are in application. EU Member States are required to apply measures transposing the Directive from June 2026.

CBI warnings on new forms of credit

2023 saw a continued regulatory focus on non-traditional loan products. In June 2023, the CBI issued a "Dear CEO" letter to high-cost credit providers ("**HCCPs**"). The letter provides an overview of findings from supervisory engagements with HCCPs, and outlines expectations in relation to credit providers' compliance with regulatory obligations. Furthermore, in November 2023, the CBI issued a warning on short-term consumer credit, specifically BNPL products. According to CBI research, many Irish consumers do not fully understand key features of BNPL. Following engagement with credit firms, the CBI has outlined its expectation that firms inform consumers of all pertinent information, to ensure that consumers can make fully informed decisions.

Digitalisation/innovation

Recent CBI authorisation activity reveals the extent to which financial services are being transformed by digitalisation and innovation. The payments sector continues to grow, and the last two years have seen the registrations of Ireland's first virtual asset service providers

(“**VASPs**”), registered with the CBI in accordance with Section 26 of the Criminal Justice (Money Laundering and Terrorist Financing) (Amendment) Act 2021. Authorisation activity has occurred in relation to providers of hire purchase, BNPL, and consumer hire financial products, as well as HCCPs, further highlighting the changing nature of the financial services sector in Ireland.

In the context of increased innovation and digitalisation, incumbent financial service providers are required to substantially invest in technology to keep pace with challenger “disruptors”, and to meet consumer demands. In September 2023, Financial Services Ireland published a report entitled “Ireland’s Fintech Future”. The report surveyed a range of firms, including fintech start-ups and longer-established firms digitalising their businesses. The survey highlights the scale of investment made by firms, both in their own operations and in the wider Irish economy.

Measures combatting financial exclusion

A further trend is evident in relation to Government measures seeking to combat financial exclusion, particularly in the context of digitalisation. Government is committed to ensuring that certain sectors of society are not left behind by the digital transition.

The Minister for Finance has published the General Scheme of the Access to Cash Bill. The legislation aims to safeguard the role of cash in the economy, to ensure that the rise of digital banking does not lead to financial exclusion, particularly in the context of generational and urban-rural divides. The Bill empowers the Minister for Finance to set “regional criteria” stipulating the minimum number of ATMs required per 100,000 people, and the proportion required to be within 10km of an ATM and a cash service point.

Over the course of 2024, the Department of Finance will finalise the National Payments Strategy, which sets a roadmap for the evolution of Ireland’s payments system, particularly in the context of digital transformation. A key element of the work will be to examine and analyse payment fraud. Much of the area is governed by EU legislation; the proposed revision of the EU Payment Services Directive, or “PSD3”, contains measures combatting fraud. During its consultation, the Department of Finance will assess whether supplementing domestic measures are required.

To further combat financial exclusion, the Department of Finance is developing a National Financial Literacy Strategy, which follows the recommendation of the retail banking review.

ESG

ESG considerations continued to be a key focus in 2023, as supervisory authorities sought to embed ESG-related risks in the prudential framework.

In September 2023, the ECB published the results of its second climate stress test. The results of the exercise revealed that an accelerated green transition would provide significant benefits for firms, compared with late-push or delayed transition scenarios. Furthermore, a proactive approach to the green transition would, according to the ECB, enable banks to benefit from both lower credit risk and larger investment needs, thereby improving their long-term income positions.

In October 2023, the EBA published a report assessing how the current prudential framework captures ESG-related risks. The report recommends enhancements to accelerate the integration of ESG-related risks across the Pillar I framework. The proposed enhancements aim to support the transition to a sustainable economy, whilst ensuring the continued resilience of the banking sector.

As part of the agreed Basel III reforms to the EU capital requirements frameworks, EU co-legislators have reached agreement on the further integration of ESG-related risks in the prudential framework. Under the agreed texts:

- EU banks will have to draw up transition plans under the prudential framework that will need to be consistent with the sustainability commitments banks undertake pursuant to other provisions of EU law;
- bank supervisors will oversee how banks handle ESG risks and include ESG considerations in the context of the annual supervisory examination review process (“**SREP**”);
- ESG reporting and disclosure requirements will apply to all EU banks, with proportionality for smaller banks; and
- banks will enjoy a favourable risk weight treatment only where they finance an infrastructure project with a positive or neutral environmental impact assessment attached to it.

It is envisaged that those changes to the EU capital requirements framework will apply from January 2025.

The EBA is also currently preparing a one-off “Fit-for-55” climate risk scenario analysis of EU banks, assessing the resilience of the financial sector in the context of the Fit-for-55 package. The one-off exercise is part of the new EBA mandate received by virtue of the European Commission’s Renewed Sustainable Finance Strategy.

In addition to the incorporation of ESG-related risk in the prudential regime, the various EU reporting regimes continue to apply, including obligations under Article 8 of Regulation (EU) 2020/852 (the “**Taxonomy Regulation**”) and prudential disclosures under the CRR. In January 2023, Directive (EU) 2022/2464 (the “**CSRD**”) came into force. The CSRD amends Directive 2014/95/EU (the “**NFRD**”) to introduce detailed reporting requirements regarding sustainability issues. The new regime will oblige in-scope companies, including banks, to disclose information on the societal and environmental impact of their operations and that of their value chain. The CSRD will apply on a phased basis beginning with reporting in 2025 for the 2024 financial year.

Additionally, the CBI has announced its intention to recognise certain sustainability knowledge and competencies as part of its Minimum Competency Code 2017 (the “**MCC**”), with effect from 1 January 2025.

Diversity and inclusion

In March 2023, the CBI released a report that presented data on the gender diversity of applications for senior positions in regulated firms that require pre-approval. Overall, the percentage of female applicants increased to 32%, compared with 31% in 2021 and 22% in 2017.

Work is ongoing in relation to the promotion of gender diversity; progress reports were published in the year on the Woman in Finance Charter, which was launched in 2022 as part of the “Ireland for Finance” strategy. Signatories of the Charter commit their organisations to improving the number of women in management and board-level positions to achieve better gender balance and a more inclusive working environment.

At an EU level, June 2023 saw the entry into force of the Pay Transparency Directive, which contains a number of measures designed to redress the gender pay gap. The provisions of that Directive are required to be transposed by Member States within three years.

New mortgage rules

The CBI continues to engage with regulated entities to ensure that they meet expectations, outlined in November 2022, on protecting mortgage consumers in a changing economic landscape, with a particular focus on supporting borrowers, and enhancements to the provision of information and options to borrowers eligible to switch mortgage product or provider. As stated above, over the course of 2024, the CBI intends to introduce a revised and modernised Consumer Protection Code, which includes consolidating existing rules with the Code of Conduct on Mortgage Arrears.

Credit union services

In December 2023, the President signed into law the Credit Union (Amendment) Act 2023. The Act provides for an expansion of credit union services in Ireland, implementing the outcomes of the review of the domestic policy framework for credit unions. The expansion of services offered by credit unions is particularly significant in the context of the shrinking retail banking sector, which entails opportunities for non-traditional credit institutions.

Client asset requirements

In January 2023, the Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1)) (Investment Firms) Regulations 2023 were published, which contain the CBI's client asset requirements ("**CAR**"). CAR will apply to banks carrying out MiFID investment business and includes provisions in respect of reconciliation and calculation, transfer of business, reporting requirements to the CBI, client disclosures and development of a client asset management plan. CAR has applied to in-scope banks since 1 January 2024.

Bank governance and internal controls

Fitness and probity

The CBI's fitness and probity regime was introduced under the 2010 Act. A key regulatory focus is the fitness and probity of individuals carrying out key and customer-facing positions in banks. Those key and customer-facing positions are categorised as CFs and PCFs. The CBI expects individuals carrying out those functions to be competent and capable, honest, ethical, of integrity, and financially sound.

The fitness and probity regime consists of three pillars:

- firstly, regulated firms are subject to ongoing obligations in relation to the application of the fitness and probity standards;
- secondly, the CBI has a "gatekeeper" role whereby it pre-approves individuals nominated for PCF functions; and
- thirdly, the CBI has investigative and enforcement powers in the event that queries arise as to an individual's fitness and probity.

In addition to the 2010 Act, the CBI's fitness and probity regime is set out in the Central Bank (Supervision and Enforcement) Act 2013 (Section 48 (1)) Minimum Competency Regulations 2017 and statutory codes, specifically the Fitness and Probity Standards and the MCC.

In line with the allocation of responsibilities between the CBI and the ECB in respect of SIs and LSIs, the ECB is responsible for the fitness and probity assessments of the management board of SIs and "Key Function Holders" in SIs.

Significant changes were introduced to the fitness and probity regime by the IAF (see in detail above), including in relation to certification, due diligence, and reporting obligation; those changes came into operation in December 2023. CBI guidance has been issued, along with Regulations designating further CFs and PCFs.

Corporate Governance Requirements for Credit Institutions 2015

The Corporate Governance Requirements for Credit Institutions 2015 impose minimum core standards upon all banks and additional requirements upon banks designated as "High Impact" by the CBI, to ensure that appropriate and robust corporate governance frameworks are in place. These requirements are minimum requirements that bank are required to satisfy, to ensure strong and effective governance. Requirements include those relating to: (i) responsibility, composition, and role of the board; (ii) the role of the Chairman; (iii) the role of the CEO; (iv) the role of the CRO; (v) independent non-executive directors and executive directors; and (vi) requirements and roles of committees.

Banks are required to submit a compliance statement, on an annual basis, or with such frequency as the CBI may notify to a bank, specifying whether they have complied with the corporate governance requirements during the relevant period.

Remuneration

Banks in Ireland are subject to governance and internal control requirements contained in the CRR and CRD IV, as transposed into Irish law, and the EBA's Guidelines on Sound Remuneration Policies. CRD IV sets out requirements in respect of identifying those persons whose professional activities have a material impact on a bank's risk profile ("**Material Risk Takers**") who will then be subject to specific remuneration requirements. The EBA states that, for Material Risk Takers, the alignment of remuneration incentives with a bank's risk profile is crucial. The EBA Guidelines also provide that remuneration policies must be gender neutral, and respect the principle of equal pay for equal work or work of equal value.

Bank capital requirements

Capital requirements for Irish banks are determined by the CRR and CRD IV, as transposed into Irish law. The CRR and CRD IV set out the required capital a bank must hold. This includes a regulatory minimum for all banks ("**Pillar I**"), and a bank-specific additional capital requirement that is decided by the relevant regulator ("**Pillar II**"). Additionally, banks must also meet a "combined buffer requirement", which operates as additional capital to prevent banks from breaching Pillar I and II requirements.

The CRR and CRD IV provide the CBI and the ECB with a range of macroprudential policy instruments to apply, including the countercyclical capital buffer (the "**CCyB**"), macroprudential measures in relation to risk weights on real estate exposures, and the systemic risk buffer (the "**SyRB**").

Both the CBI and the ECB have powers to impose stricter macroprudential requirements in specific scenarios. Pursuant to Article 458 of the CRR, the CBI has the power to implement stricter national implementing measures where it identifies changes in the intensity of macroprudential or systemic risk in the financial system with the potential to have serious negative consequences to the financial system and the real economy in Ireland. Article 5 of the SSM Regulation provides that the ECB may apply stricter requirements to macroprudential measures that are already in place at the national level.

The CBI has stated that, in setting macroprudential requirements, it takes account of the fact that Ireland is a small, open economy and, on that basis, is more susceptible to shocks relative to larger, more diversified economies. The CBI has stated that the operation of the macroprudential capital framework over the past decade, including during COVID, demonstrated the value of releasable capital buffers to better enable the banking system to support the economy.

The CBI considers the CCyB to be its primary macroprudential capital tool for safeguarding resilience to macro-financial risks. From 24 November 2023, the CCyB increased from 0.5% to 1%. According to the CBI, this is due to the fact that higher interest rates are expected to be positive for banks' profitability; the move to 1% takes account of the importance of building resilience in advance of a potential materialisation of risks.

The CBI has a target CCyB rate of 1.5%, which is intended to apply from 7 June 2024.

For systemically important banks, capital buffers for systemically important institutions ("**O-SII**") will continue to be used by the CBI. The CBI has indicated that it does not intend to introduce the SyRB at this point, though it does not rule out using the SyRB in the future.

Rules governing banks' relationships with their customers and other third parties

Relationships with customers

Banks in Ireland are subject to EU legislative frameworks regarding consumer protection; for example, consumer credit, payment services, mortgage credit and distance marketing.

Domestically, the CBI is the competent authority for conduct of business rules of banks. The CBI has stated that, where individual consumers have issues with financial products or services, their first line of protection is the bank itself. In this respect, the CBI expects banks to respond to customer complaints speedily, efficiently, and fairly. Where individual complaints are not resolved by a bank to a customer's satisfaction, those individuals may refer them to the FSPO, which is responsible for the resolution of individual complaints about banks.

Consumer protection is a key focus of the CBI. The CBI has issued codes of conduct that apply to banks in respect of consumer protection, including the Consumer Protection Code, the Code of Conduct on Mortgage Arrears, and the Code of Conduct on the Switching of Payment Accounts with Payment Service Providers.

The Consumer Protection Code is a set of principles and rules that apply to banks when dealing with consumers, covering topics such as the sale of financial products and services, the provision of financial information or advice, the advertising of financial products and services, and how complaints are handled. As detailed above, the CBI's review of the Code is expected to progress over the course of 2024, with the CBI intending to introduce a revised and modernised Code, and to consolidate rules with the Code of Conduct on Mortgage Arrears. The CBI is planning further Regulations for 2025.

The CBI issues "Dear CEO" letters, publishes speeches, holds industry roundtables, and issues discussion papers on consumer issues. The CBI has also issued the Central Bank (Supervision and Enforcement) Act 2013 (Section 48) (Lending to Small and Medium-Sized Enterprises) Regulations 2015, which set out the processes that regulated entities are required to adopt in facilitating access to lending for SMEs.

The CBI has issued a "Dear CEO" letter on protecting consumers in a changing economic landscape. This letter specifies the actions that the CBI expects regulated firms to take to ensure that consumers are protected. Areas highlighted for firms' attention include: (i) affordability and sustainability; (ii) provision of relevant, clear, and timely information; (iii) effective operational capacity; and (iv) sales and product governance.

Lending to related parties

In July 2022, the CBI issued a new edition of its Code of Practice on Lending to Related Parties. The CBI's Code covers requirements for banks when granting or otherwise dealing with loans to related parties, reporting to the CBI, and specific exemptions (for cases where a bank becomes a significant shareholder in a borrower, in respect of first home schemes and lending to natural connected persons).

Deposit Guarantee Scheme

The Deposit Guarantee Scheme (the "**DGS**"), established pursuant to the European Union (Deposit Guarantee Schemes) Regulations 2015, protects depositors in the event of a bank being unable to repay deposits. The DGS is administered by the CBI and is funded by the banks covered by the scheme. The Irish DGS protects deposits held at EU branches of authorised Irish banks. Deposits held with banks that are authorised in another EEA Member State are covered by that country's DGS.

Dormant accounts

Ireland has enacted legislation, the Dormant Accounts Act 2001, in respect of dormant accounts. Accounts are considered "dormant" where there has been no activity for 15 years. The Dormant Accounts Act 2001 provides that unclaimed money will be transferred to a fund managed by the National Treasury Management Agency (the "**NTMA**") and paid out by the Dormant Accounts Fund Disbursements Board. The Dormant Accounts Fund Disbursements Board will distribute the funds to programmes designed to assist with the personal development of those who are economically, educationally, or socially disadvantaged. The rights of original account holders are not affected by the transfer to the fund and the original account holders retain the right to reclaim the funds (including interest).

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Italy

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Introduction

The macroeconomic situation resulting from the global and European financial crisis had resulted in significant legislative changes in the last 10 years, both at a European and Italian level, aimed at strengthening banks' internal control and risk management systems, as well as ensuring that they have adequate regulatory capital to face any situation of economic and financial stress.

In this regard, it is indeed interesting to mention how the banking system (both Italian and European) has been able to deal with highly stressful situations in recent years, related to the pandemic crisis linked to the spread of COVID-19 and the Ukrainian conflict, as well as, ultimately, the crisis of certain US regional banks and Credit Suisse. In contrast with the financial crisis in 2008, in which the banking system was severely tested, over the past few years, European banks have implemented, in accordance with recent regulatory developments, governance and capital adequacy arrangements capable of better absorbing shocks from financial and economic stress and thus reducing systemic risk.

In this sense, it has been pointed out that "*weaknesses in corporate governance have been one of the main causes of the banking crises in recent years*", and, with specific reference to the recent crisis that affected non-EU banks, "*[t]he contagion only marginally affected European banks, including Italian ones. The Union's banking legislation [...] extends prudential standards based on the Basel accords to smaller banks as well. combined with often more intrusive supervisory practices, this has helped on this occasion to mitigate risks and prevent a contagion*".[1]

Over the past few years, the Italian government has launched a number of initiatives aimed at addressing the needs of Italian banks, providing greater transparency and stability to the Italian banking system, and helping Italian banks increase their attractiveness to domestic and foreign capital.

Regulatory architecture: Overview of banking regulators and key regulations

Supervisory authorities

The Italian banking prudential supervision system is strongly influenced by the progressive consolidation of the Banking Union at European level.

The Banking Union

The degree of coordination and cooperation among EU Member States is increasingly focused on a new single system of harmonised prudential rules (the Single Rulebook) that, in most cases, have a direct effect in EU Member States.

The main institutions are the European System of Financial Supervision (ESFS), which consists of the European Systemic Risk Board (ESRB), responsible for macro-prudential supervision, and three European Supervisory Authorities (ESAs) in charge of coordinating micro-prudential supervision, namely the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA), and the European Securities and Markets Authority (ESMA), their joint committee, and the Member States' competent supervisory authorities (in Italy, the Bank of Italy – BoI).

The Banking Union among euro area countries is based on three main pillars:

- the Single Supervisory Mechanism (SSM), which sets out the joint exercise, by the European Central Bank (ECB) and EU national supervisory authorities, of tasks and powers for banking supervision;
- the Single Resolution Mechanism (SRM), which establishes the framework for the crisis resolution of banks in the EU countries that adhere to the SSM. The resolution is to be managed, under harmonised rules, by the Single Resolution Committee or by national resolution authorities following joint instructions or guidelines established by the Committee and financed by a single fund, to which the banks themselves contribute; and
- the European deposit insurance scheme, which builds on the system of national deposit guarantee schemes (DGS) regulated by Directive 2014/49/EU, to provide a stronger and more uniform degree of insurance cover to banks in the euro area.

The BoI

The macro-prudential supervision of the Italian market is conducted by the BoI (in collaboration with the ECB and ESRB) in order to identify the risk factors and vulnerabilities of the financial system that could threaten its stability and to prevent or limit their effects on the real economy.

With the entry into force of the SSM, the ECB has taken on specific tasks relating to the prudential supervision of credit institutions, in cooperation with the national competent authorities of participating EU Member States.

On a practical level, the ECB focuses on significant banks and banking groups, identified in accordance with specific criteria, by regularly assessing their financial situation, verifying their compliance with prudential requirements, taking any supervisory measures necessary, and performing stress tests. All of these tasks are overseen by the Joint Supervisory Teams, comprising staff from the ECB and the BoI, which are the primary vehicle of cooperation and the first point of contact for intermediaries.

Less significant banks and banking groups are supervised directly by the BoI, which provides harmonised supervision guided by the general policies and instructions issued by the ECB.

The BoI maintains full and autonomous competence in the fields of:

- monitoring of investment companies (securities investment firms (SIMs) and groups of SIMs), asset management companies (SGRs, SICAVs and SICAFs), financial intermediaries, electronic money institutions (EMIs), and payment institutions;
- consumer protection, jointly with the National Antitrust Authority (AGCM): the BoI issues rules and regulations on marketing consumer credit products, while the AGCM ensures the market's fairness through transparency and disclosure duties;
- anti-money laundering (AML) and terrorism financing;
- payment services and markets in financial instruments;
- supervision of non-banking entities and Italian branches of non-EU banks, while EU banks are supervised by their respective home Member States' competent authorities

(except for a limited number of compulsory matters applicable to their Italian branches, such as internal controls, business continuity, registrations, outsourcing of cash management, offer of investment services, custodian banks, *etc*.); and
- transparency of contractual conditions: the BoI issues and periodically reviews a set of rules aimed at ensuring that clients can be provided with a high level of information about costs, fee structures, remedies and protection tools, together with a clear explanation of the applicable terms and conditions, distinguishing between loans, consumer credit products and banking services, applicable regardless of where the relevant bank is based.

Moreover, the BoI also has supervision powers over: financial agents (*agenti in attività finanziaria*), which provide intermediate financing product and payment services by virtue of a direct mandate from a bank; and credit brokerages (*mediatori creditizi*), which simply create contact between financial intermediaries and borrowers.

Commissione nazionale per le Società e la Borsa (Consob)

While the BoI has banking and financial supervisory powers to ensure sound and prudent management, risk containment and the financial stability of the above entities, Consob is responsible for the transparency and fairness of these entities' behaviour towards investors. Its activity is aimed at protecting investors' interests and, in relation to this, Consob is the competent authority for ensuring (among others):

- transparency and correct behaviour of financial market participants, such as investment firms, banks, asset managers, financial advisors and other intermediaries providing investment services and activities to investors located in Italy. Consob is also the competent authority for supervision of compliance with the rules of conduct in case of distribution of insurance-based investment products (IBIPs) carried out in Italy by banks and other financial intermediaries, while any other aspects related to the distribution of non-IBIPs products are supervised by the Italian Insurance Supervisory Authority (*Istituto per la vigilanza sulle assicurazioni* – IVASS), the supervisory authority on the insurance market;
- disclosure of complete and accurate information by listed companies;
- compliance with public offering and public tender rules; and
- appropriate investigations with respect to potential infringements of insider dealing and market manipulation law.

The Financial Intelligence Unit (FIU)

The FIU is an independent body that carries out its functions with full autonomy within the BoI, with the task of analysing financial information in order to prevent and combat money laundering and the financing of terrorism.

Banking and Financial Arbitrator (ABF)

The ABF is an independent body that may be seized by customers for settling disputes between intermediaries and customers out of court. The BoI provides the means, structures and human resources required by the ABF's three panels, while respecting their decision-making autonomy.

Further, Consob launched a public consultation for the establishment of voluntary alternative dispute resolution proceedings applicable to all disputes (national or international) between consumers and professionals based in the EU, in accordance with EU legislation.

Arbitro per le Controversie Finanziarie (ACF)

In May 2016, Consob established the ACF, a financial services ombudsman, whose responsibility is to resolve disputes between retail investors and intermediaries in relation to investment services and collective asset management services.

Key legislation

EU legislation

The main pieces of EU legislation governing the supervisory duties of the BoI are Regulation (EU) 575/2013 (the Capital Requirements Regulation – CRR, as amended by Regulation (EU) 2019/876 – CRR II) and Directive 2013/36/EU (the fifth Capital Requirements Directive – CRD V), as further described in the "Bank capital requirements" section below.

CRR introduced prudential supervisory rules that are directly applicable to all European banks and investment firms. CRD V sets out the conditions to be complied with to be permitted to carry on the activity of banks, the freedom of establishment and freedom to provide services for banks in the EU, prudential control, additional capital buffers, and bank corporate governance.

The legal framework for the management of bank crises is driven by Directive 2014/59/EU (the Bank Recovery and Resolution Directive – BRRD, as amended by Directive 2019/879/EU – BRRD II) on the recovery and resolution of credit institutions and investment firms, which is aimed at strengthening and harmonising the tools available to the authorities for preventing problems and managing intermediaries' crises.

Regulatory and implementing technical standards (RTS and ITS) play an increasingly important role in banking and financial regulation. They are developed by the ESAs (notably the EBA) and adopted by the European Commission (EC) via regulations. They seek to harmonise the most complex and detailed aspects to create a complete, homogeneous and unified system of rules for the single market.

The European regulatory framework is completed by the MiFID II, IDD, AIFMD and UCITS Directives packages, which influence the banking environment in several fields (investment services, funds marketing, distribution of insurance policies, *etc*.).

National legislation

The key banking and credit law is Decree 385/1993, referred to as the Consolidated Law on Banking (*Testo Unico Bancario* – TUB), as amended and supplemented from time to time, which also implements at national level the EU legislation mentioned above. Built on principles for the allocation of powers, the TUB sets out the basic rules and standards for, and defines the areas of responsibilities of, the credit authorities (Interministerial Committee for Credit and Savings – CICR, the Ministry of Economy and Finance and the BoI), and allocates the authority to issue secondary rules and regulations on technical matters and to adopt prudential measures.

Among others, the TUB provides rules on: authorisation for banking activity; establishment of banks' branches and cross-border activities; interest in banks' capital; cooperative banks; supervision on banks (standalone and on a group basis); banking groups; bankruptcy and resolution proceedings of banks; guarantee systems for depositors; non-banking financial intermediaries; electronic money; payment services; transparency rules in banking services; consumer credit; financial agents and credit intermediaries; and sanctions proceedings.

Decree 58/1998, referred to as the Consolidated Law on Finance (*Testo Unico della Finanza* – TUF), is the fundamental law governing the financial markets. It includes rules on: supervision of financial intermediaries; professional and integrity requirements of senior management; investment services (including branches' establishment and cross-border activities of investment firms); door-to-door selling; asset management companies (including branches' establishment and cross-border activities of managers); UCITS and

AIFMD funds; market regulation; centralised management of financial instruments; listed issuers, public offers, minority shareholders' rights and proxy voting; special and saving shares; external audit; criminal and administrative sanctions; and market abuse.

Secondary sources of legislation include (i) resolutions of the CICR, which, acting on the BoI's proposals, establishes the guidelines and standards for supervisory activity based on ministerial regulations, (ii) BoI circulars, regulations and supervisory rules, and (iii) resolutions, communications and Q&A(s) of the Consob.

The BoI's legal instruments can take many forms (supervisory rules, regulations, circulars) and are usually of a distinctly technical and financial nature. The BoI also issues notices containing additional information and clarifications that are not included in a legal instrument.

Recent regulatory themes and key regulatory developments in Italy

Driven by both domestic and EU initiatives, recent years have marked significant regulatory changes, aimed in particular at strengthening the banking system, increasing transparency for clients and reducing systemic risks:

- Legislative Decree 182/2021, amending the TUB, has implemented at national level CRD V and CRR II on prudential requirements for banks, which has profoundly modernised the prudential and supervisory regulatory framework of the European banking system. Among the most significant innovations introduced by the Decree, it is worth highlighting the revision of the regulation of banking groups, the harmonisation of the regulations on the ownership structure of banks and other intermediaries to the joint guidelines of the ESAs, and the specification of the powers of the BoI in the area of additional capital requirements (Pillar 2 Requirement – P2R).

  As per the revision of the regulation of banking groups, a new regulation on financial holding companies (FHCs) and mixed financial holding companies (MFHCs) has been introduced. In very general terms, FHCs and MFHCs, being the head of the banking group and, therefore, subject to prudential consolidated supervisory, have to be expressly authorised by the BoI or the ECB to act as the parent company of the banking group. It is also envisaged that these types of companies are subject to the supervision of the competent authority and responsible for the compliance of the prudential requirements applicable to the banking group.
- On July 26, 2022, the BoI issued the provisions on ownership structures of banks and other financial intermediaries (in force as of January 1, 2023). These provisions, also implementing at the secondary level of legislation the amendment introduced to the TUB by Legislative Decree 182/2021, set out the requirements, conditions, and procedure for authorising the acquisition of qualifying holdings in Italian banks, asset management companies, payment institutions, EMIs and financial intermediaries.
- Directive 2023/2225/EU was adopted on October 30, 2023, which focuses on the protection of consumers entering into credit and financings agreements, enhancing transparency requirements applicable to banks and financial intermediaries towards clients.

The EU regulatory agenda for 2024 is also very copious:

- In December 2023, the European Council, Parliament and Commission agreed the final elements for the implementation of Basel III standards in the EU (partially already addressed in CRR II and CRD V) and, therefore, the review of the banking rules on governance and prudential requirements, proposed by the EC back in October 2021 (the so-called "banking package"), is nearly complete. In particular, the banking package

consists of a legislative act to amend CRD (*i.e.* CRD VI) and CRR (*i.e.* CRR III) and should be applicable, following final approval by the European Parliament and Council, as of January 1, 2025.

The banking package essentially aims at strengthening the resilience of EU banks in the main risk areas, namely credit risk, market risk, and operational risk, implementing new or, in certain cases, different approaches to such risks in compliance with Basel III standards. It should also be noted that, among the various amendments to the current regulatory framework made by CRD VI and CRR III, provisions related to the governance of environmental, social and governance (ESG) risks will be strengthened: in such regard, banks will have to draw up transition plans under the prudential framework that will need to be consistent with the sustainability commitments that banks undertake under other pieces of EU law and specific reporting requirements will apply to all EU banks, with proportionality for EU banks.

- The EC has adopted a package of proposals to amend MiFID II, IDD, the Solvency II Directive, the PRIIPS Regulation, AIFMD, and the UCITS Directive, with a view to enhancing the protection of retail investors and to empower the same to make investment decisions that are aligned with their needs and preferences.

Bank governance and internal controls

Governance

Composition of the board and requirements for board members

Persons with administration, management and control functions in banks must meet professional, integrity, and independence requirements, as well as competence and correctness criteria. They must also devote the time necessary for the effective performance of their duties, so as to ensure the sound and prudent management of the bank.

Specific requirements are identified in Decree 169/2020, which sets out the integrity requirements (such as the absence of sentences involving certain penalties or disqualification measures) for directors, auditors and general managers, as well as correctness criteria (such as administrative sanctions imposed for violation of regulations applicable to banks, or negative assessment by an administrative authority regarding the suitability of the directors/auditors in authorisation proceedings).

Decree 169/2020 also provides that the chairman of the board of directors, the chief executive officer, and the general manager must have gained at least five years of experience in management, supervisory or control activities in banking, financial or insurance companies or listed undertakings, while non-executive directors must have at least three years of experience in university teaching or professional activities in banking, financial or insurance sectors or management supervisory and control activities in companies operating in these sectors.

In addition, members of supervisory, management and control bodies must meet competence criteria, taking into account theoretical knowledge and practical experience of such director in certain matters (*e.g.* banking and financial regulation, risk management, internal control systems, IT, *etc*.).

The supervisory and control bodies are also required to assess their adequate collective composition, so as to ensure a variety of approaches in assessing issues and making decisions and taking into account the multiple interests that contribute to sound and prudent management of the bank. In such regard, the competences of the members of supervisory

or control bodies should be evaluated, and diversification in terms of age, gender, length of tenure, and, with regard to banks operating cross-border, geographic origin. Furthermore, pursuant to the Supervisory Provisions, at least 33% of the members of supervisory and control bodies must belong to the less represented gender.

In such regard, Decree 169/2020 provides for the identification and formalisation of the optimal adequate composition of the body, followed by a comparison of such composition with the actual composition of the body. In case deficiencies are detected, remedial plans must be defined and implemented (*e.g.* training activities for members of the body who do not have certain competences required in light of the business of the entity).

The strategic supervision body must also include independent (and non-executive) members to impartially supervise management and ensure that it acts in the interest of the bank and in a manner consistent with the objectives of sound and prudent management. The independent members of the supervisory body must be, at least, 25% of the members of such body.

Finally, pursuant to the Provision of the BoI issued on August 1, 2023, which amended the BoI provisions on organisation, procedures and internal control systems for AML purposes (the BoI Provisions on AML), banks are required to appoint, within the management body, a member responsible for AML, who must possess adequate knowledge and experience in AML matters.[2]

Decree 201/2011 (converted into Law 214 of December 22, 2011 and implemented by 2012 Guidelines and FAQ from the BoI, Consob and IVASS (the Interlocking Discipline)) provides a specific rule on the prohibition of interlocking directorates in the banking, finance and insurance sectors, according to which any individual appointed in the management board, the supervisory board, the statutory board of auditors, or as executive officer in a company or group of companies operating in the Italian banking, finance or insurance services market cannot hold a similar office in a competing company or group.

The prohibition applies if: (i) the relevant activities of the concerned companies or groups are subjected to authorisation and/or supervision from sectoral authorities (*e.g.* from the BoI, Consob or IVASS); (ii) at least two of the concerned companies or groups has an Italian annual turnover in excess of €32 million (the threshold is reviewed periodically by the Italian Antitrust Authority); and (iii) the concerned companies or groups are competitors (*i.e.* they operate on at least one of the same relevant markets).

An individual appointed to serve in two or more interlocked roles must keep only one of such roles and dismiss the other(s) within 90 days of the (incompatible) appointment(s).

Failure to do so will cause the individual to be dismissed from all of his/her interlocked offices by the competent corporate bodies within 30 days from the expiry of the above 90-day period or the knowledge thereof, or by the competent supervisory authority (*i.e.* the BoI for banks and financial institutions, or IVASS for insurance companies).

Internal committees

For larger banks or banks that are more operationally complex, the Supervisory Provisions provide for the establishment, within the strategic supervision body, of specialised committees (with investigation, advisory and proposing functions), composed by a majority of independent directors, in order to facilitate decisions especially with reference to more complex activities or activities with a higher risk of conflict of interest situations.

In general, in order to ensure the consistency of corporate governance, the competence and composition of the committees shall reflect those of the bodies in which they are established.

The composition, mandate (advisory, investigation and proposing) powers, available resources and internal regulations of the committees are clearly defined and formalised. In any case, such committees are composed in general of three to five non-executive and mostly independent members.

Larger banks or banks that are more operationally complex must appoint three specialised committees relating to "appointments",[3] "risk",[4] and "remuneration".[5] Medium-sized banks only need to appoint the "risk" committee.

In smaller banks or banks that are less operationally complex, and in general with regard to all banks, committees other than those required under the Supervisory Provisions may be appointed, but only if required by real needs, notwithstanding that the committee must be composed of at least one independent member.

These committees shall not limit the decision-making powers and responsibilities of the strategic supervision body.

Remuneration policies

Banks must apply sound remuneration policies to all staff and specific requirements for the variable remuneration of staff whose activities materially impact the bank's risk profile (*i.e.* so-called "risk takers", identified by the bank in accordance with the criteria set out in its remuneration policy).

The Supervisory Provisions provide guidance on remuneration and incentive policies and practices for banks and banking groups in compliance with CRD V and taking into account, *inter alia*, the guidelines and criteria agreed at international level, including those of the EBA and the G20's Financial Stability Board (FSB).

These policies are aimed at achieving – in the interest of all stakeholders – remuneration systems that are compliant with the long-term business values, strategies and objectives of the bank (including the sustainable finance objectives, which shall take into account ESG factors), transparent, and, as the case may be, appropriate to its size, internal organisation and the nature, scope and complexity of its activities. The remuneration must relate to the bank's results, suitably adjusted to take into account all risks, and be consistent with the capital and liquidity necessary to carry out planned activities. In all cases, the remuneration system must avoid distorted incentives that could lead to regulatory violations or excessive risk-taking for the bank and the financial system.

In particular, incentive remuneration systems based on financial instruments or linked to the bank's performance must be consistent with the risk appetite framework (RAF) and risk management policies of the bank and must also be considered in its capital and liquidity planning to avoid incentives that could conflict with its long-term interests.

The strategic supervision body (together with the remuneration committee, as the case may be) sets out the remuneration and incentive policy, submits it to the shareholders' meeting, and ensures its proper implementation. It shall review it at least once a year. The ordinary shareholders' meeting, in addition to determining the remuneration for the members of the bodies it appoints, approves (i) the remuneration and incentive policies for the members of the strategic supervision body and for the remaining staff, (ii) the remuneration plans based on financial instruments, and (iii) the criteria for the determination of remuneration in case of early termination of an employment contract or early termination of appointment.

Organisation of internal control

The internal control environment represents an essential element within the Italian banking governance system that ensures the consistency of the bank's activity with its strategies and policies in light of principles of sound and prudent management.

The Supervisory Provisions expressly state that, within the second and third level control area, banks must establish the following permanent and independent internal control functions:

- Compliance function: this function must verify the risks of non-compliance, such as the risk of incurring legal or administrative sanctions, significant financial losses or reputational damages as a result of violations by the bank of mandatory rules (*e.g.* laws or regulations) or self-regulation (*e.g.* statutes or codes of conduct).

  The compliance function presides over, through a risk-based approach, the risk of non-compliance in relation to the whole bank's business in order to ensure the adequacy of the internal procedures adopted by the bank. From an organisational point of view, the compliance function must be separate from the bank's operations.

  The compliance function must present an activity programme containing all the principal risks to which the entity is exposed, including corrective measures that may be reported to the bank's corporate bodies on a yearly basis.
- Risk management function: this function is responsible for the development and implementation of the RAF and the related risk management policies through a proper process of risk management. From a general point of view, the risk management function must work closely with the operational areas of the entity. The BoI requires ongoing and substantial interaction between the two areas.

  The risk management function must present an activity programme containing all the principal risks to which the entity is exposed, including corrective measures that may be reported to the bank's corporate bodies on a yearly basis.
- Internal audit function: this function is responsible for checking that the activities carried out by the bank are being carried out properly through an evaluation (which may also include on-site verification) of the risks and of the completeness, adequacy, functionality and reliability of its organisational structure. The internal audit function must be in constant contact with the corporate bodies of the bank in order to suggest, if necessary, possible improvements.

  The internal audit function must present an audit plan, including for the control activities that it intends to carry out during the year, to the corporate bodies of the bank on a yearly basis.

At the end of each year, the three mentioned internal control functions must provide a report to the corporate bodies of the banks that summarises activities carried out during the year and the results of the controls, indicating, as appropriate, the measures that shall be adopted in order to remedy any issue.

Lastly, the BoI Provisions on AML include, among the internal control functions, the AML function. This function plays a key role in the definition of the internal control system and the procedure aimed at preventing and managing AML risks. In very general terms, the AML function carries out an ongoing assessment of the adequacy of the AML risk management process and the suitability of the internal control system, proposing amendments to the same to better mitigate any AML risk.

Furthermore, the AML function is required to present an activity plan to the corporate bodies annually, in which the main activities to be performed in the course of the year are set out, as well as a report that summarises activities carried out during the year and the results of the controls, indicating the measures that shall be adopted to remedy any issues.

Outsourcing agreements

The regulatory framework applicable to outsourcing agreements has been significantly amended by the EBA Guidelines on outsourcing arrangements (EBA/GL/2019/02 – the

Guidelines), implemented in Italy by the BoI, which has supplemented the Supervisory Provisions accordingly and entered into force in Italy on September 24, 2021.

In accordance with the Guidelines, the outsourcing of functions cannot result in the delegation of the management body's responsibilities. Banks shall therefore remain fully responsible and accountable for complying with all of their regulatory obligations. In such regard, when outsourcing, banks must ensure that the orderliness of the conduct of their business and services provided is maintained, information flow on services provided is in force, all the risks related to the outsourcing of functions are adequately identified, assessed, managed and mitigated, appropriate confidentiality arrangements are in place regarding data and other information and, in case personal data are processed, it is done so in accordance with Regulation (EU) 2016/679.

In addition, should the outsourcing arrangement concern a critical or important function, banks must be able, within an appropriate time frame, to transfer the function to alternative service providers, reintegrate the function, or discontinue the business activities that are dependent on the function.

The Guidelines also detail the process that entities must follow prior to executing an outsourcing arrangement. In this sense, banks are required to carry out a pre-outsourcing analysis and, in particular, they shall: (i) assess whether the arrangement concerns a critical or important function and that the conditions set out for the outsourcing are met; (ii) identify and evaluate the risks underlying the outsourcing agreement; (iii) undertake appropriate due diligence on the service provider; and (iv) identify and manage any conflict of interest arising from the arrangements.

The minimum contents of the agreement between the bank and the outsourcer are also stipulated by the Guidelines.[6]

Following the formal approval by the competent body of the entity to outsource a function or activity, a prior notice must be given to the BoI or the ECB (depending on the competent authority) before the start of the outsourcing agreement, setting out the start and end dates of the agreement, a description of the activities, the name of the service provider, the countries in which the services will be provided, as well as certain other information laid down in paragraph 54 of the Guidelines.

Bank capital requirements

As a Member State, Italy is generally subject to EU banking regulatory rules and specifically to CRR, which is directly applicable to firms across the EU. From a general standpoint, CRR is intended to implement the Basel III agreement in the EU. This includes enhanced requirements for:

- the quality and quantity of capital;
- a basis for new liquidity and leverage requirements;
- new rules for counterparty risk; and
- new macro-prudential standards, including a countercyclical capital buffer and capital buffers for systemically important institutions.

The BoI's regulatory powers over capital requirements are confined to the very limited areas where CRR allows some discretion to make the necessary adjustments for integration with Italian law and specific circumstances.

Rules governing banks' relationships with their customers and other third parties

Banking activities in Italy

Under the Italian legal framework, banking activity includes the joint exercise of collection of savings and liquid funds from the public and granting loans. Collection of savings and liquid funds is mainly carried out through the receipt of deposits or other repayable funds from the public.

Banks that are duly authorised to operate in Italy may exercise, *vis-à-vis* the public:
(i) banking activity (as defined above);
(ii) any other financing activity, including related and instrumental activity; and
(iii) investment services and related activities according to MiFID. The provision of investment services is subject to the rules of the TUF and its implementing regulations, and the main supervisory authority is Consob.

Lending activity

In addition to banks, the provision of any kind of financing in a professional manner to the public is also allowed for other financial intermediaries licensed under Article 106 of the TUB as well as to payment institutions authorised according to the TUB (which may only provide financing strictly related to the payment services provided, within the limits and the operational standards set out by the BoI).

Furthermore, over the last few years, Italian companies have benefitted from several legislative measures facilitating access to financing, including the possibility of non-bank entities, including insurance companies, alternative investment funds (AIFs), securitisation vehicles and insurance companies, lending directly to qualified Italian borrowers. In particular, EU AIFs (including Italian AIFs) may be authorised by the BoI to provide loans to entities other than consumers in Italy. In addition, special purpose vehicles for securitisation transactions of receivables, incorporated under the Italian Securitisation Law, have recently been approved to provide loans to entities other than individuals and micro-enterprises.

Banking activities in Italy by foreign entities

The entering of a foreign bank into the Italian market is grounded on a "dual-track mechanism": EU banks can freely perform activities subject to mutual recognition based on the passported licence regime, while non-EU banks are subject to the BoI's full authorisation.

In light of the above and considering the European legislative framework, the available options for a foreign bank wishing to operate in Italy may be summarised as follows:

- for EU banks: establish a local branch (freedom of establishment) or carry out its business on a cross-border basis (freedom to provide services); and
- for non-EU banks: obtain the BoI's authorisation on a cross-border basis or through the establishment of a local branch.

Banks' relationships with customers

Protection of client assets

Article 96 *et seq*. of the TUB regulates the DGS, a guaranteed system to which a credit institution must adhere. According to the DGS, a person holding an eligible deposit with a credit institution may obtain, under specific circumstances (*i.e.* the insolvency of the relevant credit institution), the repayment of a maximum of €100,000. Deposits up to €100,000, which are protected under the DGS, are expressly excluded from bail-in.

Regulatory framework on AML

The EU's approach to combatting money laundering is based on the EU AML Directives.

The Italian AML and terrorism financing regime is set out in (i) the Italian Criminal Code (ICC), (ii) Decree(s) implementing EU AML Directives 2005/60 and 2015/849 (the AML Decree(s)), and (iii) the implementing regulations issued by the BoI and the other Italian authorities involved in the fight against money laundering.

The purpose of the AML legislation under the relevant provisions of the ICC is to make it a criminal offence to launder money deriving from underlying crimes of any kind. The AML Decree also aims at preventing use of the financial system for the purpose of money laundering and terrorism financing and sets out specific measures to be taken by banks, financial institutions and other entities listed in the AML Decree.

In very general terms, according to the AML Decree and the relevant implementing measures, financial intermediaries and other persons engaged in financial activities must comply with their obligations in relation to: (i) customer due diligence and adequate verification of clients; (ii) recording documents; (iii) reporting suspicious transactions to the relevant authorities; and (iv) internal controls, assessing and managing risk, and ensuring compliance with the relevant provisions. In addition, the AML Decree limits each cash transaction to €1,000.

* * *

Endnotes

1. Luigi Signorini, General Manager of the Bank of Italy, "*The evolution of banking business model and the trends in supervision*", in *Bancaria*, November 2023.
2. Such member of the management body, *inter alia*, is required to: (i) monitor the policies, procedures and measures of the intermediary, in order to ensure that the same are adequate and proportionate, taking into account the characteristics and risks to which the intermediary is exposed; (ii) assist the supervisory body in the evaluations of the organisation of the AML function; (iii) ensure that supervisory and control bodies are informed on activities carried out by the AML manager, any issue detected in AML matters in the performance of his/her tasks and any remediation plans defined in light of any deficiencies detected; and (iv) set up information flows.
3. The appointment committee supports the strategic supervision and management body in (i) the appointment or co-optation (*cooptazione*) of directors, (ii) the evaluation of the boards, (iii) the verification of the professionalism, integrity and independence requirements provided for by the TUB, and (iv) setting up succession plans for top positions in the executive body.
4. The risk committee supports the strategic supervision body in relation to risks and internal control systems.
5. The remuneration committee, *inter alia*, advises on the remuneration of staff and the remuneration and incentive systems that are determined by the strategic supervision body. In addition, it directly supervises the correct application of the rules on the remuneration of the person(s) responsible for the control functions.
6. The agreement must define, *inter alia*, the rights and obligations of the parties, the expected service levels, expressed in objective and measurable terms, as well as the information necessary for the verification of their compliance, the indication of

any conflicts of interest and appropriate precautions to prevent them or, if that is not possible, to mitigate them. It must also set out the conditions under which the agreement may be modified.

* * *

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This chapter was originally drafted with the significant support of Andrea Banfi, an enthusiastic and outstanding professional who unfortunately passed away too soon. This update is in his memory.

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Lastly, Emanuele regularly assists Italian and foreign asset management in the set-up and launch of both retail and alternative investment funds.

Emanuele has won prestigious awards, including:

- "Professional of the Year – Private Clients/Family Office", as part of the Legalcommunity Finance Awards in 2021 and 2020.
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In a nutshell, Federico regularly assists Italian and foreign banks, insurance companies and financial intermediaries in their operations in Italy, with specific reference to the definition of products, drafting and negotiation of distribution agreements, and review of governance and internal control structures of regulated entities. Furthermore, he has expertise in extraordinary transactions concerning Italian institutions, also with regard to authorisation proceedings before the competent supervisory authorities (*e.g.* the European Central Bank, Bank of Italy, IVASS and Consob), in the prudential supervision of banks and financial conglomerates.

Before joining Gianni & Origoni in July 2021, Federico gained over three years' experience in an important law firm in Milan, providing legal support both to Italian and foreign companies on insurance, banking and financial regulation.

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Introduction

There are currently around 34 major banks and online banks, 100 regional banks and 56 foreign bank branches in Japan. With the continuing policy of low interest rates (unlike in other countries that have converted to positive interest rate policy) and the ageing population, the economic situation has not been easy on banks in Japan, and this situation is not likely to improve any time soon. To address this situation, deregulatory measures have been introduced in the banking sector in recent years aiming to improve banks' earnings, focusing especially on regional banks that are experiencing difficult conditions. Furthermore, it is expected that the existing banking regulations will be further amended to reinforce the banks' business foundation.

Regulatory architecture: Overview of banking regulators and key regulations

Banking regulators

The Japanese banking sector is governed and regulated by the Financial Services Agency ("FSA"), the authority responsible for ensuring the stability of Japan's financial system, giving protection to depositors, policyholders and investors, and maintaining smooth finance through planning and policymaking, inspection and supervision of financial institutions, and monitoring of securities transactions. The FSA comprises three major bureaus: the Strategy Development and Management Bureau; the Policy and Markets Bureau; and the Supervision Bureau. The Commissioner of the FSA delegates a part of the authority for inspection and supervision of financial institutions to the Directors-General of Local Finance Bureaus (local branches of the Ministry of Finance).

The Bank of Japan ("BOJ") also conducts examinations of banks' operations and assets (called "*Nichigin Kousa*"). In December 2020, the FSA and the BOJ established the "Inspection and Examination Coordination Meeting". The meeting will continue to co-ordinate plans for the FSA and BOJ inspections, and to discuss key themes on a regular basis. The FSA and the BOJ have announced that they would conduct high-quality monitoring of financial institutions, thus reducing their respective burdens, through measures such as data integration and sharing results of inspections.

The Deposit Insurance Corporation of Japan ("DICJ") conducts several types of on-site inspections, such as inspections based on the Deposit Insurance Act, which examine payments of insurance premiums, and inspections based on the Criminal Accounts Damage Recovery Act, which examine procedures for damage recovery benefits.

Key banking regulations

The Banking Act of Japan, which has been amended again and again since its enactment, is the core banking legislation providing a basic regulatory framework for the Japanese banking

sector. More notably, over the past several years, the Act has been frequently amended as part of deregulatory measures to help Japanese banks address and respond to significant changes in their external environment, such as the historically low interest rates and FinTech developments.

In its role as an overseer of banks pursuant to the Banking Act, the FSA has established "Comprehensive Guidelines for Supervision of Major Banks, etc." to guide bank regulators in their supervision over banks. While these Guidelines have been drafted mainly for the regulators' reference, they stipulate many important principles and rules for private banks to follow; indeed, the Guidelines have become an essential source of Japanese banking regulations. In addition, the answers given by the FSA during public consultations on key regulations not only reveal its views and interpretations on the subject, but are also important regulatory sources for study and consideration by private banks.

Recent regulatory themes and key regulatory developments in Japan

The recent revision of the Banking Act affects mainly the scope of business of banks and bank groups. The prudential regulations, including the capital adequacy ratio, are being progressively strengthened based on the Basel III Regime. Moreover, as regulations relating to the business scope of banking institutions differ from country to country, Japan is shifting toward significantly easing its approach *vis-à-vis* international rules. Accordingly, the business scope has recently been relaxed in IT-related businesses and operations contributing to building a sustainable society and regional revitalisation.

Major topics of Banking Act amendments in 2019

Addition of a new incidental service: the service of providing customer information to a third party

To promote better utilisation of data, the following services have been added as incidental services of banks: the service of providing customer information acquired from the customer to a third party with the customer's consent; or any other service in which the bank provides information it retains to a third party for the purpose of (a) improving the banking business, or (b) enhancing the convenience of bank users.

Review of regulations on the Large Exposure Restrictions in 2020

The Banking Act prohibits banks and groups of banks from extending credit to a specific company or person or parties related to them in excess of a certain proportion of their own capital in order to reduce credit concentration risk ("Large Exposure Restrictions"). These Large Exposure Restrictions stipulate that the amount of credit (such as loans, debt guarantees and equity investments) provided to a certain group of recipients by banks on a non-consolidated basis and on a group basis may not, as a general rule, be more than 25% of the amount of equity capital. The main contents of this revision are as follows:

- Introduction of a look-through method for funds and securitised products (when individual assets are 0.25% or more of equity capital).
- While applying Credit Risk Mitigation ("CRM") techniques, such as qualified guarantees, banks must recognise their exposure to CRM providers. The amount of exposure is the amount by which exposure to the original counterparty is being reduced.
- Call loan accounts are added to the scope of "credit" under these restrictions (with due dates other than intraday).

Major topics of Banking Act amendments in 2021

Expansion of business of Advanced Banking Service Companies

The following revisions have been made with respect to the Advanced Banking Service Companies introduced by the revision of the Banking Act in 2016:

- Expanding the definition of an Advanced Banking Service Company to include "operations that contribute to the revitalization of regions, the improvement of industrial productivity, and other aspects of building a sustainable society".
- Easing approval standards for Advanced Banking Service Companies that provide all or any of the following services ("Certain Advanced Banking Service Companies"):
  - FinTech services;
  - regional trading services with limited inventories and limited manufacturing and processing functions;
  - registered-type staffing services that contribute to the improvement of the business;
  - design, custom, sales, and maintenance of IT systems and programs developed by banks;
  - data analysis, marketing and advertising;
  - management of automatic teller machines, including their maintenance and inspection;
  - consultations related to the adult guardianship system and services relating to the affairs of adult guardians; and
  - other additional and incidental businesses.
- Easing governmental approval requirements for the acquisition of Certain Advanced Banking Service Companies. Previously, government approval was required for the acquisition of more than 5% of voting rights of a Certain Advanced Banking Service Company, but after the amendment, an approval is required only for the acquisition of more than 50% of such entity's voting rights (note, however, that a notification is required for acquisitions of more than 5% but less than 50% of its voting rights).
- In cases where a bank group that has been certified to possess certain qualities, such as having a certain level of financial soundness and governance, engages in "certain advanced services" as a subsidiary of a bank holding company, a notification system will be adopted dispensing with the need for individual approval.

Expansion of a bank's ancillary business

Businesses that mainly utilise management resources related to the banking business and contribute to the establishment of a sustainable society have been added to the ancillary businesses in which a bank can now engage. Specifically, these new businesses include:

- businesses such as consulting services and corporate matching services;
- registered-type staffing services that contribute to the improvement of the bank's business;
- design, custom, sales, and maintenance of IT systems and programs developed by banks;
- data analysis, marketing and advertising; and
- daily life support services for the elderly and other users provided by sales representatives of banks.

Deregulation of investment

In view of a shortage of providers of capital funds in the region, the following points have been revised within the investment regulations for a bank group:

- Expansion of the scope of operations of companies that specialise in investing:
  - Investments in venture business companies, business succession companies, and regional revitalisation business companies must be made through specialised investment companies. Before the amendment, the scope of business of specialised investment companies was limited to investments and loans, and operations incidental thereto. An addition of consulting and other services to the company's operations is to strengthen the hands-on support capabilities of specialised investment companies.

- Easing the requirements for venture business companies:
  - The numerical standards have been repealed, and it is now acceptable if the company is a small or medium-sized enterprise engaged in new business activities and 10 years have not yet passed since the later of the date of the establishment of the new company or the date of the commencement of the new business activities.
- Enabling early support of business revitalisation companies:
  - Requiring the preparation of management improvement and rehabilitation plans with the involvement of certain third parties other than the banking group instead of requiring a court decision to approve a rehabilitation plan in legal insolvency procedures, etc.
- The maximum period for holding of voting rights in the business succession companies has been extended from five years to 10 years.
- The limitation of investment in regional revitalisation companies has been increased from 50% to 100%.

Scope of business of foreign subsidiary companies and foreign sister companies

Before the amendment, when a Japanese bank group acquired a foreign financial institution that owned a foreign subsidiary, the bank group, as a general principle, was required to sell such foreign subsidiary within five years after the acquisition if the business of such foreign subsidiary conflicted with the scope of business restrictions under the Banking Act. However, this principle has now been changed and the application of the scope of business restrictions has been extended to 10 years after the acquisition. Thereafter, if there is a need for competition in the foreign country, the bank group may hold the foreign subsidiary without any time limitation subject to the FSA's approval.

Also, whereas, under the previous system, banks were not allowed to acquire foreign leasing companies or moneylenders that were also engaged in general business, with the 2021 amendment, banks are now permitted to acquire these businesses, and the scope of business restrictions has been extended to 10 years after the acquisition. Thereafter, if there is a need for competition in the foreign country, a Japanese bank group may own such foreign leasing companies and moneylenders without any time limitation subject to the FSA's approval.

Impact on the banking industry of the 2022 amendments to the Payment Services Act and the Banking Act

The amended Payment Services Act, etc. came into effect on June 1, 2023. This amendment clarifies the regulatory position of "Electronic Payment Instruments", i.e., so-called stable coins, and introduces a registration system for the intermediary acts of buying, selling, exchanging, managing, and mediating such Electronic Payment Instruments as a business. Also, the amendment clarifies that banks, trust companies, and fund transfer service providers are positioned as issuers of the Electronic Payment Instruments, and thus banks are allowed to issue stable coins as part of their inherent business of fund transfer transactions. Furthermore, the bank issuing the stable coins may also engage in "Electronic Payment Instrument Services" with regard to the stable coins it has issued by submitting a notification.

In addition, a new registration system for "Electronic Payment Handling Services" was introduced by the 2022 amendment to the Banking Act. Although the existence of multiple registration systems with similar names may cause confusion, this new system permits electronic fund transfers on behalf of banks only through registration, without obtaining a licence as a "Bank Agency Service", which has existed for some time.

Major topics of banking regulation amendments in 2023

Clarification of Demonstration Experiments exempted from the scope of business regulation

The FSA has clarified that pilot businesses conducted as Demonstration Experiments are exempt from the scope of business regulation by amending the Supervisory Guidelines in 2023.

In particular, the Supervisory Guidelines stipulate that when a Demonstration Experiment is conducted by a banking group, including a bank, as a preparatory act for the establishment of an Advanced Banking Service Company, the risks associated with the Demonstration Experiment should be examined on a case-by-case basis and that care should be taken not to affect the soundness of the bank or banking group and the proper management of its business. The term "Demonstration Experiment" here refers to an experiment in which a bank or a group company of a bank conducts a Demonstration Experiment within the scope of its preparatory activities for the establishment of an Advanced Banking Service Company in order to verify the profitability and business continuity of the operations to be conducted by the Advanced Banking Service Company before management decides whether or not to establish such a company.

Bank governance and internal controls

Under the Banking Act, a bank is required to be a stock company ("*Kabushiki Kaisha*"); as such, it has: (a) a board of directors; (b) a board of company auditors, an audit and supervisory committee, or nominating, compensating and auditing committees; and (c) an accounting auditor. The banks listed on the Japanese stock market are required to disclose their governance status pursuant to Japan's Corporate Governance Code, which takes the so-called "comply or explain" approach. Under this approach, in case a bank does not comply with the Code's recommendations, an explanation of the reasons for non-compliance needs to be disclosed. The "Comprehensive Guidelines for Supervision of Major Banks, etc." provide supervisory guidelines as to what kind of governance measures the banks should take. The Guidelines also stipulate the required internal controls for the banks, including compliance, countermeasures against financial crimes, AML/CFT and anti-social forces, and consumer protection.

Bank capital requirements

Japan is gradually revising its domestic prudential regulations based on the content of the Basel III agreement, which was finalised in the wake of the global financial crisis of 2008.

Capital adequacy ratio

The equity ratio is calculated using the amount of risk assets as the denominator and equity capital as the numerator. There are two methods for calculating risk assets: the standard method, which is calculated by multiplying the amount of assets held by a certain risk weight; and the internal ratings-based approach, which calculates the amount of risk assets by substituting the default rate estimated according to the banks' internal ratings into a predetermined formula. Adoption of the internal rating methodology requires regulatory approval to meet requirements, but Basel III has limited the use of the methodology for some risk exposures, including equity risk exposures.

The Capital Adequacy Ratio Regulation requires the capital adequacy ratio to exceed a certain level. This certain level varies widely depending on whether the bank in question is an internationally active bank (a bank with an overseas business base) or a domestic bank (a bank without an overseas business base).

For internationally active banks, the following three criteria must be met:

- The total capital ratio (calculated by dividing the sum of Common Equity Tier1 plus other Tier1 plus Tier2 by risk-weighted assets) may not be less than 8%.
- Tier1 capital ratio (calculated by dividing the sum of Common Equity Tier1 plus other Tier1 by risk-weighted assets) may not be less than 6%.
- Common Equity Tier1 ratio (Common Equity Tier1 divided by risk-weighted assets) may not be less than 4.5%.

In addition, the capital conservation buffer (2.5%), the countercyclical buffer (2.5% maximum, 0% within Japan and set for each country) and G-SIBs (global systemically important banks)/D-SIBs (domestic systemically important banks) (3.5% maximum, and 0.5 to 1.5% for banks selected in Japan) have been phased in for internationally active banks since 2016. In addition, G-SIBs are required to have Total Loss-Absorbing Capacity, which is based on the Basel Framework.

Domestic banks, on the other hand, are required to maintain a capital adequacy ratio (core capital divided by risk-weighted assets) of no less than 4%.

In addition, although not by way of a capital requirement, banks need to satisfy, as a prudential requirement, other standards such as liquidity standards (liquidity coverage ratio, stable funding ratio) and leverage ratio.

Early Correction Measures

In Japan, a violation of the capital adequacy standards is an important benchmark used by the authorities to take administrative measures, including issuance of business improvement orders to banks. When a bank violates the capital adequacy ratio standards, an order for business improvement is first issued, and when the ratio of non-achievement increases to or exceeds a certain level, an order for business reduction, business suspension, or discontinuation of banking business may be issued ("Early Correction Measures").

Banks that are not eligible for Early Correction Measures have mechanisms to encourage management improvement aimed at maintaining and improving soundness based on risks not captured in the capital adequacy ratio (such as concentration risk, interest rate risk) ("Early Warning System").

For foreign bank branches, corresponding capital adequacy ratio standards have not been introduced, and neither capital adequacy requirements nor Early Correction Measures are being applied to them.

Rules governing banks' relationships with their customers and other third parties

Provision of information to depositors

When accepting deposits, banks must provide their customers with information on such deposits. Specific information to be provided is stipulated in the Regulation for Enforcement of the Banking Act, which contains detailed explanations of the deposits, such as clarification of interest rates on major deposits, the amount of commissions, and deposits subject to deposit insurance, and information on the absence of principal guarantees in deposits containing derivatives. In addition, a bank that handles securities or insurance products must provide an explanation that securities or insurance products are not deposits.

Customer information management, including compliance with the Personal Information Protection Law, and management of outsourcees

Banks are required to take measures to ensure the proper management of customer information obtained in connection with their business. Details on customer information management

are set forth in supervisory guidelines. Banks dealing with personal information relating to customers who are individuals must comply with regulations related to the Personal Information Protection Law. In particular, financial institutions are required to take more strengthened measures than general companies in accordance with the Guidelines on the Protection of Personal Information in the Financial Sector.

Banks are also required to take measures to ensure proper performance of their business when entrusting business to others. Details on the management of entities to which business is outsourced are provided in supervisory guidelines. For example, in an outsourcing contract, banks should take measures such as imposing on the service-providing entity the same customer information management obligations as those applicable to the banks.

Large Exposure Restrictions

Under the Large Exposure Restrictions, the Banking Act prohibits banks and groups of banks from extending credit to a specific company or person or parties related to them in excess of a certain proportion of their own capital. The amount of credit extended to certain parties will be aggregated, including parent-child and sibling companies (based on the control criteria) and affiliated companies (based on the impact criteria). Credit as used herein refers to guarantees, equity investments, debts, and the like, as more specifically stipulated in the Regulation for Enforcement of the Banking Act and the FSA Public Notice. In general, the maximum amount of credit is calculated by multiplying equity capital by 25%; however, for some recipients, such as major shareholders of banks, the amount of equity capital is to be multiplied by 15%. The amount of equity capital is the amount of Tier1 equity for internationally active banks and the amount of total capital for domestic banks. On the creditor side, the amount of credit extended by the bank and its subsidiary corporation, etc. (parent-child relationships based on the control criteria) is combined to determine whether that amount exceeds the upper limit of the amount of credit.

Arm's length rule

A bank may not conduct transactions with its Specified Related Parties or their customers if the terms of such transactions would prejudice the bank or unduly prejudice any of the Specified Related Parties as compared to the ordinary terms and conditions of transactions conducted by the bank; provided, however, that the foregoing does not apply when there is an unavoidable reason, such as when funds are loaned within the financial group, and such transaction has been approved by the authorities.

Prohibited acts

The Banking Act prohibits banks from engaging in certain acts, as set forth below. In the past, some banks have been found to have abused their "dominant bargaining position"; moreover, sales of unnecessary bundled products by the banks have created notable problems. In recent years, however, it has been pointed out that banks do not necessarily hold a dominant bargaining position *vis-à-vis* their customers.

False notice

Making false statements to customers is prohibited.

Offering conclusive judgment

Banks are prohibited from providing customers with conclusive judgments regarding matters that are not certain, or telling them things that might lead them to believe that such matters are indeed certain.

Bundled sales

As a general rule, banks are prohibited from providing customers with credit or promising to extend credit on the condition that they carry out transactions pertaining to the business operated by the banks or a specified person to the banks. By way of exception, when it is not unreasonable, e.g., when it is reasonable to carry out multiple transactions as a package, the foregoing prohibition does not apply. Banks are also prohibited from unjustly providing customers with credit or promising to extend credit on the condition that they deal with a business designated by them.

Non-announcement of material facts

Failure to inform a customer of an important matter in light of that customer's knowledge, experience, financial status, or purpose of executing a given transaction in accordance with the content and method of business it engages in, or informing a customer of something that is likely to lead to a misunderstanding, is prohibited.

Abuse of dominant bargaining position

An act that unjustly uses a dominant bargaining position of a bank to disadvantage a customer with a view to implementing a transaction is prohibited.

Development of conflict-of-interest management systems

Banks must establish a system for ensuring that the interests of their customers and their subsidiary financial institutions are not unreasonably harmed in connection with the transactions of the banks and their parent-subsidiary financial institutions. This is referred to as the establishment of a conflict-of-interest management system.

Specifically, banks are required to: (1) establish systems to identify the transactions they intend to enter into (to identify transactions that might unduly harm the interests of customers); (2) establish systems to ensure the proper protection of customers; (3) formulate and publicise policies relating to (1) and (2); and (4) preserve records pertaining to (1) and (2). Examples of (2) include setting up the so-called Chinese Walls, changing the terms and methods of trading, suspending trading, and disclosing of information.

Confidentiality

Based on precedents, financial institutions may not, without justifiable cause, disclose customer information, such as information on transactions with customers and information on customers' credit obtained in connection with transactions with customers. These obligations of financial institutions are generally referred to as confidentiality obligations. If it is clear that financial institutions are leaking customer information without legitimate cause in violation of confidentiality obligations, the authorities may intervene (by way of issuing instructions or imposing supervision) on the ground that there is a problem with the customer information management system.

Principles of customer-oriented business conduct

There are seven principles of customer-oriented business conduct and each principle is accompanied by interpretation notes. These principles were formulated with the aim of encouraging financial businesses to compete for the provision of better customer-oriented financial products and services. Financial institutions that have adopted customer-oriented principles are required to formulate and publish a clear policy for realising customer-oriented business conduct. Most banks in Japan, including branches of foreign banks, have adopted these principles.

Customer-oriented principles employ the so-called "Principles-Based Approach" to encourage competition among financial companies for customers looking for high-quality, customer-oriented financial products and services. In addition, financial institutions that accept customer-oriented principles are not required to implement all of the seven principles; instead, the concept of "comply or explain" has been adopted, allowing them to explain the reasons and implement alternative measures *in lieu* of some of the principles. Furthermore, even if banks violate any of the principles they have adopted, they are not automatically subject to administrative actions by the FSA.

AML/CFT

With regard to AML/CFT in Japan, the related laws and regulations, such as the Act on Prevention of Transfer of Criminal Proceeds and the Foreign Exchange and Foreign Trade Act ("FEFTA"), require banks, among other things, to confirm customer identity and the purpose of the transaction at the time of opening of an account, and to report to the authorities any suspicious transactions involving criminal proceeds. In addition, financial institutions are required to comply with the content of the Guidelines for AML and CFT published by the FSA. According to these Guidelines, specified business operators, including financial institutions, need to identify and assess risks related to customers' operations in a timely and appropriate manner and take mitigating measures commensurate with such risks (so-called "risk-based approaches"), while taking into account any changes in the international situation. The results of the Fourth Round Mutual Evaluation of Japan by the Financial Action Task Force ("FATF") were published in August 2021, and Japan was rated as a country requiring an enhanced follow-up. Faced with that result, Japanese authorities are stepping up their supervisory efforts by conducting inspections performed simultaneously over various financial institutions carrying high AML/CFT risk. Furthermore, Japanese authorities may also seek to further strengthen regulations relating to AML/CFT. The FSA has requested financial institutions to complete their compliance with the requirements stipulated in the Guidelines by the end of March 2024. The FSA has explicitly stated that, should the institutions fail to comply by this deadline, it may issue administrative orders. In the context of the Fourth Round Mutual Evaluation of Japan by FATF, it has been pointed out that there is a need for appropriate exercise of administrative authority concerning AML/CFT measures. Financial institutions should be fully aware of the possibility of administrative orders being imposed on those institutions recognised as having insufficient compliance measures.

Regulatory framework on economic sanctions

Under the FEFTA in Japan, and under U.S. OFAC regulations in the U.S., banks are required to confirm at the time of entering into transactions with customers that (a) the transactions are not conducted with sanctioned countries, regions or people (such as specially designated nationals), (b) customers do not have assets in such countries or regions, and (c) the purpose of currency remittance is not related to such countries or regions.

As a recent development, to ensure the effectiveness of economic sanctions, an amendment to the FEFTA was enacted, requiring foreign exchange transaction service providers to comply with the Foreign Exchange Transaction Service Providers Compliance Standards as prescribed in the FEFTA. Under these standards, measures and systems for dealing with risks related to economic sanctions are now explicitly required as obligations under the FEFTA. In response, in November 2023, "Guidelines regarding the Foreign Exchange Inspection" were reorganised and published as "Guidelines for Compliance with the Foreign Exchange and Foreign Trade Act for Foreign Exchange Transaction Service Providers".

These Guidelines present interpretations and perspectives on compliance with the FEFTA, including the Foreign Exchange Transaction Service Providers Compliance Standards, and also provide inspection guidelines for inspectors conducting foreign exchange inspections.

Financial alternative dispute resolution

In Japan, alternative dispute resolution ("ADR") procedures are in place in addition to lawsuits to resolve disputes between banks and their customers. Financial ADRs impose three obligations on financial institutions in order to enhance the protection of users of banking services: (i) acceptance of procedures; (ii) submission of business explanations and materials; and (iii) honouring the results. In the case of banks, the Japanese Bankers Association ("JBA") is the designated dispute resolution organisation. It is necessary for banks to conclude a Basic Contract of the Implementation of Dispute Resolution Procedures with the JBA. And, if a petition for a financial ADR is filed by a customer, the bank is obligated to execute procedures based on that Contract.

Deposit insurance system by the DICJ

In Japan, as in other countries, the insurance system aims to protect depositors' deposits in the event of bankruptcy of a financial institution. The system works as follows: financial institutions pay deposit insurance premiums to the DICJ, and, in the event that a financial institution fails, the DICJ protects depositors by paying a certain amount of insurance money. Regarding the scope of the protection, the deposits for settlement are protected for up to the total amount of principal, and the principal and interest of general deposits are protected for up to 10 million yen. Amounts exceeding 10 million yen may be repaid either in part or in full depending on the status of the assets of the failed financial institution. In contrast, foreign currency deposits, certificates of deposit, and financial bonds are not covered by this protection.

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Koji Kanazawa has advised multiple financial institutions on all aspects of their operations, with a focus on financial regulatory matters. In particular, with his experience working at the Japanese Financial Services Agency, he has worked on compliance/risk management issues of financial institutions including AML/CFT, countermeasures against anti-social forces, and personal data protection. He has represented both Japanese and overseas clients, including banks, insurance companies, asset management companies, investment funds, credit card companies, leasing companies and non-bank finance companies. Such representation extends to complex financial regulatory matters (including issues relating to the Banking Act, the Insurance Business Act, the Financial Instruments and Exchange Act, the Money-lending Control Act, the Investment Act and the Asset Securitization Act), structured finance and litigation arising from sales of financial instruments.

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Katsuya Hongyo represents Japanese and overseas clients, including banks, insurance companies, asset management companies, and fintech start-ups. His practice focuses on financial regulation, finance, mergers and acquisitions, compliance/risk management, and litigation, drawing in large part on his experience working as a visiting attorney at Kirkland & Ellis LLP in Chicago and as a seconded attorney at the Japanese Financial Services Agency. During his secondment, he revised financial regulations to enable banks to invest in trading companies that expand local SMEs' sales channels and clarify requirements for banks to deal with cryptoassets or operate information banking businesses. He also partly drafted the Act on Special Provisions of the Antimonopoly Act, making it easier for banks to integrate their business, and responded to inquiries from banks for an interpretation of banking regulations.

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Liechtenstein

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Introduction

As of the end of 2022, there were 12 banks, two e-money institutions and one payment institute licensed in Liechtenstein and subject to the prudential supervision of the Liechtenstein Financial Markets Authority (*Finanzmarktaufsicht* – "**FMA**"). Traditionally, Liechtenstein banks' core business activities are private banking and asset management for local and international private and institutional clients. At the end of 2022, Liechtenstein banks and their group companies managed client assets in the amount of 411.4 billion Swiss francs.

The three largest Liechtenstein banks are LGT AG, Liechtensteinische Landesbank AG, and VP Bank AG. The latter two are publicly listed and their shares traded on the SIX Swiss Exchange. LGT AG, on the other hand, remains privately owned by the Liechtenstein Princely family.

In recent years, Liechtenstein banks and the financial sector as a whole have increased efforts to implement and comply with high standards of anti-money laundering and anti-terrorist financing. In June 2022, MONEYVAL issued its fifth country report on Liechtenstein with good results.

Recent developments in the field of private banking and wealth management have led to a consolidation amongst existing Liechtenstein banks, not least to spread the increasing regulatory burden; others have expanded their business outside of Liechtenstein.

At the same time, the Liechtenstein government has continued its efforts to improve the regulatory framework to attract fintech start-ups and innovative financial service providers.

With its AAA-rating from Standard & Poor's (confirmed in 2023) and full market access to the European single market through its membership in the European Economic Area ("**EEA**"), Liechtenstein remains an attractive wealth management centre in the heart of Europe.

Regulatory architecture: Overview of banking regulators and key regulations

Supervisory bodies

Liechtenstein banks are supervised by a single regulator: the FMA. The FMA is responsible for both prudential supervision and consumer protection.

Based on the Currency Treaty with Switzerland, the official currency in Liechtenstein is the Swiss franc, and the Swiss National Bank (*Schweizer Nationalbank* – "**SNB**") functions as the central bank for Liechtenstein. Swiss provisions on monetary, credit and currency policy therefore apply directly in Liechtenstein and the SNB has the power to enforce these provisions in relation to Liechtenstein banks. Liechtenstein banks also have reporting obligations to the SNB.

Liechtenstein is a member of the EEA, which comprises the members of the European Union ("**EU**") as well as Iceland, Norway and Liechtenstein. EU directives and regulations that have been incorporated into the EEA Agreement have to be implemented or applied directly, as the case may be, by Liechtenstein.

In particular, Regulation (EU) 1093/2010 establishing the European Banking Authority ("**EBA**") has been incorporated into the EEA Agreement and therefore has direct effect in Liechtenstein. The EBA is one of three EU supervisory authorities that have been created to strengthen oversight of cross-border groups and establish a European single rulebook applicable to all financial institutions in the EU internal market. EU legislation can confer power upon the EBA to take measures with binding effect in an EU Member State or on banks having their seat in the EU. The particular institutional set-up of the EEA Agreement made it necessary to incorporate the Regulation with amendments in this respect. Measures taken by the EBA can have no direct effect in Iceland, Norway and Liechtenstein and are not binding on banks having their seat in these EEA Member States. Instead, the European Free Trade Association ("**EFTA**") Surveillance Authority will adopt decisions with binding effect on the basis of drafts prepared by the EBA, which drafts were requested by the EFTA Surveillance Authority or were initiated by the EBA itself. Guidelines or recommendations issued by the EBA have to be applied by Liechtenstein banks if the FMA notifies the EBA within two months of their publication that it intends to comply with them.

Furthermore, Liechtenstein is obliged to comply with Regulation (EU) 1092/2010 on the financial supervision of the EU at macro level and establishing a European Systemic Risk Board ("**ESRB**"). In particular, the Regulation provides for the creation of the ESRB. The ESRB is an unincorporated body with responsibility for macroprudential oversight of the EEA financial system with the aim of contributing to the prevention or mitigation of systemic risks to financial stability in the EEA stemming from developments within the financial system. In carrying out its tasks, the ESRB is empowered, in particular, to make recommendations on remedies to identified risks. EEA Member States must comply with these recommendations.

On a national level, the FMA, the Liechtenstein government and the recently established Financial Stability Council are responsible for monitoring financial stability and implementing macroprudential policy.

Key legislation

EEA Member States have to implement EEA-relevant EU legislation that has been incorporated into the EEA Agreement by a corresponding decision of the EEA Joint Committee. One of these EEA-relevant legal areas is financial services. For this reason, Liechtenstein banking regulation is largely based on EU legislation.

The key laws applicable to banks are:

- The Banking Act (*Bankengesetz* – "**BankG**"; LGBl. 1992/108) and the Banking Ordinance (*Bankenverordnung* – "**BankV**"; LGBl. 1994/022), which set out the requirements for the pursuit of banking activities and provision of the investment and ancillary services listed in Annex I, Sections A and B of the Markets in Financial Instruments Directive (Directive 2014/65 – "**MiFID II**") in Liechtenstein. The main banking activities include deposit-taking, lending, custody of securities, payment transfer services, the assumption of guarantees, surety and similar liabilities as well as trading in foreign currencies.

  Undertakings require a licence issued by the FMA in order to take up an activity or service covered by the BankG on a professional basis in Liechtenstein. Banks or

investment firms having their seat in another Member State of the EEA may pursue activities covered by the fourth Capital Requirements Directive (2013/36/EU – "**CRD IV**") or MiFID II in Liechtenstein either on a cross-border basis or through a Liechtenstein branch if they have been licensed for such activities in their home Member State. The BankG and BankV contain detailed provisions regarding formal and material requirements for obtaining and retaining a banking licence, licensing procedures, ongoing supervision by the FMA and sanctions.

The BankG and BankV implement several EU directives in the area of banking and investment services regulation into Liechtenstein law, including the CRD IV and MiFID II. Important EU regulations such as the Capital Requirements Regulation (575/2013 – "**CRR**") and the Markets in Financial Instruments Regulation (600/2014 – "**MiFIR**") apply directly in Liechtenstein.

Furthermore, several acts related to the provision of financial services are of particular relevance to Liechtenstein banks:

- The Due Diligence Act (*Sorgfaltspflichtsgesetz*; LGBl. 2009/047) and the Due Diligence Ordinance (*Sorgfaltspflichtsverordnung*; LGBl. 2009/098), which implement the recommendations of the Financial Action Task Force to combat money laundering and terrorist financing as well as EU anti-money laundering directives in force in the EEA.
- The Bank Recovery and Resolution Act (*Sanierungs- und Abwicklungsgesetz* – "**SAG**"; LGBl. 2016/493) and the Bank Recovery and Resolution Ordinance (*Sanierungs- und Abwickungsverordnung*; LGBl. 2016/509), which implement the EU Bank Recovery and Resolution Directive (2014/59/EU – "**BRRD**"), as amended by Directive 2019/879/EU ("**BRRD II**"). The SAG applies to Liechtenstein banks and other financial institutions and establishes a framework for the recovery or orderly resolution of failing banks. It grants wide powers to the FMA in its capacity as the national resolution authority.
- The EU Market Abuse Regulation (596/2014 – "**MAR**"). The Liechtenstein implementing provisions have been adopted in the EEA Market Abuse Regulation Implementation Act (*EWR-Marktmissbrauchsverordnung-Durchführungsgesetz*; LGBl. 2020/155).
- The Payment Services Act (*Zahlungsdienstegesetz*; LGBl. 2019/213) and the Payment Services Ordinance (*Zahlungsdiensteverordnung*; LGBl. 2019/233), which implement the Second EU Payment Services Directive (2015/2366). They contain provisions regarding the formal and material requirements for the provision of payment services in Liechtenstein and the rights and obligations of payment service providers and their customers.
- The E-Money Act (*E-Geldgesetz*; LGBl. 2011/151) and the E-Money Ordinance (*E-Geldverordnung*; LGBl. 2011/158), which implement the EU E-Money Directive (2009/110/EC). They contain provisions regarding the formal and substantial requirements for issuing e-money on a professional basis as well as the rights and obligations of e-money institutions and their customers.
- The Foreign Account Tax Compliance Act (*Gesetz vom 4. Dezember 2014 über die Umsetzung des FATCA-Abkommens zwischen dem Fürstentum Liechtenstein und den Vereinigten Staaten von Amerika* – "**FATCA**"; LGBl. 2015/007), which transposes the Intergovernmental Agreement between Liechtenstein and the United States of America to Improve International Tax Compliance and to Implement FATCA into Liechtenstein law. It requires Liechtenstein banks and other financial institutions to report to the Internal Revenue Service information about financial accounts held by US persons. The Agreement signed by Liechtenstein follows Model 1 according to which taxpayer information is exchanged between national tax authorities.

- The Act on International Automatic Information Exchange in Tax Matters (*Gesetz über den automatischen Informationsaustausch in Steuersachen*; LGBl. 2015/355) and the Ordinance on International Automatic Information Exchange in Tax Matters (*Verordnung über den automatischen Informationsaustausch in Steuersachen*; LGBl. 2015/358), which implement the automatic exchange of financial account information in tax matters developed by the OECD.
- Regulation (EU) 1286/2014 on basic information sheets for packaged investment products for retail investors and insurance investment products ("**PRIIPs Regulation**"), which is directly applicable in Liechtenstein due to a national provision. The implementing provisions were adopted in the PRIIP Implementing Act (*PRIIP-Durchführungsgesetz*; LGBl. 2016/513) and the PRIIP Implementation Ordinance (*PRIIP-Durchführungsverordnung*; LGBl. 2017/232). The PRIIPs Regulation has yet to be incorporated into the EEA Agreement but has been applicable in Liechtenstein on a unilateral basis since 1 January 2018.
- The Beneficial Owner Register Act (*Gesetz über das Verzeichnis wirtschaftlicher*; LGBl. 2019/008), which has provided for a register of beneficial owners of Liechtenstein entities and trusts into which all beneficial owners or controlling persons of Liechtenstein entities and trusts shall be entered.
- The Cyber-Security Act (*Cyber-Sicherheitsgesetz*; LGBl. 2023/269), which determines measures in order to achieve a high level of security for network and information systems.
- In addition, banks and e-money institutions have to observe guidelines (*Wegleitungen*), directives (*Richtlinien*) and communications (*Mitteilungen*) issued by the FMA, as well as the guidelines and recommendations issued by the EBA with which the FMA complies.

Recent regulatory themes and key regulatory developments in Liechtenstein

Noteworthy legal and regulatory developments in 2022 and 2023 include the following:

Sustainability in the financial services sector

Liechtenstein has implemented the Delegated Directive (2021/1269/EU) regarding the integration of sustainability factors into the product governance obligations into the BankV. The law entered into force in September 2022.

Furthermore, Commission Delegated Regulation (EU) 2022/1288, which sets out regulatory technical standards for sustainability-related disclosures in the financial sector pursuant to the Disclosure Regulation, has directly applied in Liechtenstein since 1 January 2023.

General and specific framework for securitisation

The Securitisation Regulation (2017/2402) lays down a general framework for securitisation and creates a specific framework for simple, transparent and standardised securitisation. The provisions have been enacted in the EEA Securitisation Implementation Act (*EWR-Verbriefungs-Durchführungsgesetz*; LGBl. 2020/504). The law entered into force on 1 November 2022.

European covered bonds

Liechtenstein has legally defined the requirements regarding the issue of covered bonds. The Liechtenstein Act on European Covered Bonds (*Gesetz über Europäische gedeckte Schuldverschreibungen*; LGBl. 2023/142) implements Directive (EU) 2019/2162 on the issue of covered bonds and covered bond public supervision. The law entered into force on 1 May 2023. In addition, Liechtenstein has implemented a Regulation on European

Covered Bonds (*Verordnung über Europäische gedeckte Schuldverschreibungen*; LGBl. 2023/170), which entered into force on 1 May 2023. Furthermore, Liechtenstein amended Art. 3 para. 3 lit g of the BankG in order to define the "issue of covered bonds in accordance with EUGSVG" as banking business pursuant to the BankG.

Restructuring of credit institutions and investment firms

Along with the Implementing Directive (BRRD) establishing a framework for the recovery and resolution of credit institutions and investment firms and BRRD II as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms, Liechtenstein has amended the SAG as well as the BankG regarding capital requirements of credit institutions and investment firms in relation to restructuring processes. The amendments to the SAG and BankG entered into force on 1 May 2023.

Cybersecurity

In order to define measures to achieve a high level of security of network and information systems of providers of essential services in the banking sector, the Liechtenstein Cyber-Security Act entered into force on 1 July 2023 and then, on 6 September 2023, the Liechtenstein Cyber-Security Regulation (*Cyber-Sicherheitsverordnung*; LGBl. 2023/359) entered into force. The Cyber-Security Regulation includes regulations regarding the banking and financial market infrastructures sector. The law implements Directive (EU) 2016/1148 and executes Regulation (EU) 2021/887.

Upcoming changes

Several European legal acts relevant to the banking sector are pending entry into force in Liechtenstein:

- The Securities Financing Transactions Regulation (2015/2365) ("**SFTR**"). The provisions requiring national implementation have been enacted in the EEA Securities Financing Transactions Implementation Act (*EWR-Wertpapierfinanzierungsgeschäfte-Durchführungsgesetz*; LGBl. 2019/362). The FMA has published guidelines for the implementation of the SFTR. The Implementing Act and the FMA guidelines will enter into force in Liechtenstein once the SFTR has entered into force in the EEA.
- The Payment Accounts Directive (2014/92/EU – "**PAD**"). Liechtenstein will implement PAD in separate legal acts, the Payment Account Act (*Zahlungskontengesetz*) and the Payment Account Ordinance (*Zahlungskontenverordnung*). They will enter into force once PAD has been incorporated into the EEA Agreement.
- European crowdfunding: Liechtenstein has implemented Regulation 2023/1503 on European Crowdfunding Service Providers (*EWR-Schwarmfinanzierungs-Durchführungsgesetz*; LGBl. 2023/414). The law will enter into force once the Regulation is incorporated into the EEA Agreement.
- Regulation (EU) 2022/858 ("**MICAR**") was incorporated into the EEA Agreement on 5 July 2023. Upon entry into force of the EEA Joint Committee Decision, MICAR will become directly applicable in Liechtenstein. However, specific provisions of MICAR require direct implementation into Liechtenstein law and certain provisions of the BankG will be amended for this purpose.
- Banks and investment firms have been subject to the same supervisory regime for a long time. However, the risks of banks and investment firms diverge substantially. In order to overcome any uncertainties and difficulties, an independent supervisory regime for investment firms was developed on a European level. Regarding the implementation of Directive (EU) 2019/2034 and execution of Regulation (EU) 2019/2033, Liechtenstein

is envisaging a comprehensive revision of the BankG as well as the adoption of an Investment Firms Act (*Wertpapierfirmengesetz* – "**WPFG**") and an Investment Services Act (*Wertpapierdienstleistungsgesetz* – "**WPDG**").

Bank governance and internal controls

General

The key requirements for the governance of banks are set out in the BankG and BankV and the directly applicable EU law, such as the CRR, which is implemented into Liechtenstein by virtue of the EEA Register.[1] In addition, the FMA complies with relevant guidelines and recommendations of the EBA.

A Liechtenstein bank shall have: (a) a board of directors for ultimate direction, supervision and control; (b) a management board responsible for the operational management consisting of at least two members, who shall exercise joint responsibility for their activities and may not simultaneously be members of the board of directors; (c) an internal audit, which shall report directly to the board of directors; (d) a risk management system independent of the operational business; and (e) adequate procedures for employees to report violations of the BankG, CRR and MiFIR as the case may be.

The division of responsibilities between the board of directors and the management board must ensure proper supervision of business conduct. Banks and investment firms shall ensure that the members of the board of directors and the management board have the necessary knowledge, skills, and experience ("fit and proper") to collectively understand the activities of the bank, including the related risks. The composition of the management board and the board of directors reflects an appropriately broad range of experience. All members of the board of directors and the management board shall commit sufficient time to performing their functions and prove this to the FMA upon request. Each member of the board of directors shall: (a) act with honesty, integrity and impartiality; the fact that a person is a member of a related company or legal entity does not in itself constate an impediment to acting with impartiality; (b) effectively monitor, evaluate and, if necessary, challenge the decisions of the management; and (c) monitor and supervise management decision-making.

Board of directors

The board of directors of a Liechtenstein bank is responsible for the overall direction, supervision and control of the bank. The board of directors has non-transferable responsibilities such as: (i) stipulating the internal organisation and issuing internal regulations for corporate governance, business conduct and risk strategy, in particular by ensuring a division of responsibilities and implementation of measures to prevent conflicts of interest, as well as their regular review and amendment; (ii) stipulating the accounting system, financial control and financial planning; (iii) appointment and removal of the management board; (iv) supervising the management board in respect of the development of the business as well as their compliance with laws and regulations; (v) compiling business reports and approving interim financial statements, preparing the general meeting of shareholders and executing its resolutions; (vi) monitoring disclosure and communication; and (vii) regular monitoring and review of the suitability and implementation of the bank's strategic objectives in the provision of investment services, ancillary services and investment activities, the effectiveness of the bank's business regulations and the appropriateness of the bank's policy regarding the provision of services to clients, and taking the necessary steps to remedy any shortcomings.

The board of directors has to consist of at least three members. If the board of directors consists of five or more members, it may delegate responsibilities not expressly reserved by

law to a committee composed of at least three board members. Banks of material significance for the national economy have to set up – in addition to the standard committees – a risk committee, remuneration committee, nomination committee, and an audit committee.

Management board

The management board of a bank is responsible for the business operation and has to consist of at least two members with adequate experience and qualifications ("fit and proper"). Members of the management board may not, at the same time, be members of the board of directors of the same bank.

Remuneration

Liechtenstein banks are required to stipulate and implement sound remuneration policies pursuant to the requirements set out in the CRR and Annex 4.4 BankV as well as relevant Level II and Level III acts issued by the European Commission or the EBA, such as the EBA guidelines on sound remuneration policies (EBA/GL/2021/04) and remuneration policies and practices related to the sale and provision of retail banking products and services (EBA/GL/2016/06). Banks of material significance have to set up a remuneration committee consisting of members of the board of directors.

Further bodies

Banks also need to have an internal audit department that reports directly to the board of directors of the bank. For the sake of clarity, the business operations of a Liechtenstein bank shall be examined and audited every year by an external, independent audit company, which shall be acknowledged by the FMA.

Furthermore, banks shall have a risk management system independent of the operational business, a dedicated compliance department, and appropriate procedures by which employees can report violations of the BankG, CRR and MiFIR. Personnel charged with key functions need to have a good repute as well as adequate experience and professional qualifications. Banks and investment firms must report or submit to the FMA the key functions and the personnel charged with key functions.

Place of management

The effective place of management of a bank has to be in Liechtenstein. For this reason, the FMA requires the members of the management board to effectively work in and from Liechtenstein. In addition, a bank has to demonstrate in the licensing process that it will have sufficient substance in the form of office space and key personnel employed in Liechtenstein to be able to effectively operate its business in and from Liechtenstein.

Outsourcing

Banks and investment firms may enter into agreements with third parties for the outsourcing of processes, services or activities. Outsourcing must be in line with Art. 14a BankG and must comply with the relevant guidelines of the EU supervisory authorities. Banks may outsource certain functions without the prior approval of the FMA if the outsourcing guidelines pursuant to Art. 34b BankV are observed. Outsourcing of internal auditing is only permitted with the approval of the FMA. Other functions defined as key functions pursuant to Art. 35 BankV may be outsourced, but only after prior notification to the FMA.

The overall direction, supervision and control of the bank by the board of directors and the core management duties may not be outsourced. The bank is required to act with due diligence when selecting and instructing an outsourcing provider, and has to have appropriate resources to adequately monitor the outsourcing provider on a continuing basis.

Bank capital requirements

A bank must have a fully paid-up capital of at least 10 million Swiss francs or the equivalent in euros or US dollars at the time of its authorisation.

In the case of investment firms, the minimum capital must amount to at least 730,000 Swiss francs or the equivalent in euros or US dollars. The FMA has the power to reduce the amount of the initial capital in certain cases, taking into account the nature and scope of the intended business of a bank or investment firm. Pursuant to Art. 24 para. 2 BankG, the initial capital may not be less than 1 million Swiss francs or the equivalent in euros or US dollars in the case of banks. It must be apparent from the business plan at the time of authorisation that the bank's or investment firm's own funds will not fall below the initial capital after taking up business.

Rules governing banks' relationships with their customers and other third parties

General

In Liechtenstein, there is no law that exclusively governs the relationship between banks on the one hand and customers and other third parties on the other hand. In fact, the general rules and provisions on contracts and legal transactions, which are laid down in the Liechtenstein Civil Code (*Allgemeines Bürgerliches Gesetzbuch* – "**ABGB**"; LGBl. 1003/001), shall be applicable to the relationship between banks, customers and other third parties, too.

From the various types of contracts laid down in the ABGB, the contract of mandate is probably deployed most often in the banking business. Pursuant to § 1009 ABGB, the agent is obliged to procure the transaction diligently and honestly in accordance with his promise and the granted power of attorney and – with the exception of § 1009a ABGB – to transfer all benefits arising out of the transaction to the principal. Although the agent has been granted a limited power of attorney, he is entitled to use all means that are necessarily connected with the nature of the transaction or conform to the declared intention of the principal. If he exceeds the limitations of the power of attorney, he is liable for the consequences.

If, however, the agent is a bank, an investment firm or an asset management company, it may, except in the case of independent investment advice and portfolio management, assume that the principal has waived his right to be transferred any fees, commissions or grants received or still to be received by the agent from third parties, provided that: (a) the agent has complied with all of its disclosure obligations prior to the conduct of business; and (b) the principal has instructed the agent to carry out the transaction after such disclosure. Furthermore, the agent is obliged to point out the mentioned legal consequences in its General Terms and Conditions or other pre-formulated terms and conditions of business, as the case may be (*cf.* § 1009a ABGB).

Having said that, Liechtenstein banks usually have their own General Terms and Conditions on which they would base any relationship with their customers. In order to be valid and applicable, General Terms and Conditions need to meet certain criteria. Firstly, unusual provisions used by the bank in General Terms and Conditions (or standard contract forms) do not become part of the contract if they are detrimental for the customer and the customer would not have to expect these provisions due to the circumstances, in particular due to the formal appearance of the contract, unless the bank expressly made the customer aware thereof (*cf.* § 864a ABGB). Furthermore, a contractual provision contained in General Terms and Conditions that does not determine either of the mutual main obligations is void in any event if it causes a substantial imbalance of the contractual rights and obligations to the detriment of the customer when considering all circumstances of the case (*cf.* § 879 para. 3 ABGB).

Furthermore, certain provisions laid down in the Consumer Protection Act (*Konsumentenschutzgesetz* – "**KSchG**"; LGBl. 2002/164) shall be considered as well. The KSchG, which per definition contains more favourable provisions for customers, supersedes provisions of the ABGB that were otherwise applicable amongst individuals.

Cross-border banking activities

As a principle, a bank shall be entitled to take up its business in Liechtenstein only on the basis of a licence issued by the FMA.

Yet, under the freedom to provide services, a bank having its seat in one of the countries of the EEA may also take up its banking activity in Liechtenstein provided the competent authority of its home Member State has notified the FMA prior to its first-time activity in Liechtenstein (passport).

A bank outside the EEA may provide banking services in Liechtenstein only through a branch in Liechtenstein. The establishment of such branch shall be subject to a licence that shall be issued by the FMA.

Other than that, banks from third countries may not provide any banking services in Liechtenstein unless on a "reverse solicitation" basis, although the criteria for such "reverse solicitation" are not entirely clear.

Conciliation board

By virtue of the ordinance of 27 October 2009 on the extrajudicial conciliation board in the financial services sector (*Verordnung vom 27. Oktober 2009 über die aussergerichtliche Schlichtungsstelle im Finanzdienstleistungsbereich*; LGBl. 2009/279), the Liechtenstein legislator has introduced an extrajudicial conciliation board that supersedes the previously existing bank ombudsman.

The conciliation board may be called upon – amongst others – to settle disputes between customers and banks about the services provided by the bank. The conciliation board acts as a mediator to resolve complaints submitted by customers. The conciliation board is not a court of law. Also, it does not have authority to make judicial rulings. In fact, it shall encourage discussions between the disputing parties and lead them to a mutually acceptable solution; however, neither the bank nor the customers are bound to accept any generated solution. In fact, they are free to take further legal measures, as the case may be.

* * *

Endnote

1. https://www.llv.li/de/landesverwaltung/stabsstelle-ewr

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Luxembourg

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Introduction

As a leading financial centre in the European Union (the **EU**), Luxembourg offers a diverse range of financial services that connect investors and markets around the world. Luxembourg is a cross-border centre in banking, being home to 119 international banks as at 30 September 2023 providing direct jobs to more than 26,000 people. In the 2023 Global Financial Centres Index, Luxembourg was ranked as having the 16th most competitive financial centre in the world, effectively moving up the ranking (ranked 21st in September 2022), and is now positioned third in the EU and fifth in Western Europe ahead of financial centres such as Zurich. With approximately a quarter of Luxembourg's economy depending on financial services, the significance of the financial sector also results in the development of financial regulation being an important policy consideration for the Luxembourg legislator.

Bank failures in 2023

In 2023, the global banking industry suffered the biggest crisis since the financial crisis of 2008. In March 2023, California-based Silicon Valley Bank failed due to a run on its deposits triggered by a large decrease in the value of its bond portfolio as a result of rising interest rates, marking the third-largest bank failure in US history and the largest since the financial crisis of 2008. A few days later, Swiss bank Credit Suisse Group AG collapsed due to significant losses and a crisis of confidence and was then acquired by Swiss bank UBS Group AG, creating a new consolidated banking group. In May 2023, San Francisco-based First Republic Bank suffered a similar run on its deposits following the collapse of Silicon Valley Bank.

Despite the banking turmoil in March 2023, the financial sector of Luxembourg has shown its resilience and stability. Contrary to other jurisdictions such as the United States, the extensive legal framework introduced since 2008 that provides for a stable framework to mitigate risks applies to both large and small banking institutions in Europe. Hence, from a prudential point of view, it has been reported that Luxembourg banks would not have faced the solvency issues that the failed banks in the United States had encountered earlier last year. It is worth noting that Luxembourg recorded a common equity tier 1 ratio of 22.52%, which is the second highest among the countries of the European Economic Area (the **EEA**), during the second quarter of 2023, showcasing Luxembourg banks' resilience in their capitalisation levels.

Recent trends relating to digitalisation

The Luxembourg legislator's positive take on digital development has led to recent national legislative initiatives relating to the use of digital innovations in the financial sector. It is worth noting that in line with the positioning of Luxembourg as a Fintech hub and in order to face the challenges of technological innovation in the financial sector, the financial sector supervisory commission (*Commission de Surveillance du Secteur Financier*, the **CSSF**)

has created an Innovation Hub, a dedicated point of contact for any person wishing to present an innovative project or to exchange views on the major challenges faced in relation to financial innovation in Luxembourg. In this context, the CSSF collects guidance and publications on a national and international level related to specific areas of Fintech, such as virtual assets, artificial intelligence (**AI**), robo-advice and crowdfunding. As a result of the Innovation Hub, the CSSF is in permanent contact with the Fintech industry as it is open to consultation regarding the development of the regulatory framework as well as the application of regulation to potential projects. Against this background, the CSSF develops insights into Fintech developments and expectations of the industry while raising public awareness of the financial sector's digital transition.

Sustainable finance driving change in the financial sector

Sustainable finance continues to play a significant role in the Luxembourg financial sector. The recent adoption by the European Commission of delegated acts under the Taxonomy Regulation (as defined below) laying down technical screening criteria for determining whether an economic activity qualifies as environmentally sustainable, as well as the upcoming launch by the European Securities and Markets Authority (**ESMA**) of a Common Supervisory Action (**CSA**) on the integration of clients' sustainability preferences into suitability assessments and of sustainability objectives into product governance under MiFID II (as defined below), demonstrate the EU's emphasis on sustainable finance in addition to the global growing sustainability concerns and transition of the financial sector towards sustainability. Being home to the Luxembourg Green Exchange, the world's first dedicated and leading platform for green, social and sustainable securities launched in 2016, and having the largest market share of listed green bonds worldwide, Luxembourg is a leading green finance centre, as confirmed by the last edition of the Global Green Finance Index published in October 2023, which ranked Luxembourg in first place in the EU and fifth place globally.

Regulatory architecture: Overview of banking regulators and key regulations

National level

The national authorities responsible for the regulation and supervision of the banking sector in Luxembourg are the CSSF and the Central Bank of Luxembourg (the **BCL**), which are placed under the authority of the Ministry of Finance.

The CSSF

The CSSF is the authority responsible for the prudential supervision of the Luxembourg financial sector. Since 30 July 2021 and the entry into force of the so-called "Authorisation Law" of 21 July 2021, the CSSF is solely competent for granting, refusing and withdrawing authorisations of certain entities placed under its supervision (being, among others, mortgage credit intermediaries, credit institutions, investment firms, specialised professionals of the financial sector, support professionals of the financial sector, payment institutions and electronic money institutions, branches of foreign professionals of the financial sector other than investment firms, branches of third-country credit institutions, and third-country firms providing investment services or performing investment activities). Before the entry into force of the aforementioned Law, the granting, refusing and withdrawing authorisation for such authorised institutions was under the authority of the Ministry of Finance. The shifting of such competences reflects the evolution of the EU laws increasingly advocating the allocation of powers of approval to the national competent authorities in charge of prudential supervision. Further, the CSSF is the (i) national resolution authority for the resolution of credit institutions and certain investment firms in the framework of the Single

Resolution Mechanism and the Single Resolution Fund under EU Regulation 2014/806 of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending EU Regulation 2010/1093 of 24 November 2010, and (ii) resolution authority of failing national or transnational banks with the view to limiting their systemic impact as provided by the law of 18 December 2015 on the failure of credit institutions and certain investment firms (transposing EU Directive 2014/59 of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms, as amended by Directive (EU) 2019/879 of 20 May 2019 as regards the loss-absorbing and recapitalisation capacity of credit institutions and investment firms and Directive 98/26/EC (the **BRRD Package**)).

Further, the CSSF is the competent authority for the application of Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC (**Prospectus Regulation (EU) 2017/1129**) and the law of 16 July 2019 on prospectuses for securities that implements certain provisions of Prospectus Regulation (EU) 2017/1129, and provides for other requirements covering the national prospectus regime.

Its field of competence also encompasses the control of professional obligations regarding anti-money laundering and combatting the financing of terrorism (**AML/CFT**).

The CSSF is also in charge of the supervision of markets in financial instruments and their operators.

The BCL

The BCL is part of the European System of Central Banks and is specifically responsible for, *inter alia*: (i) the supervision of liquidity of credit institutions, in cooperation with the CSSF; (ii) control over the smoothness and efficiency of payments systems; (iii) the empowerment of financial stability; and (iv) the implementation of monetary policies.

The CAA

Credit institutions that are authorised to pursue insurance-related activities are also supervised for such activities by the *Commissariat aux Assurances* (the **CAA**), the authority that regulates and supervises the insurance, insurance mediation, reinsurance and management of complementary pension funds activities.

The influence of supra-national regulatory regimes or regulatory bodies

EU level

As part of the European Banking Union, the Luxembourg banking system is subject to the supervision of the European Central Bank (the **ECB**) within the framework of the European Single Supervisory Mechanism (the **SSM**). The ECB is specifically responsible for: (i) granting and withdrawing banking licences; (ii) assessing banks' acquisitions and disposals of qualifying holdings; (iii) ensuring compliance with EU prudential and governance requirements; (iv) conducting supervisory reviews, on-site inspections and investigations; and (v) setting higher capital requirements ("buffers") in order to counter any financial risks.

Since November 2014, the ECB is exclusively competent for granting licences, approvals of qualifying holdings and appointment of key function holders in all significant credit institutions, established in the Member States participating in the SSM. The ECB's role in such significant credit institutions includes the supervision of solvency, liquidity and internal governance.

It is worth noting that the supervision of less-significant institutions incorporated under Luxembourg law and branches of non-EU institutions remains under the scope of competence of the CSSF. Further, the CSSF remains the main authority for the supervision of, among others, (i) compliance with professional obligations regarding AML/CFT, and (ii) regulations for consumer protection.

The key legislation and regulation applicable to banks in Luxembourg

The principal rules and regulations applicable to the financial and banking sector are embodied in the law of 5 April 1993 on the financial sector, as amended (the **LFS**), which implements, among others, EU Directive 2013/36 of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (**CRD IV**), as recently amended by Directive (EU) 2019/878 of 20 May 2019 as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures as amended by Directive (EU) 2021/338 (**CRD V**). Notably, the LFS regulates: (i) authorisation of credit institutions and access to professional activities in the financial sector; (ii) professional obligations, prudential rules and rules of conduct; (iii) prudential supervision of the financial sector; (iv) prudential rules and obligations in relation to recovery planning, intra-group financial support and early intervention; and (v) the power of the CSSF to impose fines and sanctions.

In addition to the LFS, the main laws and regulations that govern banking activities in Luxembourg include the following:

- the law of 20 May 2021 transposing CRD V (the **CRD V Law**) and amending, among others, the LFS;
- EU Regulation 2013/575 of 26 June 2013 on prudential requirements for credit institutions and investment firms as amended by EU Regulation 2019/876 of May 2019 (the **CRR II**, together with CRD V commonly referred to as the **CRD V Package**);
- EU Regulation 2019/2088 of 27 November 2019 on sustainability-related disclosures in the financial services sector (the **SFDR**);
- EU Regulation 2020/852 of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending EU Regulation 2019/2088 (the **Taxonomy Regulation**);
- the law of 30 May 2018 on markets in financial instruments transposing, among others, the MiFID Framework (as defined below) (the **MiFID Law**);
- the law of 18 December 2015 on the resolution, reorganisation and winding-up measures of credit institutions and certain investment firms and on deposit guarantee and investor compensation schemes implementing the BRRD Package, as amended;
- the law of 8 December 2021 on the issuance of covered bonds, which, among other things, (i) transposed EU Directive 2019/2162 of 27 November 2019 on the issue of covered bonds and the public supervision of covered bonds amending Directives 2009/65/EC and 2014/59/EU, and (ii) implemented EU Regulation 2019/2160 of 27 November 2019 amending EU Regulation 575/2013 as regards exposures in the form of covered bonds;
- the law of 10 November 2009 on payment services, as amended;
- the law of 12 November 2004 on the fight against money laundering and terrorist financing, as amended (the **AML/CFT Law**), which implemented the latest provisions introduced by Directive (EU) 2015/849 of 20 May 2015 and Directive (EU) 2018/843 of 30 May 2018 (commonly referred to, respectively, as the Fourth and Fifth AML Directives);

- the law of 23 December 1998 establishing the CSSF;
- the law of 17 June 1992 on annual and consolidated accounts of credit institutions, as amended; and
- the law of 30 March 2022 on inactive accounts, inactive safe deposit boxes and unclaimed life insurance contracts.

Further, being a member of the Eurozone, regulation of the banking sector in Luxembourg is also subject to specific pieces of Eurozone legislation, including regulations and directives transposed into national law and guidelines provided by the European Banking Authority (the **EBA**). In this respect, EBA Guidelines EB/GL/2015/20, to be read in conjunction with CSSF Circular 16/647, on limits on exposure to shadow banking entities that carry out bank-like activities outside a regulated framework (and developed in accordance with article 395(2) of the CRR), should be mentioned. The EBA Guidelines apply to all institutions subject to part four (Large Exposures) of the CRR, which shall comply with the aggregate exposure limits or tighter individual limits set on exposures to shadow banking entities carrying out banking activities outside a regulated framework (including special-purpose vehicles engaged in securitisation transactions).

From the international level, Luxembourg is influenced by supra-national regulatory regimes and regulatory bodies. Moreover, Luxembourg is a Member State of (i) the Organisation for Economic Co-operation and Development (the **OECD**), establishing norms and better policies for a wide range of subjects, such as corruption and tax avoidance, and (ii) the Financial Action Task Force, which sets standards and recommendations and promotes effective implementation of legal, regulatory and operational measures for the fight against money laundering and terrorist financing (**ML/TF**).

In addition, the CSSF is one of the bank supervisors that are members of the Basel Committee on Banking Supervision, the primary global standard-setter for the prudential regulation of banks.

The European Commission, the ECB and the OECD are members of the Financial Stability Board (the **FSB**), which is an international organisation that monitors and makes recommendations for the global financial system and has a direct impact on domestic banking legislation.

Finally, the Luxembourg regulatory framework applicable to banks is complemented by Grand Ducal regulations, Ministerial regulations and CSSF regulations and circulars issued by the CSSF on various matters related to the financial sector with a view to providing more guidance on how legal provisions should be applied and issuing recommendations on conducting business in the financial sector. Of particular relevance is CSSF Circular 12/552 on the central administration, internal governance and risk management of banks and professionals performing lending operations, as amended.

Recent and proposed changes to the regulatory architecture in Luxembourg

Recent changes to the regulatory architecture

It is worth noting that changes to the regulatory architecture are mainly driven by initiatives taken at the EU and international levels. The following is an overview of the most recent changes affecting the banking regulatory architecture in Luxembourg.

Sustainability-related disclosures in the financial services sector

Commission Delegated Regulation (EU) 2022/1288 of 6 April 2022, supplementing the SFDR with regard to regulatory technical standards clarifying the content and presentation of sustainability-related disclosures in the financial services sector, has been adopted and applied

as from 1 January 2023. Accordingly, banks that provide portfolio management shall make a statement that they consider principal adverse impacts (**PAIs**) of their investment decisions on sustainability factors and describe both the relevant PAIs together with the policies on the basis of which the identification of such PAIs is effected. In addition, banks that provide investment advice shall explain in their PAI statement, which is to be published on their website, whether they rank and select financial products on the basis of the PAI indicators, including how they use the information made available by financial market participants as well as any other criteria that are used to select, or advise on, financial products.

In the context of the Taxonomy Regulation (as defined below), which establishes six environmental objectives, the European Commission has to provide lists of environmentally sustainable activities by defining technical screening criteria for each environmental objective through delegated acts. To that end, Commission Delegated Regulation (EU) 2023/2485 of 27 June 2023 amending Delegated Regulation (EU) 2021/2139 has been adopted, establishing additional technical screening criteria for determining whether an economic activity qualifies as contributing substantially to climate change mitigation or climate change adaptation. In addition, on the same day, Commission Delegated Regulation (EU) 2023/2486 was adopted, laying down technical screening criteria for economic activities that make a substantial contribution to the remaining four environmental objectives, namely circular economy, water and marine resources, pollution prevention and control, and biodiversity and ecosystems. Accordingly, as of 1 January 2024, banks are required to disclose their exposures to Taxonomy-non-eligible and Taxonomy-eligible economic activities pursuant to the adopted texts.

On 23 October 2023, the European Council adopted a regulation establishing European green bond standards and optional disclosures for bonds marketed as environmentally sustainable and for sustainability-linked bonds, laying down uniform requirements for issuers of bonds that fund environmentally sustainable projects aligned with the EU Taxonomy (the **EuGB Regulation**). The EuGB Regulation entered into force at the end of November 2023 and will be applicable from December 2024. Accordingly, an issuing bank can benefit from the designation "European green bond" or "EuGB" for its environmentally sustainable bond provided that it allocates the proceeds of such bond to eligible assets or expenditure. In addition, to avoid greenwashing in the green bonds market in general, the regulation also provides for some voluntary disclosure requirements for other environmentally sustainable bonds and sustainability-linked bonds issued in the EU. With the same purpose of fostering transparency in the green market, in July 2023, ESMA issued a public statement on the sustainability disclosure expected to be included in both equity and non-equity prospectuses pursuant to the Prospectus Regulation. Among other things, ESMA recommends that issuers include statements according to which the issuer or security adheres to a specific market standard or label with a view to ensuring that the information contained in prospectuses is as objective as possible.

The adoption of a Corporate Sustainability Due Diligence Directive (the **CSDDD**) is expected to take place in early 2024. The aim of the CSDDD is to foster sustainable and responsible corporate behaviour and to anchor human rights and environmental considerations in companies' operations and corporate governance. The new rules will ensure that companies respect human rights and the environment, including in their value chains inside and outside Europe. The CSDDD will apply to large EU companies meeting certain thresholds in terms of number of employees and worldwide turnover and third-country companies active in the EU. It will also introduce duties for the directors of the in-scope EU companies.

Regulatory developments relating to crowdfunding

Regulation (EU) 2020/1503 of 7 October 2020 on European crowdfunding service providers for business, and amending Regulation (EU) 2017/1129 and Directive (EU) 2019/1937 (the **Crowdfunding Regulation**), entered into force on 10 November 2021. The Crowdfunding Regulation was incorporated into national law by the law of 25 February 2022, which entered into force on 8 March 2022. As stipulated by the Crowdfunding Regulation, the EBA developed draft Regulatory Technical Standards (the **RTS**) specifying, *inter alia*, the information to be considered by crowdfunding service providers when conducting the creditworthiness assessment of project owners and crowdfunding projects. In May 2023, the European Commission proposed a substantial amendment to the RTS according to which personal data included in the creditworthiness assessment of perspective project owners could be kept for up to, instead of at least, five years following the loan repayment. Although the EBA accepted the amendment to the RTS, it noted the importance of enabling crowdfunding providers to improve their methods of credit risk assessment and loan valuation by gaining access to historical data, thus driving the development of the crowdfunding industry.

The Digital Operational Resilience Act (**DORA**), affecting crowdfunding service providers by imposing obligations relating to risk and compliance, ICT risk management, third-party ICT agreements, incident reporting (to relevant authorities and to clients – regarding GDPR), will come into effect on 17 January 2025.

Proposed changes to the regulatory architecture

On 24 March 2023, draft law No. 8185 was submitted to the Luxembourg Parliament aiming to, *inter alia*, transpose Directive (EU) 2021/2167 in relation to the transfer of a creditor's rights under a non-performing bank loan (**NPL**) or the NPL itself to a specialised credit manager. Once adopted, the bill will permit credit institutions to sell their NPLs to a credit purchaser who would then delegate the servicing of the NPLs to an appointed credit manager responsible for the provision of credit management activities. The draft law also provides that the credit managers would qualify as professionals of the financial sector within the meaning of the LFS and therefore the LFS would set out the authorisation rules applicable to the credit managers together with the activities concerned. Accordingly, the above will enable credit institutions holding large volumes of NPLs on their balance sheets to sell such NPLs on the secondary market, ultimately tackling high NPL ratios.

Regulatory development related to DLT market infrastructures

On 2 June 2022, Regulation (EU) 2022/858 of the European Parliament and of the Council on a pilot regime for market infrastructures based on distributed ledger technology (**DLT**) (the **EU DLT Pilot Regime**) was published in the Official Journal of the EU. The Regulation has applied in Luxembourg since 23 March 2023 and was implemented by the law of 15 March 2023, which amended, *inter alia*, the definition of financial instruments set out in the LFS to reflect financial instruments using DLT, supplements the EU DLT Pilot Regime in Luxembourg and addresses a few points left open by the previous laws on DLT. The EU DLT Pilot Regime lays down requirements in relation to DLT market infrastructures and their operators with respect to, among other things, granting and withdrawing specific permissions to operate DLT market infrastructures, operating and supervising DLT market infrastructures as well as enabling such entities to be exempted from other requirements under EU directives or regulations, including the MiFID Framework. Against this background and in the context of the Innovation Hub, applicants looking to operate a DLT market infrastructure may contact the CSSF to obtain regulatory guidance and to discuss the relevant legal requirements together

with the technology aspects of the project, or organise an exchange with the CSSF before submitting their application. In that regard, on 8 March 2023, the CSSF published CSSF Circular 23/832, integrating ESMA's Guidelines on standard forms, formats and templates to apply for permission to operate a DLT market infrastructure.

Recent regulatory themes and key regulatory developments in Luxembourg

Change to the regulatory regime following the financial crisis

European banking regulation has undergone a continuous evolution since the financial crisis of 2008 and the adoption of a certain number of directives and regulations as a response to the financial crisis. The main legislation taken in this respect could be summarised as follows:

- CRD IV;
- the CRR;
- EU Regulation 2013/1024 of 15 October 2013 conferring specific tasks on the ECB concerning policies relating to the prudential supervision of credit institutions, and EU Regulation 2013/1022 of 22 October 2013 amending EU Regulation 2010/1093 of 24 November 2010 establishing a European supervisory authority (the EBA) as regards the conferral of specific tasks on the ECB pursuant to EU Regulation 1024/2013, together establishing the SSM; and
- EU Regulation 2014/806 of 15 July 2014, as amended, establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending EU Regulation 2010/1093, and the BRRD, together establishing the Single Resolution Mechanism.

These regulations were part of a logic of risk reduction in the banking sector within the EU and the Eurozone. The gradual establishment of a Banking Union at the EU level with its unique supervision and resolution mechanisms marked the starting signal for risk pooling through the establishment of euro area-wide safety nets, including the Single Resolution Fund.

Most of the above legislative texts have already been amended with the CRD V and BRRD II Packages and are subject to further amendments following the European Commission's adoption, on 27 October 2021, of a review of the EU banking rules. The CRD V Law amending the LFS, introducing novel concepts, is analysed in subsequent sections.

Regulatory developments relating to Brexit

On 14 December 2020, the CSSF published Regulation 20-09 amending CSSF Regulation 20-02 of 29 June 2020 on the equivalence of certain third countries with respect to supervision and authorisation rules for the purpose of providing investment services or performing investment activities and ancillary services by third-country firms. As specified in the CSSF press release of 24 December 2020, the Regulation includes the United Kingdom of Great Britain and Northern Ireland in the list of jurisdictions deemed equivalent for the application of the national third-country regime.

Regulatory developments relating to Fintech

The Luxembourg legislator has taken significant initiatives in the area of digitalisation of banking and financial activities and more specifically in the implementation of technological innovations in the field of capital markets. Two distinct laws passed in 2019 and 2021 allowed the use of new technologies in the issuance, holding and circulation of securities.

The law of 1 March 2019 (the **Blockchain I Law**) amended the law of 1 August 2001, as amended (the **General Securities Law**), allowing the use of secure electronic mechanisms for the holding and circulation of securities. The Blockchain I Law represented a milestone

in the digitalisation of capital markets in Luxembourg as it acknowledged, for the first time, the issuance of security tokens, a specific category of crypto-assets defined in the parliamentary works as assets stored in a blockchain that represent the securities.

In an effort to extend and refine the scope of application of the Blockchain I Law, the Luxembourg Parliament passed the law of 21 January 2021 (the **Blockchain II Law**), which amended the law of 6 April 2013, as amended (the **Dematerialised Securities Law**) and the LFS, as amended. The Blockchain II Law extended the possibility to use secured electronic registration systems, such as DLT and databases, to the issuance of dematerialised securities. Following the Blockchain II Law, EU credit institutions and investment firms are allowed to take the role of central account keeper, and to hold and manage securities issuance accounts with such technologies through secured electronic registration systems such as DLT (e.g., blockchain) and databases.

The Blockchain I and II Laws filled a gap in a fundamental area of the Luxembourg legal framework, providing legal certainty to financial market participants and making the Luxembourg environment Fintech-oriented. By implementing the principle of digital neutrality, the legislator acknowledged not only the use of digital ledger technologies such as blockchain, but created an open-ended system enabling the smooth introduction of future technological developments in the securities market.

The Blockchain III Law entered into force on 23 March 2023 and follows in the footsteps of previous initiatives taken by the Luxembourg legislator. Since the adoption of the Blockchain I and II Laws, the Luxembourg legal framework already explicitly recognises the possibility of using DLT for the issuance and circulation of securities. All of the blockchain laws, including the latest addition, aim to ensure a principle of technological neutrality. In addition to implementing the EU DLT Pilot Regime, the new Blockchain III Law explicitly recognises the use of DLT instruments for financial collateral arrangements.

In parallel with the legislative initiatives, the CSSF regularly publishes documents to communicate its position related to financial innovation to both the public and the industry. Against this background, on 29 November 2021, the CSSF published a Communication entitled "CSSF guidance on virtual assets", which was followed by an FAQ on virtual assets for credit institutions (the **FAQ-CI**) that will be regularly updated. The aim of the recent publications is to inform professionals of the financial sector interested in getting involved with tokens of their responsibilities to: (i) carry out a thorough due diligence for the purpose of weighing up the risks and benefits before engaging with a virtual assets activity; (ii) develop both a business and a risk strategy when involved in virtual assets activities; and (iii) keep up with regulatory developments with a particular focus on the prudential treatment of virtual assets. According to the FAQ-CI, any credit institution intending to offer virtual asset services shall submit in advance a detailed business case to the CSSF including a risk-benefit assessment, required adaptations to its governance and risk management frameworks, the effective handling of counterparty and concentration risk, and the implementation of investor protection rules. In addition to information targeting professionals, the CSSF set up a dedicated section on its website regarding virtual assets through which it provides information for the attention of consumers. For example, the CSSF warned consumers of promotion campaigns for investments in virtual assets via, among others, social media platforms that highlight the possibility of high returns. In that regard, instead of user-friendly platforms, the CSSF recommends that consumers engage with regulated entities. Finally, it is worth noting that, following the entry into force of the law of 25 March 2020 implementing the Fifth AML Directive and amending the AML/CFT Law, no virtual asset service provider may be established in Luxembourg without being registered with the CSSF.

The CSSF also constantly monitors the Fintech sector, communicating the benefits and warning of the risks associated with the use of technologies in the financial sector. In this respect, on 3 May 2023, the CSSF published a thematic review on the use of AI in the Luxembourg financial sector that provides information on the usage of AI together with its related benefits and challenges, including use cases implemented by, among others, 117 credit institutions in Luxembourg. Out of a total of 158 use cases of which more than half are still in production, the top areas in which AI technology was reported are AML/fraud detection, process automation, marketing/product recommendation, customer rights and cybersecurity. Among the respondents, it appears that credit institutions are more advanced in the use of AI technology compared to other financial institutions by reference to the number of use cases. Overall, the results from the survey demonstrate that the usage of AI in the Luxembourg financial sector is still at an early stage but that investments in AI, in view of the reported general increase of such investments from 2021 to 2022 especially in the area of machine learning, are estimated to increase in the near future.

Furthermore, following the publication of the Markets in Crypto-Assets Regulation (**MiCAR**) in the Official Journal of the EU, the provisions of Titles III (Asset-Referenced Tokens, **ART**) and IV (E-Money Tokens, **EMT**) thereof relating to the authorisation and supervision of ART/EMT will apply from 30 June 2024. In that regard, credit institutions planning to carry out ART or EMT issuance activities before 30 June 2024 are encouraged to communicate such intention to the CSSF using the template that is available on the EBA's website, also having regard to the guiding principles included in the Annex to the EBA Statement dated 12 July 2023.

On 16 January 2024, the EBA extended its guidelines on ML/TF risk factors to crypto-asset service providers (**CASPs**) through the issue of guidance to CASPs to effectively manage their exposure to ML/TF risks. The new guidelines highlight ML/TF risk factors and mitigating measures that CASPs need to consider, representing an important step forward in the EU's fight against financial crime. MiCAR brings crypto-asset services and activities within the EU regulatory scope and ensures that CASPs become subject to EU AML/CFT obligations and supervision. By doing so, it prevents credit and financial institutions from engaging with providers of crypto-asset services, which will provide a stratified mitigation of risk.

Bank governance and internal controls

Key requirements set out in the LFS relating to the central administration and internal controls of credit institutions are specified in CSSF Circular 12/552, as amended. In a nutshell, Luxembourg regulation requires credit institutions to have robust internal governance arrangements, effective risk management processes, adequate internal control mechanisms, sound administrative and accounting procedures, remuneration policies and practices allowing and promoting sound and effective risk management, as well as control and security arrangements for information processing systems.

More precisely, the following general requirements apply to boards of directors of banks, committees, remuneration and internal control.

Management and central administration

The central administration of a credit institution must be established in Luxembourg. The authorised management of credit institutions must be composed of at least two members (the so-called "four-eyes principle") who must be empowered to effectively direct the business. The managers must produce evidence of their professional repute. In addition, they must have already acquired an adequate level of professional experience through the

performance of similar activities and assessed on the basis of a *curriculum vitae* and/or any other relevant evidence. The good repute of the members of the bodies performing administrative, management and supervisory functions is assessed on the basis of police records and any evidence that shows that the persons concerned have a good reputation and offer every guarantee of irreproachable conduct. The prudential approval procedure sets out the fit and proper approval process for the appointment of key function holders and members of the management body in credit institutions. Recent amendments to CSSF Circular 12/552 have enhanced the provisions with respect to the diversity and independence of the management body.

Committees

Banks may be required to put in place various committees, such as an audit committee or a risk committee, which oversee certain areas of the bank's operations. The obligations relating to committees depend on the size and scale of the bank, though a relevant point is the fact that their decisions must consider long-term public interest.

Remuneration policies

The aim of the procedures and arrangements implemented in relation to remuneration is to help ensure that risks are managed in an efficient and durable manner. Credit institutions must comply with the requirements concerning the governance arrangements and remuneration policies of CRD IV and CRD V, as transposed into the LFS. Furthermore, credit institutions must comply with the disclosure requirements of the CRR, the criteria set out in the relevant EU regulatory technical standards, the EBA Guidelines on remuneration policies and best practices, and the applicable CSSF circulars. The CRD V Law introduced some novel provisions. Most importantly, the rules governing the remuneration policy may henceforth apply on a consolidated, sub-consolidated or solo basis, depending on specific parameters. Furthermore, the above rules apply to all employees whose activities have a material impact on the risk profile of a given credit institution, and not only to the management body. The content of the latter term is defined in article 38-5(2) of the LFS, which should be read in conjunction with Commission Delegated Regulation (EU) 2021/923. Smaller and non-complex institutions benefit from some waivers concerning the application of a limited number of remuneration requirements. At the same time, the CRD V Law recognised and implemented for the first time the gender-neutral nature of the remuneration policy. Further, credit institutions are also required to comply with obligations relating to disclosure of their remuneration policy deriving from the CRR II.

Internal control environment

CSSF Circular 12/552, as amended, requires banks to have dedicated internal control functions, such as a risk control function, a compliance function and an internal audit function. The internal control functions are permanent and independent functions, each with sufficient authority. The degree of the measures required is subject to the principle of proportionality, meaning that more complex, riskier and significant institutions must have in place enhanced internal governance and risk management arrangements.

Luxembourg regulation requires that the organisation chart of the credit institution is established based on the principle of segregation of duties, pursuant to which the duties and responsibilities will be assigned so as to avoid making them incompatible for the same person. The goal pursued is to avoid conflicts of interest and to prevent a person from making mistakes and irregularities that would not be identified. In the context of mitigating conflicts of interest, the CRD V Law requires the management body of credit institutions to document data related to loans provided to the management body and share these data with the CSSF upon its request.

Outsourcing of functions is generally permitted under the conditions laid down in the LFS and relevant CSSF circulars. However, outsourcing must not result in non-compliance with the rules of CSSF Circular 12/552 as amended and, in particular, CSSF Circular 22/806 on outsourcing arrangements that includes both ICT and cloud outsourcing, by means of which the CSSF adopted and integrated, among others, the revised EBA Guidelines (EBA/GL/2019) on outsourcing arrangements (the **Circular OS**). Accordingly, all outsourcing arrangements have to comply with the general requirements laid down in Part I of the Circular OS, while ICT outsourcing arrangements also have to meet the specific requirements laid down in Part II thereof. The general outsourcing requirements include, *inter alia*, that the outsourcing institutions comply with the following requirements: (i) outsourcing arrangements, such as the concentration risk posed by outsourcing critical or important functions to a limited number of service providers, shall not create undue operational risks; (ii) the institution retains the necessary expertise to effectively monitor the outsourced services or tasks; (iii) the institution ensures protection of the data concerned in accordance with Regulation (EU) 2016/679 of 27 April 2016 on General Data Protection; and (iv) the institution applies the relevant provisions of the LFS on professional secrecy. Outsourcing does not relieve the institution of its legal and regulatory obligations or its responsibilities to its customers. Furthermore, the final responsibility or the management of risk shall lie with the outsourcing institution, while the institution shall establish an outsourcing policy and maintain an outsourcing register recording all outsourcing arrangements. In addition to the general requirements, Circular 21/785, amending Circular 12/552, replaced the obligation of prior authorisation with that of notification to the CSSF with regard to outsourcing of a critical or an important function while there are no specific formalities in place with regard to outsourcing of non-critical or non-important functions. In that regard, the CSSF released a new notification template that aligns the terminology and structure of the template with the Circular OS.

Bank capital requirements

The regulatory capital and liquidity regime currently applicable to banks in Luxembourg derives mainly from the CRD V Package and numerous underlying local regulations, circulars and circular letters adopted by the CSSF. It is worth noting that following the procyclical mechanisms that contributed to the origin of the financial crisis of 2008, the FSB, the Basel Committee on Banking Supervision and the G20 made recommendations to mitigate the procyclical effects of financial regulation. In December 2010, the Basel III Framework, which consisted of new global regulatory standards on bank capital adequacy, was issued by the Basel Committee on Banking Supervision. In June 2013, the Basel III Framework was implemented into the CRR/CRD IV Package at the EU level. As stated above, the CRD IV Package has been amended by the CRD V Package.

Capital and liquidity requirements

Share capital

Credit institutions in Luxembourg are required to have a subscribed and fully paid-up share capital of at least €8.7 million. The capital base cannot be less than the amount of the prescribed authorised capital.

Own funds

In addition to the share capital requirement, credit institutions must maintain and satisfy at all times a total capital ratio of 8% of their risk-weighted assets, composed of 4.5% of Common Equity Tier 1 capital (**CET1**) (as defined in the CRR), 1.5% of Additional Tier 1

capital (as defined in the CRR), and 2% of Tier 2 capital (as defined in the CRR). The above minimum capital requirements are part of the so-called Pillar 1 of the Basel III Framework (**P1R**). As specified in the LFS and CSSF Regulation 15-02, as amended, the CSSF is capable of imposing bank-specific capital requirements (Pillar 2 Requirements – **P2R**) that have micro-prudential considerations and apply in addition to, and cover risks that are underestimated or not covered by, P1R. Both P1R and P2R are binding and obligatory for credit institutions, which is not the case for the Pillar 2 Guidance rules (**P2G**), which constitute suggestions of the CSSF to the banks relating to their own funds. The CRD V Law has clarified the relationship between P2R and P2G.

In addition to other own funds requirements, credit institutions in Luxembourg are required to hold and maintain the following buffers:

- a capital conservation buffer of CET1 equal to 2.5% of their total risk exposure amount;
- an institution-specific countercyclical capital buffer of CET1 (equivalent to their total risk exposure). The CSSF is responsible for setting the countercyclical buffer rates applicable in Luxembourg on a quarterly basis. According to CSSF Regulation 23-04, a countercyclical capital buffer rate of 0.5% applied to credit institutions for the fourth quarter of 2023;
- a Global Systemically Important Institutions (**G-SII**) buffer, being a mandatory capital surcharge built up of CET1 and applied at the consolidated level of the identified banking groups' additional capital requirements for systemically important banks. The capital surcharge may vary between 1% and 3.5% depending on the degree of systemic importance of the relevant bank. According to publicly available information, there is no bank established in Luxembourg identified as a G-SII;
- an Other Systemically Important Institutions (**O-SII**) buffer applied on a consolidated/sub-consolidated or solo basis. In this respect, the CSSF takes its decisions after consultation with the BCL and after requesting the opinion of the *Comité du Risque Systémique*. The O-SII buffer may reach up to 3% or even surpass this threshold if the European Commission's authorisation has been granted. The CSSF and the BCL have jointly developed a calibration methodology designed to translate the systemic importance of the institutions into O-SII buffer rates; and
- a systemic risk buffer for systemic banks of at least 1% based on the exposures to which the systemic risk buffer applies, which may apply to exposures in Luxembourg as well as to exposures in third countries. The rationale of this buffer, as clarified in the CRD V Law, is the mitigation of systemic risks, to the extent that these are not already covered by the capital buffers for systemically important institutions (G-SIIs/O-SIIs) or the countercyclical capital buffer. No maximum limit applies to this buffer.

Liquidity and funding requirements

In order to ensure the stability of financial institutions, the following liquidity and funding standards (adopted in the EU and designed to achieve two separate but complementary objectives) apply to credit institutions in Luxembourg:

- a Liquidity Coverage Ratio, which aims to improve the short-term resilience of a bank's liquidity risk profile by ensuring that it has sufficient high-quality liquid assets to survive a significant stress scenario lasting for 30 days. Financial institutions are required to hold liquid assets at all times, the total value of which equals, or is greater than, the net liquidity outflows that might be experienced under stressed conditions over a short period of time (30 days). Net cash outflows must be computed on the basis of a number of assumptions concerning runoff and drawdown rates; and

- a Net Stable Funding Ratio (the **NSFR**), which aims to ensure the resilience of financial institutions over a longer time horizon of one year by promoting a sustainable maturity structure of assets and liabilities. Financial institutions are required on an ongoing basis to raise stable funding at least equal to their stable assets or illiquid assets that cannot be easily turned into cash over the following 12 months. Following the amendment of the CRR by the CRR II and now by CRR III, the NSFR is applicable to all credit institutions as of 28 June 2021. Liquidity and uniformity of institutional internal models are emphasised by CRR III to a greater extent, with the aim of reducing the risk of excessive capital reductions.

Compliance with the rules relating to bank capital and liquidity requirements is under the control of the CSSF and the ECB. In addition, financial institutions are subject to periodic reporting requirements.

This regulatory framework has substantially contributed to the strengthening of the regulations applicable to the banking system in the EU and rendered institutions more resilient to possible future shocks. Although comprehensive, those measures did not address all identified weaknesses affecting institutions. The European Commission adopted a review of the CRD V Package. Having gained important lessons from the COVID-19 pandemic and taking into consideration the necessity of approaching the CRD V Package from a greener perspective, the new framework will focus on strengthening the resilience of banking institutions to economic shocks, contributing to the green transition, mitigating ESG risk factors and ensuring sound management of EU banks and better protecting their financial stability.

Rules governing banks' relationships with their customers and other third parties

Regulation relating to customers

Banks' relationships with their customers and third parties deriving from deposit-taking, lending activities and investment services are mainly governed by:

- the law of 30 May 2018 on markets in financial instruments, as amended, transposing, among others, Directive 2014/65/EU of 15 May 2014 on markets in financial instruments (**MiFID II**) and amending Directive 2002/92/EC, Directive 2011/61/EU, and Regulation (EU) 600/2014 of 15 May 2014 on markets in financial instruments (**MiFIR**, together with MiFID II commonly referred to as the **MiFID Framework**), as well as several delegating acts, which provide for harmonised protection of (retail) investors in financial instruments;
- Regulation (EU) 1286/2014 on key information documents for packaged retail and insurance-based investment products (the **PRIIPs Regulation**) applicable since 1 January 2018. The PRIIPs Regulation requires that all packaged retail and insurance-based investment products (**PRIIPs**) manufacturers provide a key information document to retail investors in order to enable retail investors to understand and compare the key features and risks of the PRIIPs;
- the law of 17 April 2018 on key information documents for PRIIPs implementing the PRIIPs Regulation designates the CSSF and the CAA as the competent supervisory authorities regarding supervision and compliance with the requirements of the PRIIPs Regulation; and
- the provisions of the Luxembourg Consumer Code related to the protection of consumers, which also affect banks' dealings with their customers. Following these provisions, banks must, among others, comply with obligations relating to information that should be provided to customers, rules on advertising, the content of credit agreements and the prohibition of unfair business practices. Before granting a credit, the solvency of the customer needs to be evaluated.

Customer complaint handling

In addition, the CSSF is competent to receive customer complaints against the entities subject to its supervision. Provided that, *inter alia*, the customer complaint has been previously dealt with by the relevant professional without a satisfactory result, the customer may request for an out-of-court resolution from the CSSF. The CSSF then acts as an intermediary with the parties in order to seek an amicable solution. The CSSF acts in its capacity as alternative dispute resolution entity, and Luxembourg courts remain competent to handle litigations relating to consumer protection.

Protection of depositors and investors

Following the entry into force of the law of 18 December 2015 on the failure of credit institutions and certain investment firms, the following compensation schemes have been created:

- an Investor Compensation Scheme (*Système d'Indemnisation des Investisseurs Luxembourg*), being the recognised Luxembourg Investor Compensation Scheme as referred to in Directive 97/9/EC and chaired by the CSSF. The main purpose of the Investor Compensation Scheme is to ensure coverage for the claims (funds and financial instruments that its members hold, manage or administer on behalf of their clients) resulting from the incapacity of a credit institution or an investment firm. In case the relevant criteria are met and the institution holding the investor's assets is no longer able to fulfil its commitments, investors are repaid by the Investor Compensation Scheme. The repayment covers a maximum amount of €20,000 per investor; and
- a Deposit Guarantee Fund (*Fonds de Garantie des Dépôts Luxembourg*), being the recognised Luxembourg Deposit Guarantee Scheme referred to in Directive 2014/49/EU of 16 April 2014 on Deposit Guarantee Schemes. The main purpose of the Deposit Guarantee Fund is to ensure compensation of depositors in case of unavailability of their deposits. It collects the contributions due by participating credit institutions, manages the financial means and, in the event of insolvency of a member institution, makes the repayments as instructed by the *Conseil de protection des déposants et des investisseurs*, the internal executive body of the CSSF in charge of managing and administering Luxembourg compensation schemes. It is worth noting that membership to the Deposit Guarantee Fund is compulsory for all credit institutions and Luxembourg branches of credit institutions having their registered office in a third country. In case the relevant criteria are met and the institution holding the depositor's assets is no longer able to fulfil its commitments, depositors are repaid by a Deposit Guarantee Scheme. The repayment covers a maximum amount of €100,000 per person and per bank.

Restrictions on inbound cross-border banking activities

Any person wishing to conduct inbound cross-border banking activities in Luxembourg that fall under the rules of the LFS must obtain the necessary authorisation as stipulated in the LFS. However, credit institutions authorised by a competent authority within the EU/EEA may rely on the European banking passport mechanism. Pursuant to the principle of mutual recognition of authorisation, these authorised institutions are allowed to carry out a number of activities in Luxembourg, subject to having completed the necessary formalities with their home state authorities, which in turn will notify the CSSF.

The regulatory framework on AML/CFT

Banks must comply with the professional obligations arising from the AML/CFT Law and other applicable regulations, and more specifically customer due diligence obligations, adequate requirements relating to internal management and cooperation requirements with the authorities.

Luxembourg has also strengthened its obligations relating to AML/CFT by transposing certain provisions of the Fourth and Fifth AML Directives, aiming to prevent ML/TF through the implementation of (i) a register aiming to identify ultimate beneficial owners of companies registered with the Luxembourg Trade and Companies Register, which has been effective since 1 March 2019, and (ii) a central register of beneficial owners of fiduciary and similar arrangements, which entered into force on 10 July 2020. These laws require, *inter alia*, that companies registered with the Luxembourg Trade and Companies Register, trustees, and fiduciary agents, obtain and retain data relating to beneficial owners and to certain other persons specified in the respective laws. Registration of certain data collected by the relevant company, trustees and fiduciary agents to the relevant central register is mandatory; failing this, criminal sanctions are provided by these laws.

The AML/CFT Law also enacts the core principle of a "risk-based approach" whereby professionals have to take appropriate measures to identify and assess the risks of AML/CFT with which they are confronted, taking into consideration risk factors such as those related to their customers, countries' geographic areas, products, services, transactions or delivery channels.

The CSSF has the supervisory and investigatory powers to carry out its statutory mission to ensure that all entities subject to its supervision comply with the professional AML/CFT obligations. In addition, the CSSF has broad sanctioning powers. It may, for example, issue warnings or administrative fines against persons subject to its AML/CFT supervision. Monitoring risk in relation to anti-money laundering continues to be a high priority of the CSSF's supervision, and the CSSF staff in charge of the AML/CFT supervision is constantly increasing. Recent changes to the AML/CFT legislation also provide for a stronger cooperation framework between different supervisory authorities both on a national and an international level.

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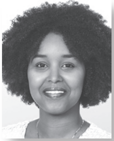

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Portugal

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Introduction

The year 2023 brought many challenges for the Portuguese banking sector. Geopolitical tensions caused by the war in Ukraine, rising inflation and increasingly higher interest rates negatively impacted the Portuguese leveraged finance market and the Portuguese economy in general, with borrowers facing increased borrowing costs and lenders tightening their documentation and loan approval criteria.

In this context, exceptional measures were put in place by the Portuguese Authorities *vis-à-vis* the protection of bank customers. Such set of measures was in place until 31 December 2023 to mitigate the effects of the rise in interest rates on variable rate loans for the purchase or construction of permanent residential properties. These measures required credit institutions to assess the impact of the interest rate increase on customers' debt service-to-income ratio and propose the renegotiation of credit agreements. Measures to facilitate the early repayment of credit agreements were also put in place. Debt restructuring, recovery and placement in the secondary market are expected to remain a key challenge for banks and borrowers throughout 2024.

In parallel, aiming to increase the resilience of institutions to the materialisation of potential systemic risk in the residential real estate market in Portugal, the Bank of Portugal ("BoP") decided, in November 2023, to introduce a 4% sectoral systemic risk buffer that will be applicable to institutions using the internal ratings-based approach, on the risk exposure amount of all retail exposures to natural persons secured by residential real estate located in Portugal. This measure will apply from 1 October 2024 and will be reviewed at least every two years.

Despite the difficulties that were felt in all sectors of the economy, the Portuguese economy registered a growth of 2.1% in 2023, according to BoP. In the coming years, BoP expects the economy to slow down to 1.2% in 2024 and to grow by 2.2% in 2025 and 2% in 2026.

Inflation is also expected to remain on a downward path, falling from 5.3% in 2023 to 2.9% in 2024 and 2% by the end of the projection horizon.

These positive predictions are supported by favourable financial conditions and the availability of EU funds, which aim at promoting economic recovery and the resilience of the EU's economies.

During 2023, the Portuguese banking market also witnessed a solid interest in fintech players and virtual asset providers, and a small movement in the M&A of regulated entities was noted. Moreover, banks were able to reduce non-performing loans ("NPLs") on their balance sheets throughout the year by means of NPL sales and write-offs, supported also by low insolvency rates.

As regards 2024, technology and AI solutions will continue to be implemented by banks with a view to transforming and enhancing the banking services offered to their clients. Environmental, social and governance ("ESG") concerns will also remain on the agenda, with an expected increase in green and sustainability-linked financial products in loan and debt securities documentation.

On the legislative side, BoP has approved the final version of the Draft Banking Activity Code (*Anteprojecto de Código da Atividade Bancária*), which is expected to be approved by the Portuguese Parliament in 2024. This new piece of legislation aims to partially revoke and consolidate the Portuguese banking legislation, following the EU's regulatory trend. The new Code shall address the new challenges of the banking sector and solve current incongruencies of the domestic system.

Considering the new legal framework for banking activity that is currently being prepared and discussed, we anticipate additional consolidation between existing banks and further cooperation with other service providers, together with an openness for innovation in the provision of standard financial services. It will depend on the exact terms of this new framework whether Portugal will be able to attract foreign banks seeking a forward-thinking and innovative environment to establish their operations within the EU.

Regulatory architecture: Overview of banking regulators and key regulations

Credit institutions in Portugal, depending on the activities pursued by such credit institutions at each given moment, are subject to the supervision of two authorities: on the one hand, when carrying out core banking activities, such as collecting deposits or other repayable funds from the public and granting credit, banks are subject to the supervision of BoP; and on the other hand, when acting as financial intermediaries and providing investment services, banks are also supervised by the Portuguese Securities Market Commission ("CMVM").

Therefore, banks' activities are mostly regulated under two statutes: (i) the Portuguese Banking Law ("Banking Law"), approved by Decree-Law no. 298/92 of 31 December 1992 (as amended); and (ii) the Portuguese Securities Code ("PSC"), approved by Decree-Law no. 486/99 of 13 November 1999 (as amended). Pursuant to its activity, BoP and CMVM both issue various regulations applicable to the banking activity.

Please note that, depending on the nature of the services provided, fintech companies may be supervised by BoP, CMVM and/or by the Authority for the Supervision of the Insurance and Pension Fund Industries (*Autoridade de Supervisão de Seguros e Fundos de Pensões*). Although there is still no consolidated legal regime addressing the special challenges of fintechs within the banking sector framework, Portugal has developed a communication channel between innovators in the financial sector – startups or incumbent institutions – and the Portuguese regulatory authorities, offering insights into the regulatory requirements needed to implement financial innovation technology projects.

BoP, in its role of Portuguese Central Bank, is part of the European System of Central Banks, which consists of the European Central Bank and all national Central Banks of each of the 27 Member States of the EU. In what concerns the securities market, CMVM is part of the European Securities and Markets Authority, which is an EU financial regulatory agency.

Portugal is part of (i) the Economic and Monetary Union, established to accomplish economic integration to achieve economic stability, higher growth, and more employment in all EU Member States, and (ii) the Banking Union. The Banking Union shall be based, over time, on three complementary pillars: the Single Supervisory Mechanism; the Single Resolution

Mechanism; and a Common Deposit Guarantee Scheme. The first two pillars are already implemented, but the last one is yet to be accomplished. However, once implemented, it is expected to contribute to promoting and assuring the liquidity of the banking system.

Banks in Portugal are one of various types of credit institutions statutorily provided for and are essentially governed by the Banking Law. They are required to adopt the form of a joint-stock company (*Sociedade Anónima*). Moreover, banks are entitled to carry out banking activities and perform all banking and financial transactions permitted by the Banking Law, including entering into derivatives transactions (no specific restrictions being applicable thereof). A bank's capacity is determined by reference to the Banking Law and its by-laws, which in general will be drafted in broader terms. The incorporation of banks in Portugal is subject to prior authorisation and registration before BoP and – whenever a bank provides investment services or acts as financial intermediary – CMVM. Under the Banking Law, banks may carry out transactions, directly or on behalf of their clients, relating to (i) financial and currency instruments, (ii) future financial instruments and options, (iii) currency or interest rates, and (iv) commodities and securities.

Under article 49 (freedom of establishment) and article 56 (freedom to provide services) of the Treaty on the Functioning of the European Union, reflected in provisions of the Banking Law, credit institutions carrying out the activities listed in Annex I of Directive no. 2013/36/EU of the European Parliament and of the Council of 26 June 2013 in one Member State may, provided that prerequisites are met, (i) carry out economic activity in a stable and continuous way, namely through branches, in Portugal, or (ii) offer and provide their services in Portugal on a temporary basis while remaining in their country of origin.

In respect to the United Kingdom ("UK"), since the Brexit transition period ended on 31 December 2020, EU law ceased to apply to institutions with head offices in the UK. These are now considered third-country entities. Such institutions may only continue to carry out their activities in Portugal under the terms of Decree-Law no. 106/2020 of 23 December 2020. Briefly, Decree-Law no. 106/2020 established that credit institutions, payment institutions and electronic money institutions with head offices in the UK, operating in Portugal under the right of establishment and the freedom to provide services, could, until 31 December 2021, continue to take all steps necessary for the performance and fulfilment of contracts entered into on or before 31 December 2020. However, these entities may only enter into new contracts or carry out new operations as of such date in Portugal if an authorisation by BoP is granted. The latter, however, must abide by the framework applicable to third-country entities. Please note that the rules established under Decree-Law no. 106/2020 ceased to apply on 31 December 2021, with the exception of: (i) article 7 (UK-based common representative of bondholders may continue to perform its activity until maturity of the issuance or issuance programme, provided that certain requisites are met); (ii) Chapter III (insurance contracts entered into with an insurance company based in the UK covering risks situated in Portuguese territory shall remain in force until the termination date stipulated in the contract); and (iii) Chapter IV (credit institutions, payment institutions and electronic money institutions with head offices in the UK may enter into new contracts or carry out new operations after 31 December 2020 in Portugal, if an authorisation by BoP is granted under the framework applicable to third-country entities).

Recent regulatory themes and key regulatory developments in Portugal

The new Portuguese Banking Activity Code

In 2021, BoP approved a final draft of the new Portuguese Banking Activity Code that – if approved by the Portuguese Parliament – will replace the current legal framework

governing banking activities and the provision of financial services in Portugal and imply a significant change to the banking landscape for financial companies and banks doing business from and to Portugal.

The final version of the draft aims to consolidate the framework for banking activities in Portugal in a single document. In addition, the draft includes several important legislative changes, such as: (i) the adoption of a single type of financial company; (ii) a more stringent regime for cross-border transactions with non-EU countries; (iii) new rules on transparency, conflicts of interest and transactions between related parties; (iv) new standards for subcontracting by financial companies; and (v) the increase of BoP's supervisory powers.

The new Code is expected to be approved in 2024.

Transposition of CRD V and BRRD II

Law no. 23-A/2022 of 9 December 2022 implemented in Portugal Directive (EU) no. 2019/878 on the access to banking activities and prudential supervision ("CRD V") and Directive (EU) no. 2019/879 on the recovery and resolution of credit institutions and investment firms ("BRRD II").

This law amended a wide range of banking and financial legislation, namely the Banking Law, the liquidation regime of credit institutions and financial companies headquartered in Portugal and their branches seated in another Member States (approved by Decree-Law no. 199/2006 of 25 October 2006) and the regime establishing the enforcement of the financial soundness of credit institutions within the scope of the initiative for the reinforcement of financial stability and the availability of liquidity in the financial markets (approved by Law no. 63-A/2008 of 24 November).

The transposition of CRD V encompasses a wide range of new rules in connection with the scope of prudential supervision, including matters related to the remuneration of employees whose activities have a significant impact on the risk profile of the credit institution, supervisory measures and powers, capital conservation measures and reinforcement of the principle of diversity in management bodies.

Moreover, the transposition of BRRD II implied the introduction of new rules in the area of credit institution resolution, as well as the promotion of mechanisms available to resolution authorities to better deal with these events. For instance, the Minimum Requirement for Own Funds and Eligible Liabilities ("MREL") regime and the regime for the contractual recognition of internal recapitalisation have been amended by the Portuguese legislator.

Legal Regime for Asset Management

Decree-Law no. 27/2023 of 28 April 2023 approved the new Legal Regime for Asset Management. This regime aimed to bring together, in one single piece of legislation, all asset management aspects, including venture capital, private equity and specialised investment activity. It also aimed to simplify the regulation of the asset management sector and create a regulatory regime that is more proportional to and appropriate for small management companies.

ESG and sustainable finance

ESG concerns continued to be an increasingly central factor in the banking and financial sector during 2023.

Portugal has been witnessing a continuous growth, both in terms of number and size, of green products and projects, while investors are more alert to green loans and ESG/

sustainability-linked loans. Simultaneously, Portuguese banks are being pressured to make their loan books "greener". ESG key performance indicators ("KPIs") have also been increasingly incorporated in loan transactions, associated with better pricing for borrowers and more favourable debt conditions.

On the legislative side, both the Sustainable Finance Disclosure Regulation and the Taxonomy Regulation have come into force. Asset and portfolio managers are now obliged to report and disclose ESG-related information in an appropriate and efficient manner, considering the framework set forth in the Taxonomy Regulation and in the Low Carbon Benchmark Regulation.

In addition, on 30 November 2023, the EU Green Bond Regulation was published in the Official Journal of the European Union (Regulation (EU) no. 2023/2631 of the European Parliament and of the Council of 22 November 2023 on European Green Bonds and optional disclosures for bonds marketed as environmentally sustainable and for sustainability-linked bonds).

By laying down uniform requirements for issuers that wish to use the designation "European Green Bond" or "EuGB" on their environmentally sustainable bonds, this Regulation is an important step towards increasing market efficiency by reducing discrepancies, guaranteeing the reliability of the information made available and increasing investor confidence in the market.

This Regulation is expected to start applying by the end of 2024.

AML and virtual asset providers

BoP Notice no. 1/2023 has come into force, complementing the Portuguese AML regime by setting out the procedures and requirements applicable to compliance with the preventive duties against money laundering and terrorism financing within the scope of the activity of entities that carry out activities with virtual assets.

Information duties of issuers and rules applicable to takeover bids

CMVM Regulation no. 1/2023 on the information duties of issuers of securities subject to the supervision of CMVM and the rules applicable to takeover bids entered into force. This Regulation aimed at simplifying the existing legislation and increasing the transparency and comprehensibility of the current rules for issuers to promote investor confidence and market competitiveness.

This Regulation consolidates all the duties that had previously been established in multiple CMVM Regulations.

The following CMVM Regulations have been revoked: CMVM Regulation no. 7/2018 (amendment of CMVM Regulation 5/2008); CMVM Regulation no. 5/2008 (disclosure requirements); CMVM Regulation no. 3/2006 (bids and issuers); CMVM Regulation no. 11/2005 (scope of International Accounting Standards); and CMVM Regulation no. 6/2002 (presentation of financial information by segment).

New voluntary carbon market

Aiming at carrying out a transition to a carbon-neutral society and bound by the Roadmap for Carbon Neutrality, the National Energy and Climate Plan 2030 and the Climate Framework Law, the Portuguese Government has recently approved Decree-Law no. 4/2024 of 5 January 2024, which established a voluntary carbon market in Portugal. This Decree-law was published in the Official Gazette on 5 January 2024 and entered into force on 6 January 2024.

In broad terms, the creation of this market will allow companies, organisations, and individuals to acquire carbon credits generated by projects that seek to reduce greenhouse gas emissions or carbon sequestration. In addition, carbon credits may be used to offset the company's own greenhouse gas emissions or to support climate change mitigation or climate change adaptation projects.

The legal framework, now approved, also provides rules regarding emissions offsetting actions and the creation of a Carbon Credits Fund for cases of unintentional reversal of sequestered emissions.

Several points of the voluntary carbon market framework still need to be regulated by means of ministerial order or information to be made available by the competent authorities.

Bank governance and internal controls

The Banking Law requires credit institutions to present solid governance mechanisms, with clear, transparent and coherent responsibility allocation among members of its managing and supervisory bodies, as well as adequate internal control procedures.

Specifically, the Banking Law establishes that the suitability of management and supervisory bodies consists of the capacity to ensure the sound and prudent management of credit institutions, particularly with a view to safeguarding the financial system and the interests of their customers, depositors, investors, and other creditors. Members of management and supervisory boards must, therefore, meet a set of demanding requirements of suitability, professional qualifications, independence, and availability.[1] Compliance with these requirements is firstly assessed by the credit institution itself and subsequently by BoP, as part of the authorisation process of the credit institution, through the fulfilment of questionnaires prepared by and available on BoP's website.

The management and supervisory boards are mainly responsible for the following:

(a) taking responsibility for the credit institution, namely by approving and overseeing the implementation of its strategic objectives, risk strategy and internal governance;
(b) ensuring the integrity of the accounting and financial reporting systems, including financial and operational control and compliance with the laws and regulations applicable to the credit institution;
(c) overseeing the disclosure process and information duties to BoP; and
(d) monitoring and controlling the activity at top management levels.

Credit institutions that are significant in size, internal organisation, nature, scope, and complexity of their activities, shall establish a risk committee composed of members of the management body who do not perform any executive function and who possess the adequate knowledge, skills and experience to be able to fully understand and monitor the risk strategy of the credit institution.

In addition, the credit institutions must have an internal control system in place, organised in accordance with the following three lines of defence: (i) the business line, which must defend the institution from taking risks that are not duly mitigated nor in line with the institutional rules adopted for risk-taking; (ii) the risk management and compliance functions, which must develop the methodologies used for the management of risks inherent in the institution's business; and (iii) the internal audit, which shall ensure that the other functions within the institution operate as expected.

Pursuant to the Banking Law and BoP Notice no. 3/2020, the implementation of a remuneration committee is mandatory for the following institutions: (i) credit institutions identified as

other systemically important institutions (identified in accordance with an assessment based on at least one of the following criteria: size; importance to the EU or the national economy; importance of cross-border activities; and/or interconnectedness of the credit institution or the group, as applicable, with the financial system); or (ii) institutions that, having not been identified as other institutions of systemic importance, have employees, including members of the management and supervisory boards, that earn a particularly high income, expressed in an annual income equal to or higher than EUR 1 million per financial year. Additionally, the management body must ensure that the institution defines, implements, and evaluates its remuneration policy and records, in specific documents, the respective procedures. The remuneration policy is transparent and accessible to all employers.

Banks must disclose information on their website (if existent) of the remuneration policy of all employees, among others, as well as the rules that regulate the policies applicable to the members of the management and supervisory boards, namely in respect to suitability, professional qualification, availability, and independency.

Bank capital requirements

The Portuguese framework for regulatory capital derives from the European regime. The Portuguese jurisdiction has implemented the Basel III framework, through CRD IV and EU Regulation no. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) no. 648/2012 ("CRR"), directly applicable in Portugal, with no major deviations.[2]

In broad terms, credit institutions operating in Portugal have to comply with requirements on capital adequacy, liquidity and leverage ratio.

Capital adequacy

Credit institutions must maintain adequate levels of own funds and therefore comply with the following own funds requirements: (i) Common Equity Tier 1 ("CET1") capital ratio of 4.5% of their risk-weighed assets ("RWAs"); (ii) Tier 1 capital ratio of 6% of their RWAs; and (iii) a total capital ratio of 8% of their RWAs.

In addition, credit institutions are required to maintain a capital conservation buffer of 2.5% and a countercyclical capital buffer ("CCyB") between 0% and 2.5%. This buffer requires banks to accumulate capital when cyclical systemic risk is increased to improve their resilience during stress periods when losses materialise. Specific requirements also apply in case of capital buffers for global systemically important institutions ("G-SIIs").

Liquidity

Credit institutions shall hold adequate liquidity buffers to face any possible imbalance in liquidity flows over a period of 30 days, i.e., they should have sufficient capacity on their balance sheet to absorb losses (loss-absorbing capacity) and, in case of resolution, to ensure recapitalisation. To that end, they are required to meet a Liquidity Coverage Ratio ("LCR") of at least 100% as required by the LCR Delegated Regulation and a Net Stable Funding Ratio ("NSFR") of at least 100%.

Leverage ratio

Credit institutions shall also comply with a binding leverage ratio requirement of 3% of Tier 1 capital (with an option to impose additional leverage ratio requirements at the discretion of the supervisory authorities).

Institutions are required to monitor the level and changes in the leverage ratio as well as leverage risk as part of the internal capital adequacy assessment process.

Credit institutions must provide BoP with all information necessary for it to evaluate the institution's compliance with its capital requirements. The failure by banks to comply with its capital requirements is a particularly serious offence, which may result in the application of a fine ranging between EUR 10,000 and EUR 5 million.

Rules governing banks' relationships with their customers and other third parties

In general terms, banking activity shall comply with the following general obligations in the context of relationships with clients and third parties:

(1) *Anti-money laundering and terrorism financing rules*, as foreseen in Law no. 83/2017 of 18 August 2017 (as amended). BoP is the supervising authority for these matters and its regulatory obligations govern the following financial entities: (i) credit institutions; (ii) payment institutions; (iii) electronic currency institutions; (iv) investment and other financial companies; (v) self-managed collective investment companies and management companies of collective investment undertakings; (vi) venture capital funds and managers of qualified venture capital funds; (vii) private equity companies, managing companies of private equity companies and their investors; (viii) qualified social entrepreneurship funds and companies and their managers; (ix) securitisation companies and companies managing securitisation funds; (x) companies publicly offering investment contracts in physical assets; (xi) consultants for securities investment and securities investment companies; (xii) self-managed, long-term investment funds of the EU under the designation "ELTIF"; and (xiii) real estate investment and management companies in Portugal, among other non-financial companies.

(2) *Specific rules as to the registration of the Ultimate Beneficial Owner*, as foreseen in Law no. 89/2017 of 21 August 2017 (as amended), which transposed Chapter III of Directive (EU) no. 2015/849 of the European Parliament and of the Council of 20 May 2015. Under this regime, a national database was created to include sufficient, accurate, and current information on the natural person or persons who, even indirectly or through a third party, have ownership or effective control of the entities subject to the legal regime, as specified under article 3, paragraphs 1 and 2, thus promoting greater transparency.

(3) *Banking resolution rules*, set forth in the Banking Law and in line with BRRD II. Overall, BoP may apply the following resolution measures: (i) the total or partial sale of the business activity of the entity in distress; (ii) the transfer, in full or in part, of the activity of the entity in distress to a bridge bank; (iii) segregation and partial transfer of the activity of the entity in distress to an asset management vehicle; and (iv) internal recapitalisation of that entity (bail-in tool). According to the "no creditor worse-off principle", no creditor can be put in a worse situation resulting from a resolution measure than it would be in a winding-up procedure.

Additionally, the applicable rules to banks' relationships with customers and third parties may vary depending on the type of service being provided, the position of the bank in such relationship, and the qualification of the investor.

In respect to the activity of taking deposits, the Deposit Guarantee Fund (*Fundo de Garantia de Depósitos*, "FGD") guarantees the reimbursement of deposits held by (i) Portuguese banks, and (ii) Portuguese branches of credit institutions incorporated in a non-EU Member State, if the deposits are not covered by a similar compensation scheme to the FGD, up to the amount of EUR 100,000 per depositor.

In cases where the bank is acting as financial intermediary, specific duties apply for the protection of the investor. In this regard, provisions of the Banking Law and of the PSC

determine that financial intermediaries must adopt codes of conduct and disclose them publicly, which shall include the principles and rules of conduct underlying the bank-client relationship, as well as the mechanisms and internal procedures adopted in the assessment of the claims, including having a complaints book. If customers wish to complain against banks (e.g., because the bank failed to act properly in the marketing of retail banking products and services), they may do so directly to BoP, either by letter or through a form available at https://clientebancario.bportugal.pt/formulario-nova-reclamacao

Furthermore, financial intermediaries shall comply with demanding information duties when contracting with non-qualified investors and keep effective and transparent procedures to handle their claims. A breach of these duties may trigger civil liability.

Under Portuguese law, the following types of entities are deemed institutional investors: credit institutions (including banks); investment companies; insurance companies; collective investment undertakings and respective management companies and pension funds and its management companies; securitisation funds and special purpose vehicles ("SPVs") and securitisation fund management companies; entities that trade in commodities derivatives; financial companies of non-EU Member States; national and regional governments; supranational organisations; Central Banks; public entities that manage public debt or funds aiming at the financing of social security systems, pension systems or workers protection; entities whose main activity is investment in securities; and companies that fulfil two of the following criteria: (i) a subscribed capital of EUR 2 million; (ii) net assets of EUR 20 million; and/or (iii) net revenues of EUR 40 million.

In the context of lending activities, Decree-Law no. 227/2012 of 25 October 2012 (as amended), reinforced the importance of a prudent, correct, and transparent provision of services by credit institutions, financial companies, payment institutions and electronic money institutions and established a special regime for the protection of consumers who default their housing, consumer and overdraft facility loans. It allows them to, upon request, restructure the outstanding debt and agree on extrajudicial payment plans. In this context, Decree-Law no. 74-A/2017 of 23 June 2017 (as amended) establishes measures that promote close monitoring of consumer default and the responsible granting of credit, attending to the correct evaluation of real estate and adequate management of conflicts of interest.

* * *

Endnotes

1. Suitability refers to the way in which a person usually manages business or performs the job, especially in aspects that reveal his capacity to make decisions in a thoughtful and judicious manner, or his tendency to fulfil obligations timely or to behave in a manner compatible with preserving the trust of the market, taking into consideration all circumstances that make it possible to assess professional behaviour for the functions in question. All of this shall be evaluated based on objective criteria, and past professional information is also considered. Professional qualifications are understood as the necessary skills and qualifications to perform the respective functions, acquired through academic qualifications or specialised training appropriate to the position to be held and through professional experience with a duration and level of responsibility that are in line with the characteristics, complexity and size of the credit institution, as well as with the risks associated with its activity.

Finally, members of the management and supervisory bodies of a credit institution must be sufficiently available for the exercise of their position, to the extent that they may not be allowed to exercise management or supervisory functions in other entities if BoP considers that the accumulation of positions is likely to jeopardise the exercise of the functions already performed by the person concerned, e.g., because there are serious risks of conflicts of interest or such fact would result in the absence of adequate availability for the exercise of the primary position.

2. It is also a general principle of the Banking Law that credit institutions must apply the funds at their disposal to ensure adequate levels of liquidity and solvency. In addition, banks must have a minimum share capital of EUR 17.5 million, as foreseen in Order no. 95/94 of 9 February (as amended).

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Introduction

As rapid advancements in financial technology ("**fintech**") reshape the international flow of goods and services, Singapore's banking system is keeping pace with innovative forms of financing. In recent years, Singapore has made steady progress along her banking liberalisation journey to facilitate the provision of financial services by non-bank entities and to cement Singapore's position as an international financial centre and a business hub for the region, while at the same time ensuring the sufficiency of regulatory safeguards in relation to new instruments such as digital tokens ("**DTs**"). Recent notable developments in Singapore's banking landscape include the upcoming regulations and guidelines for digital payment token service providers ("**DPTSPs**") in Singapore, the introduction of the Financial Institutions (Miscellaneous Amendments) Bill ("**FIMA Bill**") and enhanced anti-scam controls in light of recent phishing/digital scams. These developments reinforce Singapore's position as one of the world's leading international financial centres, and demonstrate the flexibility of Singapore's responses to advancements in technology and developments in the conduct of international business.

Regulatory architecture: Overview of banking regulators and key regulations

<u>Regulatory entities</u>

The Monetary Authority of Singapore ("**MAS**") is Singapore's central bank and sole bank regulator, and oversees all financial institutions in Singapore.

Beyond MAS, international regulatory bodies possess varying degrees of influence over the regulatory regime in Singapore by virtue of Singapore's membership and participation in international finance fora and committees. These regulatory bodies include the International Monetary Fund, the World Bank, the Financial Stability Board, the Basel Committee on Banking Supervision ("**BCBS**"), the International Organization of Securities Commissions, and the Financial Action Task Force ("**FATF**"). MAS works closely with these entities to implement domestic regulatory regimes that correspond with international standards.

Domestically, the Association of Banks in Singapore ("**ABS**") publishes guidelines for consumers and banks as well as codes of practice for various areas of banking practices. The Singapore Foreign Exchange Market Committee ("**SFEMC**") promotes adherence to the FX Global Code for wholesale market participants. SFEMC also publishes the Singapore Guide to Conduct and Market Practices for the Wholesale Financial Market for principles and market conventions relating to wholesale FX trading.

<u>Key legislation and regulations</u>

The Banking Act 1970 ("**BA**"), together with its subsidiary legislation, including the Banking Regulations ("**Banking Regulations**") and the Banking (Corporate Governance)

Regulations ("**CG Regulations**"), is the primary legislation governing the licensing and regulation of the businesses of banks in Singapore. The notices, circulars, and other publications issued by MAS must be complied with by banks in Singapore.

Capital market services, financial advisory services, and insurance brokering are regulated activities under the Securities and Futures Act 2001 ("**SFA**"), the Financial Advisers Act 2001 ("**FAA**"), and the Insurance Act 1966 ("**IA**"), respectively. While licensed banks are generally exempt from separate licensing under the SFA, FAA and IA, the requirements thereunder still apply to their conduct of regulated activities.

The Monetary Authority of Singapore Act 1970 ("**MAS Act**") grants MAS a wide range of powers to exercise supervisory oversight over banks in Singapore, including implementing a recovery and resolution regime. This includes requiring banks (where notified by MAS) to prepare, maintain and submit recovery and resolution plans. Amongst others, MAS is also empowered to transfer or restructure compulsorily all or part of a bank's business or shares.

Banks are required under the MAS Act to inform MAS immediately if they are or are likely to become insolvent or unable to meet their obligation or suspend payments. Thereafter, MAS may prescribe the next course of action, or manage the bank by stepping in itself or by the appointment of a statutory advisor.

The Financial Services and Markets Act 2022 ("**FSMA**") was introduced in 2022 as an omnibus act to meet MAS's need for a financial sector-wide regulatory approach (in tandem with the current regulatory approach that is based on the specific entity and activity type). The FSMA also strengthens regulation over DT service providers in line with international regulatory standards promulgated by the FATF. The FSMA was implemented in phases, with the first phase starting on 28 April 2023. In May 2023, the Financial Services and Markets (Amendment) Bill was passed to incorporate the Collaborative Sharing of ML/TF Information & Cases ("**COSMIC**") platform. This digital platform enables participating financial institutions to mutually share information on customers who exhibit "red flags" that may indicate potential financial crime concerns. MAS is currently developing the COSMIC platform together with six major commercial banks in Singapore, namely DBS, OCBC, UOB, SCB, Citibank and HSBC.

On 10 January 2024, the FIMA Bill was introduced in Parliament. The FIMA Bill rationalises and enhances MAS's investigative, reprimand, supervisory and inspection powers across the FAA, FSMA, IA, Payment Services Act 2019 ("**PSA**"), SFA and Trust Companies Act 2005 ("**TCA**"). The FIMA Bill also amends certain Acts under MAS's purview that are: (a) consequential from the introduction of new processes; (b) clarificatory or technical in nature; and (c) meant to update the provisions or remove certain administrative constraints.

The powers granted to MAS under the various pieces of legislation above allow them to effectively regulate banks' businesses to preserve the continuity and stability of the banking and finance industry in Singapore, ensuring that Singapore remains competitive as a business hub.

<u>Payment Services Act 2019 and subsidiary legislation</u>

The provision of payment services in Singapore is regulated under the PSA, which came into operation on 28 January 2020.

The PSA consolidates all regulation of payment services under a single legislation. Besides streamlining payment services, the PSA was enacted for the purpose of enhancing the scope of regulated activities to adapt to developments in payment services, including the growing use of e-money and digital payment services.

Broadly speaking, the PSA empowers MAS to regulate payment services to safeguard against the following risks:

(a) money laundering and terrorism financing;
(b) loss of funds owed to consumers or merchants due to insolvency;
(c) fragmentation and limitations to interoperability; and
(d) cyber risks.

To achieve its aims, the PSA comprises two regulatory approaches: a licensing regime for payment service providers; and a designation regime for specific payment services. Under the licensing regime, a licence will be required to provide any of the following payment services:

(a) account issuance;
(b) domestic money transfer;
(c) cross-border money transfer;
(d) merchant acquisition;
(e) e-money issuance;
(f) digital payment tokens ("**DPTs**");[1] or
(g) money changing.

The licensing regime is not primarily intended to regulate banks that are licensed under the BA. This is to avoid double regulation of the same activity in two separate pieces of legislation. Consistent with this, section 13(1)(a) of the PSA provides that banks licensed under the BA are exempt from the requirement to have in force a licence to provide the regulated payment services. Notwithstanding this, certain types of payment services (such as account issuance and select domestic money transfer services) offered by banks are still regulated under the PSA as if the banks were licensees.

Under the PSA's designation regime (the second regulatory framework), MAS can designate a specific payment service as a designated payment system for the purposes of the PSA provided that certain conditions are fulfilled. These conditions include, amongst others, where disruption of the operations of the payment system can trigger widespread consequences in Singapore's financial system.

The PSA is supplemented by the Payment Services Regulations 2019, which set out further requirements for licensed payment service providers as prescribed for by the PSA and exemptions under the PSA. MAS has imposed new requirements for DPTSPs with the aim of enhancing investor protection and market integrity, such as to safekeep customer assets under a statutory trust, mandating the implementation of business conduct and consumer access measures, and stipulating minimum technology and cyber risk management requirements. It is intended that these regulatory measures be implemented through regulations and guidelines, which will take effect in phases from mid-2024.

General restrictions on businesses of banks

Singapore has in place an anti-commingling policy to segregate financial and non-financial businesses ("**NFBs**") of banks in Singapore – banks in Singapore are generally restricted to conducting banking and financial businesses, and businesses incidental thereto, unless otherwise authorised by MAS.

Under the current Banking Regulations, banks in Singapore are permitted to engage in a prescribed list of non-banking businesses as set out in Part IX of the Banking Regulations. The list includes the following types of businesses (details of which are set out in the respective Regulations):

(a) property management;
(b) alternative financing;
(c) purchase and sale/interbank purchase and sale;

(d) joint purchase and periodic sale;
(e) purchase and sale at spot price;
(f) procurement and sale of assets;
(g) private equity or venture capital;
(h) related or complementary businesses (please see below); and
(i) related or complementary business that is non-revenue generating.

In keeping up with developments in the financial industry, Singapore's anti-commingling framework has been streamlined in recent years pursuant to amendments to the Banking Regulations in order to improve the ease with which banks are able to conduct or invest in permissible NFBs that are related or complementary to their core financial businesses (i.e. as per item (h) above). This list, which is set out in Regulation 23G of the Banking Regulations, covers a broad variety of industries, including the operation of online commerce platforms, the online sale of consumer goods and services, trading of commodities, sale of software developed by the bank, and the leasing of buildings.

The entry by banks into the permitted NFBs under Regulation 23G of the Banking Regulations are subject to the following key restrictions:
(a) the NFB must be a "business related or complementary to a core financial business of the bank";
(b) the bank must put in place risk management and governance policies that are commensurate with the risks posed by the NFB (such policies to be approved by the board of directors of the bank);
(c) the bank must provide certain notifications to MAS; for example, a description of the NFB, the nature and extent of the bank's investment, and the regulatory requirements that the business will be subject to; and
(d) the aggregate size of the NFB must be limited to 10% of the bank's capital funds (for Singapore-incorporated banks), or 1.5% of its total assets, less net interbank lending (for Singapore branches of foreign-incorporated banks).

Should a bank in Singapore wish to conduct any non-banking business that is not prescribed as permissible under the Banking Regulations, it may seek approval from MAS on a case-by-case approval under section 30(1)(e) of the BA. MAS has stated that in reviewing such application, it will consider whether "*the business is related or complementary to the bank's core financial businesses, the strategic value of the business, and the associated risks*".[2]

The amendments to the anti-commingling framework thus evinces MAS's openness to reshape the banking landscape in response to how technology has altered consumer preferences.

Different types of banks

To conduct banking business in Singapore, banks must be licensed by MAS. There are three categories of bank licences: (a) full bank licence; (b) wholesale bank licence; and (c) merchant bank licence.

Full banks may engage in the full range of banking activities permitted under the BA. However, foreign banks with full bank licences may only operate a limited number of office branches and automated teller machines ("**ATMs**"). Nonetheless, the qualifying full bank ("**QFB**") scheme allows QFBs to operate at more locations, share their ATMs and relocate their branches freely.

Merchant banks are generally prohibited from soliciting or accepting deposits in Singapore dollars ("**SGD**"), and raising money in Singapore (e.g. by issuing promissory notes/commercial papers/certificates of deposits, or accepting/endorsing bills of exchange). Previously,

merchant banks were regulated under the MAS Act. However, pursuant to the Banking (Amendment) Act 2020, the regulatory regime for merchant banks has now been consolidated under the BA.

Recent regulatory themes and key regulatory developments in Singapore

In line with Singapore's robust regulatory framework, several key legislative changes have been introduced to address banking developments, particularly the advent of fintech and digital offerings. These changes highlight Singapore's speed of response to fresh developments, and represent Singapore's aims to increase consumer protection and to incite fintech developments in pursuit of innovation. MAS also provided comprehensive guidance in light of the global transition away from LIBOR, ensuring that key milestones were met by banks in Singapore within the necessary deadlines.

MAS finalises stablecoin regulatory framework

On 15 August 2023, MAS announced a new regulatory framework that aims to ensure a high degree of value stability for stablecoins regulated in Singapore, and to facilitate the usage of stablecoins as a reliable digital medium of exchange.

Stablecoins are DPTs that maintain a constant value against one or more specified fiat currencies. The new regulatory framework applies to single-currency stablecoins ("**SCS**") pegged to SGD or any G10 currency that is issued in Singapore.

Issuers of such SCS must fulfil requirements relating to:

(a) Value stability: SCS reserve assets will be subject to requirements relating to their composition, valuation and audit, so as to provide a high degree of assurance of value stability.
(b) Capital: Issuers must maintain minimum base capital and liquid assets to reduce insolvency risk and enable an orderly wind-down of business if necessary.
(c) Assumption at par: Issuers must return the par value of SCS to holders within five business days from a redemption request.
(d) Disclosure: Issuers shall provide appropriate disclosures to users, including information on the SCS's value stabilising mechanism, rights of SCS holders, as well as the audit results of reserve assets.

Only stablecoin issuers that fulfil all the framework's requirements can apply for stablecoins to be labelled and recognised as "MAS-regulated stablecoins". Users can then readily distinguish MAS-regulated stablecoins from other DPTs.

Strengthening regulatory measures for DPT services

With the continued advancements in blockchain technology and the increasing popularity of DPTs as an exchange or storage of value, local and overseas regulators are concerned by the increasing risk that DPTs present. The Payment Services (Amendment) Act 2021 was passed on 4 January 2021 to address the risks of money laundering and terrorism financing. On 3 July 2023, MAS released a consultation paper setting out proposed amendments to the Payment Services Regulations 2019, to implement key segregation and custody requirements for DPT services. More recently on 23 November 2023, MAS announced the finalised measures relating to business conduct, consumer access and managing technology and cyber risks for DPTSPs.

In the area of business conduct, MAS proposed introducing business conduct standards for DPTSPs in the following key areas:

(a) Segregation of customers' assets: Customers' assets must be segregated from the DPTSPs's assets, and held for the customers' benefit. Timely reconciliation of all customers' assets should be conducted on a daily basis and a statement of account, comprising information on the customers' assets and transactions, should be provided on a monthly basis at a minimum.
(b) Lending and staking: DPTSPs are restricted from mortgaging, charging, pledging or hypothecating retail customers' DPTs. For non-retail customers, a clear risk disclosure document must be provided, and the customer's explicit consent must be obtained.
(c) Identify, mitigate and clearly disclose conflicts of interest: DPTSPs must establish and implement effective procedures and policies to identify and address conflicts of interest, and disclose to their customers the general nature and sources of conflicts of interest and the mitigatory steps to address them.
(d) Disclosure of DPT Listing and Governance Policies: DPT trading platform operators should disclose their policies addressing:
    (i) the criteria, due diligence, processes and fees applied in making a DPT available for trading on the DPT trading platform;
    (ii) the conditions under which DPTs may remain available for trading, be suspended or removed from trading;
    (iii) the processes by which DPTs are removed from trading, and the rights available to customers;
    (iv) the requirements to address unfair or disorderly trading practices of DPTs on the DPT trading platform; and
    (v) the settlement procedures of DPT transactions.
(e) Complaints Handling: There must be adequate policies and procedures to handle customer complaints.

For consumer access measures, DPTSPs must discourage cryptocurrency speculation by retail customers by determining a customer's risk awareness to access DPT services, not offering any incentives to trade in cryptocurrencies, not providing financing, margin or leverage transactions, not accepting locally issued credit card payments and limiting the value of cryptocurrencies in determining a customer's net worth.

For technology and cyber risk, MAS requires DPTSPs to maintain high availability and recoverability of their critical systems, in line with current requirements imposed on financial institutions.

The above regulatory measures will be implemented through regulations and guidelines released by MAS, and shall commence in phases from mid-2024, so that DPTSPs are given an adequate transitional period to comply.

Financial Institutions (Miscellaneous Amendments) Bill

The FIMA Bill was introduced in Parliament on 10 January 2024. It aims to strengthen MAS's investigative powers under MAS-administered Acts, so as to enhance its ability to gather evidence. The FIMA Bill also includes miscellaneous amendments to certain Acts under MAS's purview that are: (a) consequential from the introduction of new processes; (b) clarificatory or technical in nature; and (c) meant to update the provisions or remove certain administrative constraints.

Amendments to the FIMA Bill have been made to four key areas:
(a) Enhance MAS's investigative powers: Investigative powers are enhanced under the SFA and FAA, and the IA, PSA, TCA and FSMA are amended to broadly align the investigative powers under those Acts with those under the FAA and SFA.

(b) Clarify applicability of reprimand powers: Clarifies that MAS has the power to reprimand a "relevant person" (which refers to financial institutions regulated by MAS or employees, officers, partners or representatives of such regulated financial institutions, whom MAS is satisfied to be guilty of misconduct) at the time of the misconduct, even if the person has ceased to be a "relevant person" since the misconduct, i.e. the person is no longer regulated by MAS or has left the employ of a regulated financial institution.
(c) Expand MAS's powers to issue directions to capital markets services licence holders that conduct unregulated business: MAS can issue written directions on the minimum safeguards and standards to be implemented when such licence holders and their representatives conduct unregulated business.
(d) Enhance supervisory and inspection powers: These powers are enhanced under the SFA, FAA and TCA to ensure that MAS has consistent powers across those Acts, and to align with the BA.

Digital bank licence

As jurisdictions globally embrace fintech and the rise of digital or virtual banking, MAS has implemented the issuance of digital full bank ("**DFB**") and digital wholesale bank ("**DWB**") licences. Generally, both digital licences allow the entity to offer banking services (such as deposits, loans and investment products) online, without the need for any physical infrastructure in Singapore. A DFB can offer such banking services to retail and non-retail customers, while a DWB is restricted to SMEs and other non-retail customers.

There are currently five digital banks in Singapore and they are:

Name	Key shareholders	Licence
MariBank	Sea Limited	DFB
GXS Bank	Grab Holdings and Singapore Telecommunications Limited	DFB
ANEXT Bank	Ant Group	DWB
Green Link Digital Bank	Greenland Financial Holdings Group Co. Ltd, Linklogis Hong Kong Ltd, and Beijing Co-operative Equity Investment Fund Management Co. Ltd	DWB
Trust Bank	Standard Chartered Bank and FairPrice Group	DFB

There is a two-phase framework on DFB licensees. A DFB licensee will commence as a restricted DFB and is subject to certain restrictions in its initial years of operation, such as a cap on individual deposits of up to S$75,000, deposit caps of S$50 million in the aggregate, and a lower minimum paid-up capital of S$15 million. Once the DFB has demonstrated its ability to manage its risks, the restrictions will be lifted, and the minimum paid-up capital will be raised in proportion to its risk profile assessed by MAS and depending on how the bank is delivering on its value propositions. The restricted DFB will then become a fully functioning DFB with all deposit caps lifted once it has met all relevant milestones and has been assessed to pose no significant supervisory concerns. The full-fledged DFB must also meet a minimum paid-up capital requirement of S$1.5 billion; however, it will not be subject to any business restrictions.

To protect retail customers and to ensure the stability of the wider banking sector, DFBs (even when fully functioning) will have the same risk-based capital rules as other domestic systemically important banks ("**D-SIBs**"). While DFBs may not yet be categorised as D-SIBs for the purposes of MAS Notice 649: Minimum Liquid Assets and Liquidity Coverage Ratio, MAS has determined that the same level of protection is required given the "untested business models" of DFBs, where higher risk-based capital rules are necessary to mitigate the effects of any unexpected losses by the bank. DFBs, like other normal banks, will also be subject to the same liquidity requirements promulgated by MAS.

As for DWBs, in addition to the aforementioned capital and liquidity requirements, they will operate within the established Guidelines applicable to wholesale banks. DWBs also cannot provide facilities to retail investors.[3]

As banking in Singapore is a mature industry and banking facilities are already widely accessible to most Singapore residents, digital banks face the challenge of penetrating an already saturated market filled with well-established "traditional" banking incumbents who also have digital/mobile banking product offerings. Digital banks must bring their own unique value propositions to customers to differentiate themselves and to promote uptake.

Previously only launched on a by-invite basis, MariBank is the latest digital bank to fully launch its services to the general public. Currently, MariBank is running aggressive promotional campaigns such as offering attractive interest rate promotions and cashback vouchers on the Shopee online shopping platform if customers pay using their Mari Savings Account on Shopee.

With the entry of digital banks into the market and the growing popularity of digital banking in Singapore, another area of concern is the expanded risk of fraudulent activities, as well as money laundering and terrorism financing. With the lack of physical infrastructure, digital banks (as well as traditional banks providing digital services) may face difficulties in customer onboarding and complying with existing anti-money laundering/combatting the financing of terrorism ("**AML/CFT**") requirements. As such, in addition to existing Guidelines in MAS Notice 626, MAS previously issued a Circular in January 2018 to address certain issues regarding non-face-to-face verification measures, which are highly applicable to digital banks.

MAS has also introduced new measures to increase the standards of anti-scam controls across the financial sector, such as enhancing the E-Payments User Protection Guidelines ("**EUPG**") and proposing a shared responsibility framework ("**SRF**") for sharing responsibility for scam losses amongst financial institutions, telecommunications and consumers. These measures will be further elaborated below in the "Eliminating cheques" section.

As the banking industry in Singapore navigates the various opportunities and challenges provided by digital banking, the hope is that these new digital banks can cater to underserved market segments and spur on existing banks to enhance the quality of their own digital offerings, while maintaining robust safeguards against money laundering, terrorism financing, and fraudulent activities.

Discontinuation of LIBOR and transition to risk-free rates

Recent years have seen an industry-wide transition away from LIBOR, the pre-eminent interest rate benchmark that was widely referenced in the determination of interest rates across most financial instruments. On 5 March 2021, the ICE Benchmark Administrator and Financial Conduct Authority announced that all LIBOR settings will either cease to be provided by an administrator or will no longer be representative by June 2023. As at the present date, all LIBOR and related settings have ceased and transited to alternative reference rates, save for the Singapore Interbank Offered Rate ("**SIBOR**"), which will be discontinued on 31 December 2024.

Russia-Ukraine conflict

On 14 March 2022, MAS issued two notices (Notice SNR-N01 and Notice SNR-N02) detailing the scope of Singapore's financial sanctions against the Russian Federation ("**Russia**"). All financial institutions regulated by MAS are required to comply with the notices.

Notice SNR-N01 sets out financial sanctions implemented by Singapore against a number of entities, including four Russian banks (each defined in the Notice as a "**Designated Bank**"):
(a) VTB Bank Public Joint Stock Company;
(b) the Corporation Bank for Development and Foreign Economic Affairs Vnesheconombank;
(c) Promsvyazbank Public Joint Stock Company; and
(d) Bank Rossiya.

Generally, under Notice SNR-N01, financial institutions cannot:
(a) Establish business relations with, undertake any financial transactions for or with, provide financial assistance to, or transfer any assets or resources to any Designated Bank or Designated Entity.[4]
(b) Undertake any financial transactions for or with, provide financial assistance to, or transfer any assets or resources to, any person, if such activity relates to the export, transhipment or transit to Russia of any item specified in the relevant Schedules to the Strategic Goods (Control) Order 2021, which includes various military goods, electronics and dual-use goods.
(c) Enter into financial transactions or provide financial assistance/services in relation to the raising of new funds for the Russian Government or the Russian Central Bank.
(d) Undertake any financial transactions for or with, provide financial assistance to, or transfer any assets or resources to, any person in relation to any activity in relation to specific sectors in Donetsk or Luhansk (which include the transport, telecommunications, energy and resource exploration sectors).
(e) Enter into or facilitate any DPT transaction (e.g. payments in cryptocurrencies) in furtherance of any activities prohibited in (a) to (b) above.

All financial institutions must also freeze all funds, financial assets or economic resources owned or controlled by a Designated Bank or Designated Entity, and ensure that such funds, financial assets or economic resources are not made available to such banks/entities.

Notice SNR-N02 contains the exceptions to the prohibitions in Notice SNR-N01, which include:
(a) payments or transfers necessary for basic expenses of any Designated Bank/ Designated Entity (including insurance premiums, tax, mortgage payments, utility or telecommunication charges);
(b) payments or transfers exclusively for payment of fees or service charges in relation to the routine holding or maintenance of frozen assets, and reasonable professional fees for audit, tax, legal or payroll services;
(c) transactions to facilitate a person's withdrawal of assets pursuant to the termination of existing business relations between the person and the Designated Bank (where such person is not a Designated Bank); and
(d) transactions that are necessary for the performance of the functions of the Russian Embassy in Singapore.

Importantly, all financial institutions must keep accurate and complete records of any transactions entered into in reliance of the exceptions.

With the conflict in Russia and Ukraine not abating, it remains to be seen whether the existing scope of sanctions will be modified. Given Singapore's status as an international financial centre and the predominance of the US dollar in international trade, banks in Singapore will need to consider and comply with the broader sanctions promulgated by other major foreign jurisdictions such as the USA and the European Union. Financial institutions in Singapore must monitor developments closely and adapt swiftly to any further developments in this area.

Management of outsourced relevant services for banks

On 11 December 2023, MAS released its Guidelines on Outsourcing ("**Guidelines**") and issued two notices (Notice 658 and Notice 1121) ("**Notices**"). The Guidelines and Notices apply to banks and merchant banks and will take effect on 11 December 2024.

The Notices outline the types of relevant services that will be outsourced and the revised requirements applicable to Singapore banks/merchant banks for the management of the bank's outsourced relevant services. Briefly, the revised requirements include the need for the bank to maintain an inventory of outsourced relevant services to be submitted to MAS semi-annually or upon MAS's request, to obtain customer consent where sub-contracting arrangements involve customer information, and to implement adequate measures to protect customer information that is disclosed to the service provider/sub-contractor.

The Guidelines outline MAS's expectations of a bank/merchant bank that has entered into, or is planning to enter into, an arrangement for ongoing outsourced relevant services ("**Outsourcing Arrangement**"). The bank/merchant bank must conduct a self-assessment of all existing Outsourcing Arrangements against these Guidelines, so as to ensure that risks of the Outsourcing Arrangement are minimised. The bank must also demonstrate to MAS its observance of the expectations in the Guidelines, and where MAS is not satisfied with such observance, MAS may implement additional measures to address any deficiencies noted or take the non-observance into account in its bank assessment.

Bank governance and internal controls

Banks incorporated in Singapore must comply with the CG Regulations and MAS's Guidelines on Corporate Governance for Financial Holding Companies, Banks, Direct Insurers, Reinsurers and Captive Insurers that are incorporated in Singapore ("**CG Guidelines**"). Further, Singapore-incorporated banks listed on the Singapore Exchange must adhere to the Code of Corporate Governance 2018 on a "comply-or-explain" basis.

Under the BA and the CG Regulations, MAS's approval is required for the appointment of key appointment holders ("**KAH**") and directors of banks incorporated in Singapore. MAS's approval is similarly required for the appointment of chief executive officers and deputy chief executive officers of Singapore branches of foreign banks.[5]

The CG Regulations require banks incorporated in Singapore to establish board committees according to MAS requirements. These requirements are explored below.

Board composition

Pursuant to the CG Regulations, a bank incorporated in Singapore must ensure that the majority of the board are independent directors. An independent director must:

(a) be independent from any management and business relationship with the bank;
(b) be independent from any substantial shareholder; and
(c) not have served on the board of the bank for a continuous period of nine years or longer.

Additionally, the majority of the board must be Singapore citizens or permanent residents. For foreign-owned banks incorporated in Singapore, at least one-third of the board must be Singapore citizens or permanent residents.

The CG Guidelines further state that the directors of the board and its committees should collectively provide an appropriate balance of diversity of skills, experience, gender, and knowledge of the bank.

Nominating Committee

The Nominating Committee reviews nominations for the appointment of the bank's KAH. Under the CG Guidelines, the Nominating Committee should assist the board in determining whether a director is independent in character and judgment and whether there are relationships or circumstances that are likely to, or could appear to affect, the director's judgment.

Remuneration Committee

The Remuneration Committee recommends remuneration frameworks for the bank's KAH and reviews remuneration practices. The CG Guidelines provide guiding principles that the Remuneration Committee should take into account when planning remuneration. For instance, long-term incentive schemes are generally encouraged, and remuneration should be pegged to performance.

Risk management and internal controls

Pursuant to the CG Regulations, banks incorporated in Singapore must establish a Risk Management Committee to manage risks on an enterprise-wide basis and review the bank's risk management functions, as well as an Audit Committee to review the bank's financial reporting issues, internal controls and audit functions, and the terms of engagement of external auditors.

The above Committees should comprise at least three directors, the majority of whom, including the Chairman, should be independent.

MAS's Guidance on Private Banking Controls and the information paper "Effective AML/CFT Controls in Private Banking" are also relevant for internal control policies as they recommend AML/CFT policies and practices required for private banking business.

Bank capital requirements

Capital adequacy requirements

MAS Notice 637: Notice on Risk-based Capital Adequacy Requirements for Banks Incorporated in Singapore sets out the capital adequacy requirements for banks incorporated in Singapore. Generally, these requirements are set higher than the Basel III global capital requirement.

The key requirements under MAS Notice 637 are as follows:

	Minimum CAR
Minimum Common Equity Tier 1 Capital Adequacy Ratio ("**CAR**")	6.5%
Minimum Tier 1 CAR	8%
Minimum Total CAR	10%

MAS Notice 637 also states that banks incorporated in Singapore must maintain a capital conservation buffer to be introduced on the following dates:

	From 1 January 2016	**From 1 January 2017**	**From 1 January 2018**	**From 1 January 2019**
Capital Conservation Buffer	0.625%	1.25%	1.875%	2.5%

MAS published revisions to MAS Notice 637 on 20 September 2023 to implement the final BaseI III reforms. The revised notice will be effective from 1 July 2024, with the requirements in the revised notice coming into effect as follows:

(a) for all standards other than the revised market risk and credit valuation adjustment ("**CVA**") standards: to come into effect from 1 July 2024;
(b) for the revised market risk and CVA standards: with effect from 1 July 2024 for compliance with supervisory reporting requirements, and with effect from 1 January 2025 for compliance with capital adequacy and disclosure requirements; and
(c) for the output floor: to commence at 50% from 1 July 2024 and reach full phase-in at 72.5% on 1 January 2029.

Minimum liquid assets framework

MAS Notice 649: Minimum Liquid Assets and Liquidity Coverage Ratio requires the bank to possess liquidity risk management practices. Banks must hold sufficient liquid assets to meet their estimated short-term cash outflows. This ensures that banks possess sufficient liquid assets to draw down when faced with a liquidity crisis.

MAS Notice 649 provides two categories of liquidity risk management framework: Minimum Liquid Asset ("**MLA**"); and Liquidity Coverage Ratio ("**LCR**"). A bank in Singapore ("**Reporting Bank**") that is an internationally active bank or has been notified by MAS that it is a D-SIB need only comply with the LCR framework. The framework provides for a detailed assessment of the bank's liquidity as well as the buffer that the bank would be required to possess to avoid a funding squeeze during liquidity stress. Smaller financial institutions may be given a choice on whether to comply with the LCR or MLA framework.

MAS Notice 651 on Liquidity Coverage Ratio Disclosure further imposes reporting obligations as to the LCR information for a Reporting Bank incorporated in Singapore that is an internationally active bank or that has been notified by MAS that it is a D-SIB. MAS Notice 651 also sets out additional requirements on quantitative and qualitative information that a Reporting Bank must disclose. Cumulatively, these disclosures facilitate market participants' understanding of the Reporting Bank's liquidity risk profile and thereby promote market discipline.

In line with the BCBS's Net Stable Funding Ratio ("**NSFR**") Standard, MAS introduced MAS Notice 652: Net Stable Funding Ratio setting out the minimum all-currency NSFR requirements that a Reporting Bank that is an internationally active bank, or that has been notified by MAS that it is a D-SIB, is required to comply with. MAS Notice 653: Net Stable Funding Ratio Disclosure then sets out the disclosure requirements for such banks in relation to its NSFR. Together, the two MAS Notices are designed to complement the LCR requirements in Singapore.

Rules governing banks' relationships with their customers and other third parties

In Singapore, besides the statutory legislation, the bank-customer relationship is governed largely by contract and tort law by virtue of Singapore's common law heritage. Consequently, liability may arise from contractual or negligence claims.

Under common law, the bank-customer relationship can be characterised as a debtor-creditor relationship. The bank is obliged to honour the customer's mandate regarding the payment of money from the customer's bank account. Generally, banks are legally obliged to repay the deposited sum upon demand. The relationship may also be characterised as trustee-beneficiary, bailor-bailee, or principal-agent, depending on the facts of each case. In most cases, banks owe a duty to act with reasonable care to the customers. Other common law rights that banks may avail themselves of in relation to their customers include the

banker's right of lien and right of set-off. Unless the bank and its customer have agreed otherwise, the right of lien may be exercised over securities deposited by the customer in the ordinary course of business to cover the indebtedness incurred by the customer, while the right of set-off entitles the bank to combine a customer's accounts with the bank against a debt payable by the customer to the bank and to treat the balance as the amount actually standing to the customer's credit.

Section 47 of the BA provides that customer information shall not be disclosed by a bank in Singapore or any of its officers except as expressly provided for in the BA. Contravening this is an offence that is punishable (a) in the case of an individual, to a fine not exceeding S$125,000 or to imprisonment for a term not exceeding three years or to both, or (b) in any other case, to a fine not exceeding S$250,000.

Banks must adhere to the Personal Data Protection Act 2012 ("**PDPA**") in the collection, use and disclosure of personal data. The bank can only collect, use or disclose personal data with the individual's knowledge and consent, for purposes that were communicated to the individual, in a reasonable manner. Additionally, individuals must be given the rights to access and to correct their personal data.

Where the banks' activities fall within the scope of the SFA and FAA, compliance with the relevant legislation is necessary. This includes the requirement to provide proper risk-disclosure statements, disclosure of product information when recommending investment products, and ensuring proper segregation of certain customer monies and assets. The Consumer Protection (Fair Trading) Act 2003 also empowers consumers (i.e. individuals not acting exclusively in the course of business) of "financial products" and "financial services" to seek civil redress for unfair practices.

ABS Code of Consumer Banking Practice

ABS introduced the Code of Consumer Banking Practice to promote good consumer banking practices, to increase transparency as to banking services, to develop a fair bank-customer relationship, and to foster greater confidence in the banking sector.

Under the code, the members of ABS undertake to provide certain standards of banking practice, including making available a contact point to handle customers' queries, providing sufficient information as to the key features and risks of their financial products, and committing to a 14-day timeline for investigation of customers' complaints.

Dispute resolution

Apart from litigation and arbitration, disputes between banks and customers may be adjudicated by the Financial Industry Disputes Resolution Centre ("**FIDReC**"). FIDReC is an independent institution that specialises in the resolution of disputes relating to banking and financial services. All licensed banks are FIDReC members.

From January 2017, the jurisdiction of FIDReC in adjudicating disputes between consumers and financial institutions is up to S$100,000 per claim. FIDReC's services are available to all consumers who are individuals or sole proprietors. However, it is not mandatory to refer disputes to FIDReC for resolution.

FIDReC's dispute resolution process begins with mediation, failing which, the matter will then be heard before a FIDReC Adjudicator or a Panel of Adjudicators.

Money laundering and tax evasion

Singapore, being a member of the FATF, has complied with most of the FATF's recommendations concerning AML/CFT. The following pieces of legislation were enacted to pursue the objectives of AML/CFT:

(a) the Corruption, Drug Trafficking and Other Serious Crimes (Confiscation of Benefits) Act 1992;
(b) the Organised Crime Act 2015;
(c) the Terrorism (Suppression of Financing) Act 2002;
(d) the United Nations Act 2001; and
(e) the Mutual Assistance in Criminal Matters Act 2000.

MAS Notice 626 on Prevention of Money Laundering and Countering the Financing of Terrorism requires banks to take appropriate steps to identify and assess their money laundering and terrorism financing risks and to comply with requirements relating to correspondent banking, wire transfers and record-keeping. As part of their due diligence, banks must continually monitor their business relationships and check the status of their customers against relevant information sources. The Guidelines to MAS Notice 626 further state that when screening customers results in a positive hit against relevant sanctions lists, the bank is obliged to immediately, and without notice, freeze the funds or other assets of designated persons and entities that it has control over. With the enactment of the PSA, MAS has issued MAS Notice PSN01: Prevention of Money Laundering and Countering the Financing of Terrorism – Holders of Payment Services Licence (Specified Payment Services) and MAS Notice PSN10: Prevention of Money Laundering and Countering the Financing of Terrorism – Exempt Payment Service Providers. These Notices set out additional requirements relating to AML/CFT for banks that provide payment services for a specified product. Furthermore, MAS Notice 626 was amended in 2022 to implement various additional safeguards against the higher risks involved in DT transactions. MAS has also issued several guidelines, such as "Strengthening AML/CFT controls on risks of misuse of legal persons/arrangements and complex structures" and "Strengthening Financial Institutions' Countering the Financing of Terrorism Controls", to set out its supervisory expectations of effective AML/CFT controls for risk mitigation.

As part of an initiative by the G20 and the Organisation for Economic Co-operation and Development ("**OECD**"), the Common Reporting Standard ("**CRS**") was implemented to detect and deter tax evasion through the use of offshore accounts. Given that Singapore is on the OECD's "white list" of countries, it has committed to implementing the Automatic Exchange of Information under the CRS. The Income Tax (International Tax Compliance Agreements) (Common Reporting Standard) Regulations 2016 require and empower banks to implement necessary processes to obtain CRS information from account holders for submission to the Inland Revenue Authority of Singapore (i.e. Singapore's tax authority).

MAS Notice 643: Transactions with Related Parties

MAS Notice 643 was promulgated in order to minimise the risk of abuse arising from conflicts of interest in banks' transactions in Singapore with their related parties.

Subject to specified exceptions, every bank in Singapore is required to establish and implement policies and procedures for the purposes of, amongst other things, identifying every person in relation to whom a conflict of interest may arise, ensuring that terms and conditions provided to related parties are not more favourable than to non-related parties, and setting out certain materiality thresholds. Any exception to this rule must be subjected to an independent approval or review process.

Deposit insurance scheme

All full banks are required to participate in a deposit insurance scheme under the Deposit Insurance and Policy Owners' Protection Schemes Act 2011 ("**DIPOPSA**"). The DIPOPSA

introduces limited protection for depositors by insuring their deposits for up to S$75,000 per depositor per member bank. This will rise to S$100,000 from April 2024.

Eliminating cheques

With the fall in cheque usage in Singapore, the cost of clearing a cheque has increased rapidly. Banks cannot absorb these costs and will therefore commence charging for SGD-denominated cheques.

MAS has proposed a roadmap aimed at retiring the cheque truncation system. With this, all corporate cheques will be eliminated by the end of 2025. Individuals have been given a longer period of time and can use cheques for a period beyond 2025.

Scams (anti-phishing) developments

To protect retail customers from digital banking scams, in 2022, MAS and ABS announced measures to be implemented by Singapore banks ("**Measures**"), including:

(a) requiring additional customer confirmations to process significant changes to customer accounts and other high-risk transactions identified through fraud surveillance;
(b) setting a default transaction limit for online funds transfers to S$5,000 or lower;
(c) provision of an emergency self-service "kill switch" for customers to suspend their accounts quickly if they suspect that their bank accounts have been compromised;
(d) removal of clickable links in emails or SMSs sent to retail customers;
(e) threshold for funds transfer transaction notifications to customers to be set by default at S$100 or lower;
(f) implementing a delay of at least 12 hours before activation of a new soft token on a mobile device; and
(g) notification to an existing mobile number or email registered with the bank whenever there is a request to change a customer's mobile number or email address.

On 25 October 2023, MAS released a consultation paper seeking comments on proposed enhancements to the EUPG that were introduced in 2018 to foster public confidence in using electronic payments. The proposed enhancements mainly deal with three main areas:

(a) aligning the financial industry with the established anti-scam industry practices implemented by major retail banks (i.e. the Measures above);
(b) additional duties of responsible FIs (as defined below) to facilitate prompt detection of scams by consumers and a fairer dispute resolution process; and
(c) reinforcement of consumers' responsibility to take necessary precautions against scams.

Additionally, MAS has also proposed an SRF for sharing responsibility for scam losses amongst financial institutions, telecommunications and consumers. The SRF will be implemented as part of the overall suite of anti-scam measures, with three key policy objectives: (i) to preserve confidence in digital payments and digital banking in Singapore; (ii) to strengthen relevant entities' direct accountability to consumers on losses incurred from digital scams; and (iii) to emphasise individuals' responsibility to be vigilant against scams. The SRF is expected to apply to all full banks and relevant payment service providers, in particular retail banks and payment service providers who provide e-wallet services, as custodians of consumers' money ("**FIs**"). The SRF and EUPG are to complement each other.

The SRF introduces specific anti-scam duties for FIs, and failing to fulfil any of the relevant duties will render the FI responsible for making payouts to consumers for their losses. These duties ensure that crucial communication channels are present to keep consumers informed when transactions or high-risk activities are performed, as well as safeguards to

mitigate consumers' exposure to scam losses when their accounts are compromised. It is also proposed that responsibility be shared for losses arising from phishing scams based on a "waterfall" approach, with the FI first being expected to bear all losses if any of its duties have been breached. This recognises that Fis are primarily accountable to consumers as custodians of their money.

The SRF is a welcome development to reinforce consumer confidence in digital banking and enhance the accountability of the banking and telecommunications channels.

* * *

Endnotes

1. Note: A digital payment token is currently defined under the PSA as a digital representation of value (save for an "excluded digital representation of value" prescribed as such by MAS) that: (a) is expressed as a unit; (b) is not denominated in any currency, and is not pegged by its issuer to any currency; (c) is, or is intended to be, a medium of exchange accepted by the public, or a section of the public, as payment for goods or services or for the discharge of a debt; (d) can be transferred, stored or traded electronically; and (e) satisfies such other characteristics as MAS may prescribe.
2. Paragraph 3.4, MAS Responses to Feedback Received – Review of the Anti-Commingling Framework for Banks (30 November 2019).
3. This refers to individuals who do not fall within the definition of "accredited investor" under the SFA.
4. A "Designated Entity" in MAS Notice SNR-N01 refers to entities to be identified in a subsequent Annex (who are involved in the export of certain items listed in the relevant Schedules to the Strategic Goods (Control) Order 2021).
5. This requirement is now provided for in section 53A(2) of the BA, as MAS Notice 622A: Appointment of Chief Executives of Branches of Banks Incorporated Outside Singapore has been cancelled as of 3 June 2019.

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Ting Chi Yen is a Senior Partner at Joseph Tan Jude Benny LLP with 19 years of practice experience. He has a broad general corporate and commercial practice, with a focus on banking and finance and corporate advisory.

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In addition, Chi Yen has a breadth of experience in all aspects of non-contentious shipping work and frequently acts for shipping lines and banks in the financing, sale and purchase of vessels, registration and mortgages in local and international ship registries, including leasing arrangements, charterparties, carriage and freight. His practice includes real estate and conveyancing and covers the acquisition, disposition and securitisation of residential, industrial and retail/commercial properties.

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Introduction

In February 2023, the Financial Action Task Force ("**FATF**") announced that South Africa had been placed on the "grey list" of countries subject to increased monitoring and scrutiny by the FATF as a consequence of its failure to comply with the FATF's 40 Recommendations on Money Laundering ("**40 Recommendations**"). Following the announcement, the South African Reserve Bank ("**SARB**"), Prudential Authority ("**PA**") and Financial Intelligence Centre ("**FIC**") were amongst the regulatory bodies that published, *inter alia*, guidance notes, standards and communiques to address the deficiencies identified by the FATF. The SARB's Financial Stability Department ("**FSD**")[1] confirmed that, notwithstanding South Africa's robust banking regulatory framework, steps were also required to be taken by banks to comply with the 40 Recommendations in order for South Africa's "grey listing" to be lifted as soon as possible.

Regulatory architecture: Overview of banking regulators and key regulations

The "twin peaks" model of financial regulation was first introduced in South Africa through the enactment of the Financial Sector Regulation Act ("**FSR Act**"),[2] which establishes the PA[3] and Financial Sector Conduct Authority ("**FSCA**")[4] as the bodies responsible for prudential and market conduct regulation, respectively. The functions of both authorities are carried out, *inter alia*, to protect financial customers and maintain financial stability.[5] The PA is primarily concerned with the regulation and supervision of financial institutions that provide financial products or services and market infrastructure, whereas the FSCA regulates and supervises the conduct of financial institutions.[6] The FSR Act regulates co-operation between these bodies, the SARB, Financial Stability Oversight Committee, National Credit Regulator, and FIC.

The Code of Banking Practice ("**Banking Code**")[7] aims to "promote good banking practices" by setting minimum standards for banks when dealing with their customers by increasing "transparency", promoting a "fair and open relationship" between banks and their customers, and "fostering confidence in the banking system".[8]

The commercial and retail banking sector is primarily regulated in terms of the Banks Act,[9] which requires that a public company must be registered as a bank in terms of the Banks Act to conduct "the business of a bank",[10] and such registered banks must renew their licences annually.[11]

Other key pieces of legislation with which Banks must comply are set out below and supplemented under "Rules governing banks' relationships with their customers and other third parties":

1. Banking Institutions Act;[12]
2. Bills of Exchange Act;[13]
3. Companies Act;[14]
4. Cybercrimes Act;[15]
5. Financial Advisory and Intermediary Services Act ("**FAIS Act**");[16]
6. Financial Institutions (Protection of Funds) Act;[17]
7. Financial Intelligence Centre Act ("**FIC Act**");[18]
8. Financial Markets Act;[19]
9. Financial Sector and Deposit Insurance Levies (Administration) and Deposit Insurance Premiums Act;[20]
10. Financial Sector and Deposit Insurance Levies Act ("**FSDIL Act**");[21]
11. FSR Act;[22]
12. Income Tax Act;[23]
13. National Payment System Act;[24]
14. Prevention and Combating of Corrupt Activities Act ("**PRECCA Act**");[25]
15. Prevention of Organised Crime Act ("**POC Act**");[26]
16. Promotion of Access to Information Act ("**PAI Act**");[27]
17. Protection of Constitutional Democracy Against Terrorist and Related Activities Act ("**POCDATARA Act**");[28]
18. Protection of Investment Act;[29]
19. Protection of Personal Information Act ("**POPI Act**");[30]
20. Securities Transfer Tax Act ("**STT Act**");[31]
21. Securities Transfer Tax Administration Act ("**STTA Act**");[32]
22. Tax Administration Act;[33] and
23. Value Added Tax Act.[34]

In addition to participating in and contributing to international fora such as the Basel Committee on Banking Supervision ("**BCBS**") and the FATF, the PA is a member of several organisations in Africa, such as the Community of African Banking Supervisors[35] and the Eastern and Southern Africa Anti-Money Laundering Group.[36]

The Southern African Development Community ("**SADC**") is subject to the SADC Protocol on Finance and Investment ("**Protocol**"), which seeks to "foster harmonisation of the financial and investment policies of the State Parties" by, *inter alia*, promoting co-operation and co-ordination amongst central banks regarding: exchange control policies; legal and operational frameworks; payment, clearing and settlement systems; bank supervision; and information and communications technology. The implementation of the Protocol is facilitated through the Committee of Central Bank Governors in SADC and the SADC Banking Association.[37]

The Banks Act prohibits undesirable conduct by imposing certain restrictions on the activities of banks.[38] Generally, the assets of a bank must be held in its own name, unless the assets are hypothecated in good faith to secure an actual or potential liability, where such assets have either been exempted by the PA in writing or have been designated as exempted in the *Government Gazette*. Investments by a bank in immovable property or shares, and loans made to subsidiaries of the bank with the primary object of acquiring and holding or developing immovable property, are restricted.[39]

Recent regulatory themes and key regulatory developments

Chapter 12A of the FSR Act[40] introduces a new regulatory framework governing the resolution of "designated institutions" ("**DIs**").[41] DIs include banks and "systemically

important financial institutions".[42] Section 166J empowers the SARB to recommend to the Minister of Finance that a DI be placed in resolution in specified circumstances, and section 166D(1) sets out the steps that may not be taken in relation to a DI without the concurrence of the SARB.

Any such steps taken without the concurrence of the SARB are void.[43] On 31 May 2023, the PA released "Prudential Standard RA01 – Stays on Early-Termination Rights and Resolution Moratoria on Contracts of Designated Institutions in Resolution" and "Prudential Standard RA02 – Transfers of Asset and Liabilities of a Designated Institution in Resolution" ("**RA02**"). RA02 regulates the orderly resolution of a DI by the SARB.

In December 2022, significant amendments to the FIC Act were effected, including the expansion of the list of "accountable institutions"[44] in Schedule 1 to include, *inter alia*, co-operative banks and payment clearing service operators. The amendments to the FIC Act also impose obligations on accountable institutions to establish the identity of the "beneficial owner"[45] of their clients that are juristic persons, and to take reasonable steps to verify the same.

The FIC has issued directives regarding additional reporting requirements and screening obligations.[46] Directive 7 of 2023[47] requires accountable institutions to submit information "regarding their understanding of money-laundering (ML), terrorist financing (TF) and proliferation financing (PF) risks and their assessment of compliance with obligations in terms of [the FIC Act] to the FIC through [the completion] of a risk and compliance return". Directive 8 of 2023[48] requires all accountable institutions, *inter alia*, to screen prospective and current employees for competence and integrity.

On 31 September 2023, the PA published a Proposed Directive on Proposed Amendments to the Regulations Relating to Banks for comment, to incorporate the remaining Basel III post-crisis reforms agreed by BCBS into the Regulations Relating to Banks ("**Banking Regulations**"),[49] which are intended to be implemented by 1 July 2025, and contain revisions to the standardised and internal ratings-based approaches for credit risk, streamlining of the operational risk framework, refinements to the definition of the leverage ratio exposure measure, and the commencement of a phase-in output floor percentage.[50]

The 2021 FATF Mutual Evaluation Report ("**ME Report**"), which was compiled subsequent to a review of the degree to which the South African anti-money laundering ("**AML**") and combatting of terrorist financing ("**CTF**") regime complied with the FATF's 40 Recommendations, concluded that South Africa was deficient in its compliance with 20 of the 40 Recommendations. After failing to make sufficient progress to achieve the recommendations set out in the ME Report, South Africa was added to the list of jurisdictions subject to "increased monitoring" by the FATF, commonly referred to as the "grey list", on 24 February 2023. This led to the publication of the "South African Reserve Bank's commitment to the fight against money laundering, the financing of terrorism and proliferation financing" that same day.

A follow-up report published by the FATF on 28 November 2023, entitled "South Africa; Follow-up Report on Technical Compliance Re-Rating", indicated that significant progress had been made in addressing the deficiencies identified in the ME Report. Steps taken include the enactment of the General Laws (AML and CTF) Amendment Act[51] and amendment of the POCDATARA Act. According to a media statement released by the SARB on 29 November 2023, South Africa is compliant with 35 of the 40 Recommendations.

On 9 December 2023, the PA published Circular 4 of 2023: "Guidelines for matters related to the prevention of banks or controlling companies being used for terrorist financing or other related unlawful activity", which deals, *inter alia*, with the identification and assessment

of terrorist financing risks, customer due diligence (to assess whether or not prospective customers pose a high terrorist financing risk), transaction monitoring and payment screening.

In March 2023, the FSR Act was amended by the Financial Sector Laws Amendment Act[52] to provide for the establishment of a deposit insurance scheme ("**DIS**"), including a Corporation for Deposit Insurance ("**CODI**") and Deposit Insurance Fund ("**DIF**"). On 3 April 2023, the SARB published a media statement in which it announced the establishment of the CODI, the primary responsibilities of which will be to "build up and manage" the DIF, "from which depositors will be paid out in the event of their bank failing and its subsequent closure", and to "promote awareness among the public … of the protection provided to them by the DIS".

The Draft Deposit Insurance Regulations ("**Draft Regulations**")[53] were published to provide for procedural and administrative matters necessary for the effective operation of the CODI and DIF.[54] Amongst other things, the Draft Regulations define the scope of qualifying deposits and qualifying products for purposes of the DIS. In this regard, a "qualifying depositor" includes an account holder of a simple account, a beneficiary of a formal beneficiary account, and an informal beneficiary account holder, that holds a qualifying product. "Qualifying product" is, in turn, defined as "a product included in depositor protection, namely a deposit, qualifying deposit or a product where the capital amount is guaranteed and repayable at par, regardless of its term or currency". The Draft Regulations provide that the maximum amount the CODI may apply from the DIF in respect of a qualifying depositor of a bank in resolution for their qualifying deposit balance (the sum of all qualifying deposits) is R100,000.

Section 166BC of the FSR Act will, once in effect, empower the CODI to charge members deposit insurance levies ("**DILs**"). In this regard, the FSDIL Act[55] provides for the imposition and collection of levies from supervised entities such as banks. Such levies will replace the annual licence fees presently paid by banks under the Banks Act. Section 9 of the FSDIL Act, which provides for the payment of DILs, commences on 1 April 2024. In light of concerns regarding the "potential for double-charging emanating from the transition" to the payment of these levies, the PA published Prudential Communication 14 of 2022, in which the PA undertook to "refund the pro-rata surplus of the annual licence fees" paid by banks, which surplus will be calculated based on the date of commencement of the FSDIL Act.

On 28 October 2022, the PA published the Guidelines Related to Risk Management Practices Concerning Proliferation Financing Risk ("**PF Guidelines**") to provide guidance on the implementation of AML and CTF measures in line with FATF Recommendations. The PF Guidelines, *inter alia*, identify proliferation financing risks and provide guidance on the content of the proliferation financing risk assessment that is to be undertaken by banks to ensure an effective risk approach.

On 10 November 2022, the PA and SARB published the Anti-money laundering, counter-financing of terrorism and counter-proliferation financing (AML/CTF/CPF) awareness communique 1 of 2023, the purpose of which was to provide periodic updates on the PA's key observations on the deficiencies of accountable institutions in complying with the provisions of the FIC Act, and to encourage accountable institutions to take note of the deficiencies and scrutinise their compliance programmes where necessary.

The draft Joint Standard ("**Draft Joint Standard**")[56] was issued to ensure that certain financial institutions are prepared for potential cyberattacks. If a financial technology ("**FinTech**") provider is classified as a "financial institution"[57] under the Draft Joint Standard, then that FinTech provider will be required to comply with the minimum requirements set out therein. The Draft Joint Standard sets out the minimum requirements for sound practices and processes of cybersecurity and cyber resilience to which financial institutions are required to

adhere. The Draft Joint Standard requires financial institutions to, amongst others, (i) ensure that any or all potential risks relating to cybersecurity and cyber resilience are considered, and (ii) take steps to mitigate the impact of a breach of its cybersecurity systems.

On 1 August 2023, the PA published its Proposed Guidance on climate-related disclosure practices for banks ("**Proposed Climate Disclosure Guideline**"), to strengthen and regulate the supervision of climate-related risk management to enhance the financial soundness and stability of banks. The objectives of the Proposed Climate Disclosure Guideline will require the board of directors ("**Board**") and senior management of banks to (i) develop processes and policies for assessing the potential impacts of climate-related risks, and (ii) assign the roles and responsibilities throughout the bank's organisational structure to manage climate-related risks. No effective date for the Proposed Climate Disclosure Guidelines has been published.

In November 2023, pursuant to the BRICS Summit, which concluded on 24 August 2023, the "*Bridging climate data gaps with Frontier Technology*" ("**BRICS Report**") was published. The report highlights the climate data required by the BRICS central banks in emerging technologies to bridge the climate data gaps. In the BRICS Report, the BRICS countries note that new technological data advances, such as artificial intelligence, distributed ledger technologies and earth observation satellites, may strengthen financial institutions' ability to use climate-related opportunities and build resilience to climate risks.

Bank governance and internal controls

Regulation 40(1)[58] provides that the directors of a bank are required to have "a basic knowledge and understanding of the conduct of the business of a bank and of the laws, codes of conduct and customs that govern the activities of such institutions" and that the competence of every director of a bank is required to be commensurable with the nature and scale of the business conducted by that bank. Regulation 40(2)[59] requires that directors "perform their functions with diligence and care" and with a reasonable degree of competence.

In terms of section 1(1A) of the Banks Act, the PA bears the responsibility to ensure that a person is fit and proper to hold the office of director or executive officer of a bank or controlling company. In this regard, section 60(5) provides that banks must give written notice of the nomination of any person for appointment as chief executive officer, director or executive officer by providing prescribed information concerning the nominee to the PA. The Banks Act authorises the PA to determine whether a person is fit and proper to hold office as a director of a bank or controlling company by requesting that person to complete a questionnaire to allow the PA to form an opinion regarding that person's qualities.[60]

Regulation 42(1) requires banks and controlling companies to submit a duly completed statement and declaration to the Registrar prior to the appointment of prospective directors or "executive officers".[61] On 25 July 2023, the PA published Circular 2 of 2023, which confirms that the definition of "executive officer" includes employees "in charge of a risk management function of the bank".

Section 66(2)(b) of the Companies Act requires that all public companies have a minimum of three directors and section 60(3) of the Banks Act provides that not more than 49% of the directors of a bank may be employees of that bank or any of its subsidiaries, or its controlling company or its subsidiaries. Furthermore, no more than 49% of the directors of a controlling company may be employees of that company or any bank in respect of which that company is registered as a controlling company and at least two directors must be employees of the bank.[62]

Regulation 49(1)[63] requires all banks to establish and maintain an independent compliance function to "ensure that the bank continuously manages its regulatory and supervisory risk". The compliance function must be led by a compliance officer who is a senior executive officer of the bank, and it must be provided with sufficient resources to address non-compliance with laws, regulations and supervisory requirements to establish a "compliance culture" in the bank. The compliance officer must function independently from functions such as internal audit and must be demonstrably independent.

Regulation 39(6)(b)(vii) requires the segregation of duties to (i) promote sound governance and effective risk management in the bank, and (ii) avoid conflicts of interest, to be implemented and maintained by the Board and senior management of a bank, and regulation 50(1) requires banks to "implement and maintain robust structures, policies, processes and procedures to guard against the bank being used for purposes of market abuse such as insider trading".

On 11 July 2014, the SARB published Guidance Note 5/2014,[64] which informs banks of the "potential risks arising from the use of service providers" and provides guidelines on "assessing and managing risks pertaining to outsourcing relationships". All outsourcing arrangements that involve "material business activities and functions" entered into by banks must be subject to "appropriate due diligence, approval and ongoing monitoring by the bank". Material business activities and functions generally not permitted to be outsourced include management oversight, governance and risk management, internal audit, and core banking and financial reporting information technology systems.

Section 64(1) of the Banks Act requires that at least three members of the Board must serve on an audit committee, which assists the Board by, *inter alia*, evaluating the adequacy of the bank's internal control systems, accounting practices, information systems and auditing processes. At least three directors, of whom at least two are non-executive directors, must be appointed to form a risk and capital management committee that will assist the Board with risk policy, mitigation and management.[65] Furthermore, a directors' affairs committee and remuneration committee, comprising only non-executive directors, must be established. The directors' affairs committee assists the Board in, *inter alia*, determining and evaluating the bank's corporate governance structure and practices, and establishing and maintaining a directorship continuity programme.[66] The remuneration committee will assist the Board by overseeing the design and operation of the bank's compensation system and consulting with shareholders.[67]

Regulation 43(1)(e)(ii) provides that banks must, on a regular basis but at least annually, disclose to the public certain required qualitative and quantitative information related to remuneration. The particulars of such required information are specified in regulation 43(2)(f), and include the bank's remuneration structure and processes, the link between remuneration and performance, oversight of remuneration, and the amount of remuneration awards for the financial year. No rules or limitations in respect of remuneration paid to staff generally have been published.

Bank capital requirements

Section 70(2B)(a) of the Banks Act provides that a bank whose business includes trading in financial instruments must manage its affairs in such a way that the sum of its "common equity tier 1 capital, additional tier 1 capital and tier 2 capital, and its common equity tier 1 unimpaired reserve funds, additional tier 1 unimpaired reserve funds and tier 2 unimpaired reserve funds"[68] do not at any time amount to less than the greater of R250 million, or a

prescribed percentage of the sum of amounts relating to the different categories of assets and other risk exposures, calculated in the prescribed manner. The minimum capital and reserve funds for banking groups are set out in section 70A.[69]

Section 72(1) provides that "a bank shall hold in South Africa level one high-quality liquid assets to a value which does not amount to less than the sum of amounts, calculated as prescribed percentages", but not exceeding 20%, of such different categories of its liabilities as may be specified by regulation. Section 72(3) prohibits a bank from pledging or otherwise encumbering any portion of the level one high-quality liquid assets held in compliance with section 72(1). The PA may, however, exempt a bank from this prohibition.

The South African banking sector implemented Basel III: A global regulatory framework for more resilient banks and banking systems in a phased approach between 2013 and 2019 ("**Basel III**") and the PA has since published and continues to publish directives pertaining to the implementation of Basel III. Basel III comprises three main pillars, namely: (i) the minimum capital requirements; (ii) supervisory review; and (iii) market discipline.

On 19 September 2023, the PA published a Proposed Directive on Matters Related to Pillar 3 Disclosure Requirements ("**Proposed Disclosure Requirements**").[70] The Proposed Disclosure Requirements require the use of the specific templates for banks' quarterly, semi-annual and/or annual reporting periods and set out five guiding principles for the disclosures, i.e. that the disclosure must be (i) clear, (ii) comprehensive, (iii) meaningful to users, (iv) consistent over time, and (v) comparable across banks. The Proposed Disclosure Requirements also impose obligations on the Board and senior management of a bank to establish and maintain effective internal control structures for the disclosure of financial information, including in relation to Pillar 3 of Basel III. Such disclosures must include suitable and appropriate information regarding (i) capital distribution constraints, (ii) the nexus between financial statements and regulatory exposure, (iii) the encumbered and unencumbered assets on its balance sheet, (iv) the remuneration and special payments awarded during the relevant financial year, (v) credit risks, (vi) counterparty credit risks, (vii) securitisation and sovereign exposure, and (viii) interest rate risk.

Rules governing banks' relationships with their customers and other third parties

Third parties and customers

The Consumer Protection Act ("**CP Act**")[71] applies to every "transaction"[72] occurring within South Africa, unless one of the exemptions provided for in section 5 of the CP Act applies. "Service", as used in the definition of a "transaction", is, in turn, defined as including "any banking services, or related or similar financial services", subject to specified exceptions. The CP Act aims to "promote and advance the social and economic welfare of consumers in South Africa" by establishing national norms and standards regulating interactions with consumers and prohibiting certain unfair practices.

The Home Loan and Mortgage Disclosure Act[73] promotes "fair lending practices, which require disclosure by financial institutions of information regarding the provision of home loans" in its annual financial statements. Information that must be disclosed includes the total number and amount in South African Rand of home loan applications received, declined, closed and disbursed, and approved during a financial year in respect of which financial statements have been prepared.

The National Credit Act ("**NC Act**")[74] aims, *inter alia*, to "promote a fair and non-discriminatory marketplace for access to consumer credit and for that purpose to provide for the general regulation of consumer credit and improved standards of consumer information".

In this regard, a lender is required to be registered as a credit provider in terms of the NC Act "if the total principal debt owed to that credit provider under all outstanding credit agreements, other than incidental credit agreements" exceeds a prescribed threshold.[75] Absent such registration, a lender is not permitted to offer, make available or extend credit, enter into a credit agreement, or agree to do any of the aforementioned activities. The NC Act applies to credit agreements between parties on an arm's-length basis, made within or having an effect within South Africa, subject to the exceptions provided for in section 4.

As mentioned above, the PAI Act provides for the right of access to records of private bodies where such records are required for the exercise or protection of any rights. Several grounds for refusal of a request for access to records are provided for in Chapter 4, including the mandatory protection of the privacy of third parties who are natural persons, as well as the protection of the commercial or confidential information of third parties, subject to the public interest override provided for in section 70.

Employees

Several statutes regulating the employer-employee relationship, both on an individual and collective level, apply to the interaction between banks and their employees, including the:

1. Compensation for Occupational Injuries and Diseases Act;[76]
2. Unemployment Insurance Act;[77]
3. Labour Relations Act;[78]
4. Basic Conditions of Employment Act;[79]
5. Employment Equity Act;[80]
6. Employment Tax Incentives Act;[81]
7. Occupational Health and Safety Act;[82]
8. National Minimum Wage Act;[83]
9. Promotion of Equality and Prevention of Unfair Discrimination Act;[84]
10. Skills Development Act;[85]
11. Skills Development Levies Act;[86] and
12. Unemployment Insurance Contributions Act.[87]

Anti-money laundering and anti-terrorism financing

Banks are obliged to comply with AML and CTF legislation such as the POC Act, FIC Act, Banks Act, PRECCA Act, POCDATARA Act and Directive for Conduct within the National Payment System in respect of the FATF Recommendations for Electronic Fund Transfers ("**Directive 1 of 2022**").[88] In this regard:

1. the POC Act creates three general money-laundering offences, being: the substantive money-laundering offence;[89] assistance of another in laundering the proceeds of unlawful activities; or acquiring, using or possessing the proceeds of unlawful activities;
2. the FIC Act seeks to combat money laundering through the creation of the FIC, which is responsible for identifying the proceeds of unlawful activities. The FIC Act imposes extensive obligations on accountable institutions, including banks, such as "know-your-customer" requirements, in terms of which accountable institutions must establish and verify the identity of prospective clients.[90] Banks are also required to report cash transactions[91] and international electronic transfers above a prescribed limit,[92] as well as "suspicious and unusual" transactions, to the FIC;[93]
3. regulation 50(1) of the Banking Regulations requires banks to establish policies and processes to protect themselves from being used for financial crimes such as money laundering; and
4. Directive 1 of 2022 was issued to regulate the conduct of accountable institutions relating to electronic fund transfers ("**EFTs**") as prescribed by FATF Recommendations.

As discussed above, section 31 of the FIC Act requires that accountable institutions authorised to conduct international funds transfer transactions report transactions above a prescribed limit to the FIC by way of an international funds transfer report ("**IFTR**"). According to Guidance Note 9 on International Funds Transfer Reporting in terms of section 31 of the FIC Act, issued by the FIC on 17 November 2023 ("**Guidance Note 9**"), the threshold is currently R19,999. Guidance Note 9 deals, *inter alia*, with the period for reporting an IFTR, methods for submission of an IFTR, and practical implementation of such reporting.

Directive 1 of 2022 applies to accountable institutions that facilitate or enable the origination or receipt of both domestic and cross-border EFTs, and/or act as an intermediary in receiving or transmitting EFTs. The Directive sets out the responsibilities of ordering, intermediary and beneficiary financial institutions. The ordering financial institution must, *inter alia*, include as part of an EFT certain information concerning the originator of the EFT, including the originator's name, account number, identity/passport number and address. The ordering financial institution is also required to include certain information of the beneficiary.

South Africa's targeted financial sanctions regime is implemented by way of the FIC Act and POCDATARA Act. In terms of the FIC Act, the financing of a person or entity that is the subject of targeted financial sanctions, which sanctions have been imposed by way of a resolution of the United Nations Security Council under Chapter VII of the Charter of the United Nations, is prohibited.[94] The Director of the FIC is required to give notice of such persons or entities "by appropriate means of publication".[95] Furthermore, section 4 of the POCDATARA Act provides that the culpable financing and facilitation of the activities of an entity that is the subject of targeted financial sanctions, not only by accountable institutions but by "any person", either "directly or indirectly", constitutes an offence. In this regard, the person in question must intend that the assistance be used for the benefit of that entity, or must know or ought reasonably to have known or suspected that the assistance would be used for the benefit of that entity.

Enforcement

Section 45C(1) of the FIC Act provides that the FIC or a supervisory body "may impose an administrative sanction on any accountable institution, reporting institution or other person to which [the FIC Act] applies when satisfied on available facts and information that the institution or person" has failed to comply with the provisions of the FIC Act.

Section 45C(3) of the FIC Act states that administrative sanctions may include a caution, reprimand, directive to take remedial action or make specific arrangements, the restriction or suspension of certain specified business activities, or a financial penalty not exceeding R10 million in respect of natural persons and R50 million in respect of incorporated entities. Section 45C also regulates the powers of the FIC and the procedural aspects of the administrative sanctions framework.

Conclusion

The various banking regulatory bodies in South Africa developed the regulatory framework not only to address the effects of South Africa's "grey listing", but to ensure that third parties and customers who engage with the banking sector are treated fairly. The regulatory framework makes provision for a resilient financial sector that addresses (i) technological advances in FinTech, (ii) the climate change crisis and the effect thereof on the banking sector, (iii) the increased need for cybersecurity practices to prevent potential cybersecurity breaches, and (iv) enforcement of any contraventions of the provisions of the framework.

Endnotes

1. "*An event-window assessment of the impact of FATF grey-listing on the South African stock market and financial stability consequences*" published by the SARB's FSD in September 2023.
2. No. 9 of 2017.
3. Section 32 of the FSR Act.
4. Section 56 of the FSR Act.
5. Sections 33 and 57 of the FSR Act.
6. Sections 34(1)(a) and 58(1)(a) of the FSR Act.
7. Published by the Banking Association of South Africa, available at https://www.banking.org.za/wp-content/uploads/2019/04/Code-of-Banking-Practice-2012.pdf (accessed on 24 January 2024).
8. Preamble of the Banking Code.
9. No. 94 of 1990.
10. Section 1 of the Banks Act.
11. Section 35 of the Banks Act. The provisions of the Banks Act are not applicable to mutual banks or co-operative banks, as these institutions are regulated in terms of separate statutes. Mutual banks are separate banking institutions whose members qualify as such by virtue of their being shareholders in the bank, and are entitled to participate in the exercise of control in a general meeting of the bank, which bank is a separate juristic person. Mutual banks must be registered in terms of the Mutual Banks Act No. 124 of 1993. Co-operative banks are co-operatives or co-operative financial institutions, registered in terms of the Co-Operative Banks Act No. 40 of 2007 ("**Co-Operative Banks Act**"), whose members fall within the ambit of the Co-Operative Banks Act. This is also the position with regard to the Land Bank and the Development Bank of Southern Africa, the provisions of which are not considered in this chapter.
12. No. 25 of 1946, which provides for the registration of banking institutions governed as companies, upon application by such institutions.
13. No. 34 of 1964, which regulates bills of exchange and promissory notes.
14. No. 71 of 2008, which deals, *inter alia*, with: the incorporation, registration, organisation and management of companies; the relationships between companies, their shareholders and directors; and amalgamations, mergers and takeovers of companies.
15. No. 19 of 2020, which creates offences pertaining to cybercrime and regulates several aspects incidental to such offences, including the investigation and reporting of cybercrimes.
16. No. 37 of 2002, which regulates the rendering of certain financial advisory and intermediary services to clients.
17. No. 28 of 2001, which, *inter alia*, provides for and consolidates the laws relating to the investment, safe custody and administration of funds and trust property by financial institutions.
18. No. 38 of 2001, which, *inter alia*, establishes the FIC to combat money laundering ("**ML**") activities and the financing of terrorist and related activities ("**FTRA**"), and imposes certain duties on institutions and other persons that might be used for ML purposes and FTRA.
19. No. 19 of 2012, which, *inter alia*: regulates financial markets; licenses and regulates exchanges, central securities depositories, clearing houses, central counterparties and trade repositories; regulates and controls securities trading, clearing, settlement, custody and administration; and prohibits insider trading and market abuses.

20. No. 12 of 2022, which provides for, *inter alia*, the collection and administration of levies imposed in terms of the Financial Sector and Deposit Insurance Levies Act No. 11 of 2002.
21. No. 11 of 2002, which provides for the imposition of financial sector levies on supervised entities, the imposition of a deposit insurance levy, the exemption from such levies under certain circumstances and the allocation of amounts levied to financial sector bodies.
22. The FSR Act "aims to achieve a stable financial system that works in the interests of financial customers and that supports balanced and sustainable economic growth in the Republic" by establishing a regulatory and supervisory framework that promotes the objectives stipulated in the FSR Act.
23. No. 58 of 1962, which, *inter alia*, consolidates the law relating to the taxation of incomes and donations, and provides for the recovery of taxes on persons.
24. No. 78 of 1998, which regulates the activities of participants in the payment, clearing and settlement systems, including banks.
25. No. 12 of 2014, which, *inter alia*, creates offences relating to corrupt activities, provides for the strengthening of measures to prevent and combat such activities, and imposes duties on certain persons to report corrupt transactions.
26. No. 121 of 1998, which, *inter alia*, introduces measures to combat organised crime and ML, prohibits certain racketeering activities and provides for the recovery of the proceeds of unlawful activity.
27. No. 2 of 2000, which gives effect to the constitutional right of access to any information held by the State and any information that is held by another person that is required for the exercise or protection of any rights.
28. No. 33 of 2004, which, *inter alia*, provides for measures to prevent and combat terrorist and related activities and the funding of those activities.
29. No. 22 of 2015, which, *inter alia*, protects investments in accordance with and subject to the Constitution of the Republic of South Africa 1996, in a manner that balances the public interest and the rights and obligations of investors.
30. No. 4 of 2013, which establishes certain conditions for the lawful processing of "personal information" (as defined in section 1 of the POPI Act), being accountability, processing limitation, purpose specification, further processing limitation, information quality, openness, security safeguards and data subject participation. The POPI Act also establishes the Information Regulator (as defined in section 1 of the POPI Act) as the juristic person responsible for enforcing and monitoring compliance with the POPI Act.
31. No. 25 of 2007, which provides for the levying of a securities transfer tax ("**STT**") in respect of every transfer of any security.
32. No. 26 of 2007, which provides for the administration of STT.
33. No. 28 of 2011, which aims to ensure the effective and efficient collection of tax.
34. No. 89 of 1991, which provides for taxation in respect of the supply of goods and services and the importation of goods.
35. The Community of African Banking Supervisors is a technical committee of the Association of African Central Banks.
36. https://www.resbank.co.za/en/home/what-we-do/Prudentialregulation/participation-in-international-forums (accessed on 24 January 2024).
37. https://www.resbank.co.za/en/home/what-we-do/payments-and-settlements/regional-and-continental-initiatives (accessed on 24 January 2024).
38. Section 78(1) of the Banks Act.

39. We note that a similar restriction is in place regarding investments in and loans or advances to “associates” under section 37(1) of the Banks Act.
40. Chapter 12A of the FSR Act came into effect on 1 June 2023.
41. Section 29A of the FSR Act.
42. Section 1 of the FSR Act.
43. Section 166D(2) of the FSR Act.
44. “Accountable institution” is defined in section 1(1) of the FIC Act as “a person referred to in Schedule 1” of the FIC Act. Item 6 of Schedule 1, in turn, lists “[a] person who carries on the “business of a bank” as defined in the Banks Act” as an accountable institution.
45. Section 1 of the FIC Act.
46. Section 43A(3) of the FIC Act.
47. Published under GN 3253 in *GG* 48256 of 31 March 2023.
48. Published under GN 3257 in *GG* 48357 of 31 March 2023.
49. Published under GN R1029 in *GG* 35950 of 12 December 2012.
50. https://www.resbank.co.za/content/dam/sarb/publications/prudential-authority/pa-documents-issued-for-consultation/2023/proposed-directive---proposed-amendments-to-regulations/Proposed%20Directive-Proposed%20amendments%20to%20Regulations.pdf (accessed on 28 January 2024).
51. No. 2 of 2022.
52. No. 23 of 2021.
53. Published under GN 3645 in *GG* 48891 of 4 July 2023.
54. We note that the intended effective date of the Draft Regulations is 1 April 2024.
55. Assented to by the President on 6 December 2022.
56. Draft Joint Standard published under the FSR Act relating to Cybersecurity and Cyber Resilience Requirements, published by the FSCA and PA in December 2021.
57. Paragraph 3 of the Draft Joint Standard.
58. Regulation 40(1) of the Banking Regulations.
59. Regulation 40(2) of the Banking Regulations.
60. Section 1(1A)(c) of the Banks Act.
61. An “executive officer” is defined in the Banks Act as including “any employee who is a director or who is in charge of a risk management function of the bank, the compliance officer, secretary of the company or any manager of the bank who is responsible, or reports, directly to the chief executive officer of the bank”.
62. Regulation 41(5) of the Banking Regulations.
63. Regulation 49(1) of the Banking Regulations.
64. Published by the SARB on 11 July 2014.
65. Section 64A of the Banks Act.
66. Section 64B of the Banks Act.
67. Section 64C of the Banks Act.
68. Definitions of the aforementioned terms are set out in section 1 of the Banks Act.
69. Section 70A of the Banks Act.
70. Published in terms of Regulation 43 of the Banking Regulations.
71. No. 68 of 2008.
72. Section 1 of the CP Act defines a “transaction” as including, *inter alia*, an agreement for the supply of services, and the performance of such services, in exchange for consideration, where the supplier of such services is acting in the ordinary course of business.

73. No. 63 of 2000.
74. No. 34 of 2005.
75. Section 40(1) of the NC Act.
76. No. 130 of 1993.
77. No. 63 of 2001.
78. No. 66 of 1995.
79. No. 75 of 1997.
80. No. 55 of 1998.
81. No. 26 of 2013.
82. No. 85 of 1993.
83. No. 9 of 2008.
84. No. 4 of 2000.
85. No. 97 of 1998.
86. No. 9 of 1999.
87. No. 4 of 2002.
88. Published under GN 2291 in *GG* 47019 of 15 July 2022.
89. In terms of section 4 of the POC Act, any person who knows or ought reasonably to have known that property is or forms part of the proceeds of unlawful activities and enters into any agreement or engages in any arrangement or transaction with anyone in connection with that property, whether such agreement, arrangement or transaction is legally enforceable or not; or performs any other act in connection with such property, whether it is performed independently or in concert with any other person, which has or is likely to have the effect of concealing or disguising the nature, source, location, disposition or movement of the said property or the ownership thereof or any interest that anyone may have in respect thereof; or of enabling or assisting any person who has committed or commits an offence, whether in the Republic or elsewhere, to avoid prosecution, or to remove or diminish any property acquired directly, or indirectly, as a result of the commission of an offence, shall be guilty of an offence.
90. Sections 21 and 22 of the FIC Act.
91. Section 28 of the FIC Act.
92. Section 31 of the FIC Act.
93. Section 29 of the FIC Act.
94. Section 26B of the FIC Act.
95. Section 26A of the FIC Act.

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Switzerland

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Introduction

In the aftermath of the financial crisis of 2008/2009, Switzerland launched a massive overhaul of its financial regulations. These reforms followed several objectives. First, banking regulations were revised to ensure the stability of the financial system, in line with the recommendations of the Financial Stability Board ("**FSB**") and other international standard-setters. Second, Switzerland reacted to EU law in order to ensure equivalence and to be able to continue to access the European market as a third-party state. Therefore, the reforms also aimed to align Swiss law with EU regulations Directive 2014/65/EU on Markets in Financial Instruments II ("**MiFID II**") and Regulation (EU) No 600/2014 on Markets in Financial Instruments ("**MiFIR**"). Finally, the reforms were geared towards revising Swiss regulations from a patchwork of sectoral rules to a consistent regulatory framework.

The core of the new Swiss banking regulation consists of the existing Federal Act on Banks and Savings Banks of 8 November 1934 ("**BankA**"), the existing Federal Act on the Swiss Financial Market Supervisory Authority of 22 June 2007 ("**FINMASA**"), the Federal Act on Financial Market Infrastructures and Market Conduct in Securities and Derivatives Trading of 19 June 2015 ("**FinMIA**"), as well as the Federal Act on Financial Services of 15 June 2018 ("**FinSA**") and the Federal Act on Financial Institutions of 15 June 2018 ("**FinIA**"). The latter two, together with the implementing Ordinance on Financial Services of 6 November 2019 ("**FinSO**") and the Ordinance on Financial Institutions of 6 November 2019 ("**FinIO**"), entered into force on 1 January 2020, subject to transitional periods (the last of which expired on 31 December 2022) and have materially changed the Swiss regulatory landscape. The changes have affected domestic financial service providers as well as foreign providers with a physical Swiss establishment, but – in a departure from the former liberal regime – also foreign providers that pursue their Swiss business on a cross-border basis only. All these players had (or still have) to review the new regulatory requirements and adapt their business accordingly.

Banks in Switzerland have been facing pressure due to regulatory and legal developments, which have led to heavily increased reporting burdens. In addition, the tougher international capital and liquidity standards such as Basel III, issued by the Basel Committee on Banking Supervision ("**BCBS**"), or the new standards set by the FSB over the last few years, have led to increased costs of a bank's capital and long-term funding and other regulatory requirements including, *e.g.*, new standards for resolution planning.

In addition, the importance of the sanctions regimes has grown over recent years due to the outbreak of the war in Ukraine.

Besides these increased burdens, other major challenges currently lie in responding to strong competitive pressure, including from new entrants and business models coming from

the technology sector, and more transparency on fees. Further, in Q2 of 2023, the Swiss National Bank ("**SNB**") increased its benchmark interest rate to 1.75% in its continuing efforts to fight inflation in Switzerland. The positive interest rate continues to prove to be favourable to banks in the core banking business.

The current environment has also been characterised by a variety of related legal developments, particularly in international tax matters. Switzerland implemented the automatic exchange of information ("**AEOI**") based on the Organisation for Economic Co-operation and Development ("**OECD**") Common Reporting Standard ("**CRS**"). In this context, the Federal Act on the International Automatic Exchange of Information in Tax Matters of 18 December 2015 ("**AEOI-Act**") entered into force on 1 January 2017, and the Federal Tax Administration for the first time exchanged information with partner states in September 2018. In addition, in the course of the implementation of the revised recommendations of the Financial Action Task Force ("**FATF**") and the Global Forum on Transparency and Exchange of Information for Tax Purposes ("**Global Forum**"), several laws have been amended and further reforms are under way. Since 2016, aggravated tax misdemeanours constitute a predicate offence for money laundering. Furthermore, the legal framework on anti-money laundering ("**AML**") and anti-terrorism financing has also become more stringent. In addition, foreign regulations are a limiting factor for outbound Switzerland cross-border banking business.

The accumulation of these factors has forced many banks to scale back some of their activities in Switzerland and has consequently led to a trend towards consolidation in the Swiss banking sector in recent years (from 292 banks in 2014 to 239 banks in 2022 (FINMA statistics, supervised financial market participants 2021, https://www.finma.ch/de/dokumentation/finma-publikationen/kennzahlen-und-statistiken/statistiken/aufsicht/)). These tendencies towards consolidation are primarily seen with small banks and Swiss subsidiaries of foreign banking groups, while the latter in particular either close down their operations in Switzerland by liquidation or sale, or try to seek a critical mass of assets under management through acquisition or merger.

Despite this currently challenging environment, Switzerland is still a very attractive financial centre, as it combines many years of accumulated expertise, particularly in private banking and wealth management. In particular, the Swiss financial centre is the global market leader in the area of assets managed outside the owner's home country, with a global market share of approx. 25% (see *Swiss Banking, Banking Barometer 2022: Economic trends in the Swiss banking industry*, available at https://www.swissbanking.org). Professional advice, top-quality services and sophisticated banking products are the traditional strengths of Swiss financial institutions.

A good educational and training infrastructure, guaranteeing a reliable stream of qualified staff, political and economic stability, a flexible labour market and well-developed infrastructure are also convincing arguments to build up a Swiss banking presence.

Furthermore, Switzerland has positioned itself to become a hub for innovative financial technologies ("**Fintechs**"), and projects such as Diem (formerly Libra), the envisaged global cryptocurrency, even if eventually not realised in Switzerland, brought it into the focus of the public globally. As part of this effort, the Swiss regulatory framework is continuously being adjusted to address the needs of Fintech providers and to create a suitable environment for applications of distributed ledger technology ("**DLT**"). As a first measure, the Swiss Federal Council adopted amendments to the Federal Ordinance on Banks and Savings Banks of 30 April 2014 ("**BankO**") that entered into force on 1 August

2017 (see below). In addition, the Swiss Parliament amended the BankA with effect from 1 January 2019 to introduce a so-called Fintech licence as a new regulatory licence category geared towards limited deposit-taking activities, with less stringent requirements compared to the fully fledged banking licence. Within the regulatory framework defined by federal laws and regulations, the Swiss Financial Market Supervisory Authority ("**FINMA**") aims to take a technology-neutral approach in its practice and revised several of its circulars to remove obstacles for technology-based approaches to financial services.

On 25 September 2020, the Swiss Parliament adopted the new Federal Act on the Amendment of Federal law in light of the Developments regarding DLT. The new regulations include a number of fairly significant changes to federal laws, in particular the Federal Code of Obligations of 30 March 1911 ("**CO**"), the Federal Debt Enforcement and Bankruptcy Act of 11 April 1884 ("**DEBA**"), the Federal Act on the Prevention of Money Laundering and Terrorist Financing of 10 October 1997 ("**AMLA**"), and the FinMIA. The changes introduce, in particular, a concept of ledger-based securities (*Registerwertrechte*) into civil securities law pursuant to the CO, as well as a new stand-alone licence type under the FinMIA for so-called "DLT Trading Facilities" (*DLT-Handelssysteme*), *i.e.*, institutions for multilateral trading in standardised DLT securities. On 1 February 2021, the provisions related to the introduction of the ledger-based securities entered into force, while the remaining new provisions and the implementing ordinance entered into force on 1 August 2021. The new regulation improves the environment for blockchain and DLT projects in Switzerland.

Most recently, the serious crisis of Credit Suisse group, leading to intervention by Swiss authorities and rescue by way of a merger with UBS group, has significantly shaken the financial marketplace and might result in changes to the Swiss regulatory framework in the longer term.

Regulatory architecture: Overview of banking regulators and key regulations

Responsible bodies for banking regulation

FINMA is the supervisory authority for banks, securities dealers and other financial institutions such as collective investment schemes and insurance undertakings. FINMA's primary tasks are to protect the interests of creditors, investors and policyholders and to ensure the proper functioning of financial markets. To perform its tasks, FINMA is responsible for licensing, prudential supervision, enforcement and regulation.

In parallel, the SNB, the Swiss central bank, is responsible for monetary policy and the overall stability of the financial system. This includes the mandate to determine banks and bank functions as systemically important, in consultation with FINMA.

Under the so-called dual supervisory system in the banking regulation, FINMA largely relies on the work of recognised audit firms. As the extended arm of FINMA, these audit firms exercise direct supervision over financial institutions. They conduct regulatory audits of the banks on behalf of FINMA. In addition, FINMA may undertake targeted, on-site supervisory reviews with the aim of achieving timely and comprehensive supervision. As an exception to the dual supervisory system, FINMA has a dedicated supervisory team that is responsible for directly monitoring the largest Swiss banking group under UBS Group AG. Furthermore, FINMA also increasingly performs on-site inspections and takes "deep dives" into selected financial intermediaries to get a better understanding of the inner workings of supervised entities.

Key legislation or regulations applicable to banks

The key legislation for Swiss banks includes the following:

- the FINMASA defines the role and powers of FINMA;
- the Federal Act on the Swiss National Bank of 3 October 2003 defines the role and powers of the SNB;
- the BankA and BankO provide for the general regulatory framework governing banks, including the banking licence requirements and accounting rules for banks;
- the FinMIA and the Ordinance on Financial Market Infrastructures and Market Conduct in Securities and Derivatives Trading of 25 November 2015 ("**FinMIO**") contain, among others, (i) licence requirements for stock exchanges, multilateral trading facilities, operators of organised trading facilities, central depositories, central counterparties, payment systems and trade repositories, (ii) takeover and disclosure rules referring to listed companies, and (iii) regulations on market conduct in securities and derivatives trading; and
- the FinSA and FinSO provide for rules of conduct for all financial service providers, including banks, as well as rules on prospectuses and key information documents for certain financial instruments.

Further important regulations are:

- the Ordinance of FINMA on Foreign Banks in Switzerland of 21 October 1996 ("**FBO-FINMA**"), which provides for additional requirements for banks controlled by foreign persons as well as branches and representative offices of banks incorporated abroad;
- the Ordinance on Capital Adequacy and Risk Diversification for Banks and Securities Dealers of 1 June 2012 ("**CAO**");
- the Ordinance on Liquidity for Banks of 30 November 2012 ("**LiqO**"), governing capital adequacy and liquidity requirements applicable to banks and securities dealers;
- the Ordinance of FINMA on the Insolvency of Banks and Securities Dealers of 30 August 2012 ("**BIO-FINMA**"), governing the resolution and recovery as well as insolvency proceedings applicable to banks and securities dealers;
- the Federal Act on Collective Investment Schemes ("**CISA**") of 23 June 2006 and the Ordinance on Collective Investment Schemes of 22 November 2006 on investment funds and companies as well as rules on distribution;
- the Federal Act on Consumer Credit of 23 March 2001; and
- the AMLA and its implementing ordinances.

In addition, FINMA specifies its practice in numerous circulars. FINMA circulars as such are, in principle, not binding for Swiss courts but constitute a mere codification by FINMA of how it interprets and applies the applicable financial laws and regulations. However, the guidance of FINMA circulars might *de facto* have a binding effect as a Swiss court might be reluctant in practice to interpret the regulation differently before having thoroughly considered the view of FINMA.

Furthermore, the Swiss financial sector has a long tradition of self-regulation by self-regulatory organisations ("**SROs**"). Against this background, FINMA has recognised several self-regulatory guidelines and agreements of SROs as minimum standards, thus incorporating them within the regulatory framework and subjecting non-compliance to enforcement action (available at https://www.finma.ch/en/documentation/self-regulation/anerkannte-selbstregulierung/). An important example of self-regulation is the agreement on the Swiss bank's code of conduct with regard to the exercise of due diligence of 2020 ("**CDB 20**") by the Swiss Bankers Association ("**SBA**"). It defines the know-your-customer rules that banks and securities dealers must apply.

Influence of supra-national organisations and regulatory regimes or regulatory bodies

Switzerland is engaged in several international bodies, such as the FSB, the Bank for International Settlements, the BCBS and the International Organization of Securities Commissions. Furthermore, Switzerland is a member of the FATF, which sets out international standards in the area of AML, the OECD, and the Global Forum. Finally, although Switzerland is not a member of the G20, it has regularly been invited to participate in this international forum, which plays a leading role in defining international initiatives.

International standards have an increasing importance for Switzerland, as it has to ensure access for its financial institutions to foreign markets and maintain a good reputation of the Swiss financial market overall. The standards established by supra-national organisations, including, *e.g.*, the FSB's Key Attributes of Effective Resolution Regimes for Financial Institutions dated 15 October 2014, and Guidance on Arrangements to Support Operational Continuity in Resolution dated 18 August 2016, thus have a strong impact on Swiss regulation in the financial sector. As a case in point, Basel III had a significant influence on the Swiss regulatory framework, such as the capital adequacy and liquidity standards specified in the CAO and the LiqO.

The Swiss regulatory framework is particularly influenced by developments in the European Union. As an example, the European Union harmonised its capital market regulation with MiFID II and MiFIR. Consequently, the Swiss legislator is following up and voluntarily harmonising certain aspects of Switzerland's legislation with similar provisions in the FinMIA and FinSA, with the aim of ensuring access to the European financial markets (which requires, among others, a regulation that is equivalent to the EU regulation). Furthermore, the revised Federal Act on Data Protection ("**FADP**"), as well as its implementing ordinances, entered into force on 1 September 2023, which is likely to have an impact on several industry sectors, including the banking sector. The revision harmonised the FADP with the recently revised data protection regime of the European Union, in particular the General Data Protection Regulation (EU) No 2016/679. The same also applies in the context of derivatives trading. The provisions on derivatives trading of the FinMIA are significantly influenced by the respective provisions in the European Market Infrastructure Regulation (EU) No 648/2012 and by rules of other international regulatory bodies; for example, the FinMIA implements the commitments assumed at the G20 summit in Pittsburgh in 2009, and adapts the Swiss regulation of the financial market infrastructures and derivatives trading to international requirements.

In December 2023, Switzerland and the UK signed the "Berne Financial Services Agreement" on the mutual recognition of their regulatory regimes regarding financial services, aiming at boosting competitiveness and fostering cooperation between these two major international financial centres. The agreement is based on the concept of mutual recognition of equivalence of the legal and supervisory frameworks of the parties, and based on that improves market access for the financial institutions and service providers of either jurisdiction in selected areas of the financial sector (*e.g.*, banking, investment services, insurance, asset management and financial market infrastructures). The agreement will allow, *inter alia*, Swiss financial institutions to provide financial services to high-net-worth individuals (assets exceeding GBP 2 mn.) and professional clients in the UK, and the provision of cross-border insurance services in certain areas of non-life insurance to Swiss clients by UK insurance undertakings. The agreement has to be approved by the Parliaments of both countries before entering into force; no specific date has yet been set.

Restricting on the activities of banks

A bank must obtain a licence from FINMA in order to operate in Switzerland, or from Switzerland abroad. Switzerland follows a model of universal banking. Therefore, a bank is allowed to engage in any other business in the financial industry in addition to its deposit-taking business, if it has an appropriate organisation to carry out such activity, manages the operational risks and meets the requirements for fit and proper conduct of business. There are a few exceptions where an additional licence is required (*e.g.*, if the bank acts as a depository of collective investment schemes). Moreover, a bank cannot operate a fund management company, an insurance company or a financial market infrastructure except payment systems.

A bank is required to describe in detail the scope of business (including the subject matter and geographical scope) of its activities in the licence application (and in the articles of association and the organisational regulations). In case of any changes (in particular, an expansion) in the scope of the business activities of a bank, a bank is respectively required to inform and obtain prior approval of FINMA. Consequently, the scope of a banking licence is *de facto* individualised and, hence, varies from case to case.

Furthermore, many larger financial groups have separate entities engaging in fund management. By contrast, financial conglomerates, including both banks and insurance undertakings, are a relatively rare occurrence in Switzerland.

Recent regulatory themes and key regulatory developments

New architecture of the Swiss regulatory framework

Under the new regulatory framework of the FinSA and FinIA that entered into force on 1 January 2020, financial institutions are subject to cross-sectoral regulation. The FinSA aims to protect customers of financial service providers. It regulates the provision of financial services by financial service providers (including banks, securities firms, *etc*., to the extent they provide financial services, but not insurance undertakings) and the offering of financial instruments. It includes, *e.g.*: regulation on client segmentation; rules of conduct; registration requirements for client advisors of financial service providers that are not subject to prudential supervision; rules on prospectuses; and information leaflet requirements for financial instruments. In addition, the FinSA introduces the concept of a mandatory affiliation with an ombudsman office (subject to exemptions). This new framework was phased in with a transitional regime, which granted – generally speaking – financial service providers two years (*i.e.*, until 1 January 2022, with some deadlines having been extended until 31 December 2022) to comply with the new rules of conduct and organisational duties.

The FinIA regulates the licence requirements for certain financial institutions, including securities firms, fund management companies, managers of collective assets, asset managers and trustees. In contrast, banks and Fintechs remain subject to the regulatory requirements set out in the BankA (and the BankO). Asset managers and trustees are subject to a FINMA licence requirement but supervised by a FINMA-authorised, private supervisory body.

In the course of the new regulatory framework, FINMA adopted the Ordinance of FINMA on Financial Institutions of 4 November 2020, amended various FINMA ordinances and FINMA circulars. These amendments entered into force on 1 January 2021 with transitional provisions.

With the aim of strengthening the competitiveness of Switzerland as a jurisdiction for the establishment of investment funds, the CISA has been partially revised. The revised CISA provides for a new fund category specifically for qualified investors (in the sense of the FinSA and CISA), the so-called "Limited Qualified Investor Fund" ("**L-QIF**"). The L-QIF

is exempt from FINMA authorisation and approval requirements and can, in principle, take any of the legal forms of Swiss collective investment schemes (*e.g.*, in particular, the form of a contractual fund or a corporate form such as a SICAV). However, while the fund itself is exempt, the asset manager or fund management company responsible for an L-QIF must be an eligible institution supervised by FINMA. This indirect supervision takes due account of the level of protection required by qualified investors. The partial revision of the CISA is expected to enter into force in the first half of 2024.

Regulation of systemically important banks

In the financial crisis of 2007/2008, the Swiss government had to bail out UBS AG, the largest Swiss bank, with a capital injection of CHF 6 bn. and liquidity support from the SNB. Consequently, Switzerland decided to take a position as a forerunner in the global efforts to improve the resolution of systemically relevant financial institutions carried out under the aegis of the FSB.

The Swiss approach consists of a policy mix of stringent capital requirements, both on a risk-weighted and absolute (through a leverage ratio) basis, and liquidity ratios for systemically important banks ("**SIBs**"), as well as recovery and resolution planning by the financial institutions and FINMA, acting as a resolution authority. In addition to the standard capital requirements, Switzerland phased in the requirements regarding total loss-absorbing capacity ("**TLAC**") to ensure that sufficient capital is available to finance the resolution of SIBs.

Unlike other jurisdictions, however, the Swiss framework did not impose explicit requirements on ring-fencing or bans on proprietary trading. By contrast, it relied on a carrot-and-stick approach. The stick consisted of a regulatory requirement imposed on SIBs to ensure that they can be resolved in an orderly manner without compromising their systemically relevant functions. At the same time, the regulator was empowered to grant discounts to SIBs that take additional measures to enhance their resolvability. This led the two global SIBs ("**G-SIBs**"), UBS AG and Credit Suisse Group AG, to restructure their corporate group to be controlled by a holding company, which is to serve as a single point of entry in resolution, to carve out their domestic business in a separate financial institution, and to create dedicated service entities to ensure that the domestic business, which houses the core of the systemically relevant activity, can remain viable even if the group enters into resolution.

In March 2023, the Swiss regulatory framework was tested when an acute crisis of confidence threatened the continuation of the business of Credit Suisse group and resulted in the merger of Credit Suisse Group AG with UBS Group AG. FINMA, SNB and the Swiss Federal Council supported the merger, taking into consideration that a resolution under the too-big-to-fail regulations might likely be very risky in view of the fragile environment and potentially trigger a national or even international financial crisis with severe impacts on the Swiss financial market even for the longer term. The measures taken included, among others, a federal loss protection guarantee for UBS in the amount of CHF 9 bn. (terminated in August 2023), a loan of CHF 100 bn. from the SNB in the form of an Emergency Liquidity Assistance ("**ELA+**"), and a guarantee of CHF 100 bn. in favour of the SNB to secure liquidity assistance loans in the form of a Public Liquidity Backstop ("**PLB**") (terminated in August 2023), by means of an emergency ordinance. Following these events, the too-big-to-fail regulations will be reviewed comprehensively, the results of which are expected to be submitted to the Swiss Parliament in Spring 2024.

Resolution stay, bail-in, and PLB

To facilitate the resolution of the SIBs, Swiss law was amended to grant FINMA the authority to order a resolution stay applying to all termination rights, and automatic termination clauses triggered by the commencement of resolution proceedings for a period

of two business days (art. 30*a* BankA). To ensure the enforceability of these powers, all banks and securities dealers are required to take measures to ensure that agreements that are not subject to Swiss law and the jurisdiction of Swiss courts provide for the contractual recognition of a resolution's stay. However, whereas the resolution stay powers of FINMA extend to all agreements, FINMA determined that only certain financial arrangements needed to be covered by the contractual recognition (art. 56 BIO-FINMA).

Furthermore, FINMA was also granted the power to bail in or write off unsecured and unprivileged claims in connection with the approval of a resolution plan (art. 31 (3) BankA and art. 49 BIO-FINMA). However, unlike the resolution stay and the approach in the European Union, Swiss law does not require a contractual recognition of bail-in powers. This is testimony to the fact that FINMA relies more on capital requirements and, for SIBs, TLAC than on bail-in powers to carry out a resolution of financial institutions.

In March 2022, the Swiss Federal Council had already defined parameters for introducing a PLB toolkit, which was later implemented by means of an emergency ordinance to address the Credit Suisse group crisis in March 2023. After a shortened consultation period until June 2023, the Swiss Federal Council adopted a dispatch on the introduction of a PLB for systemically important banks, which would introduce provisions similar to those of the emergency ordinance into ordinary law, creating a statutory framework for the granting of extraordinary liquidity support as a subsidiary measure in a restructuring scenario of a systemically important Swiss bank.

Fintech

To ease the Swiss regulatory regime for providers of innovative Fintech solutions, including, *e.g.*, crowdfunding and crowdlending, electronic payment services, robo-advice, and cryptocurrencies, the regulation provides for the following measures:

- Third-party monies accepted on interest-free accounts for the purpose of settlement of customer transactions do not qualify as deposits from the public (and, therefore, do not count towards a potential banking licence requirement) if the monies are held for a maximum of 60 days (instead of only seven days, as was the case before the amendment) (art. 5 (3)(c) BankO).
- Firms accepting deposits from the public or publicly offering the acceptance of deposits are exempted from the banking licence requirement as long as: (i) the deposits accepted do not exceed CHF 1 mn.; (ii) no interest margin business is conducted; and (iii) depositors are informed, before making the deposit, that the firm is not supervised by FINMA and that the deposit is not covered by the depositor protection scheme (art. 6 (2) BankO). This exemption from the banking licence requirement is available to Fintechs as well as any other type of business that fulfils the requirements. It aims at creating an innovation space, a so-called "sandbox".
- The new Fintech licence – a licence with more lenient requirements compared to the fully fledged banking licence – was introduced by an amendment to the BankA with effect as of 1 January 2019. This regime applies to institutions that hold deposits of less than CHF 100 mn. If the customers are protected through additional safeguards, FINMA can approve a higher deposit ceiling on a case-by-case basis. Under this licence, the deposits may not be invested and no interest may be paid on them. The holders of a Fintech licence are not subject to the depositor protection regime. Further, they are not required to comply with the capital adequacy requirements under the CAO, but instead are subject to the minimum capital requirements under the BankO, *i.e.*, at least CHF 300,000 or 3% of the deposits taken from the public held. Accounting is

carried out in accordance with the CO, which is a further relaxation compared to the rules applying to a bank. However, the requirement to be subject to the AMLA remains unchanged compared to the fully fledged banking licence.

- The new Federal Act on the Amendment of Federal law, in light of the Developments regarding DLT, introduced a new stand-alone licence type under the FinMIA for so-called "DLT Trading Facilities" (*DLT-Handelssysteme*), *i.e.*, institutions for the multilateral trading in standardised DLT securities. Unlike the licences for traditional trading venues such as stock exchanges and multilateral trading facilities, the DLT Trading Facility licence is a unified licence allowing its holder to also provide certain post-trading services that are normally reserved to other financial market infrastructures, such as central custody/depository services as well as clearing and settlement. Furthermore, DLT Trading Facilities are allowed to also admit private individuals and unregulated legal entities to trading instead of regulated participants only.

In addition, FINMA issued several guidance papers on the use of blockchain in financial services. These set out FINMA's interpretation of the law when reviewing business models relating to digital assets or otherwise making use of blockchain technology, and provide guidelines to interested parties wishing to submit their project for review by FINMA prior to launch, often with the goal of being provided with a so-called "no-action letter" or to ascertain applicable licence requirements (see, *e.g.*, FINMA guidance 04/2017 on the regulatory treatment of initial coin offerings ("**ICOs**") of 29 September 2017, the FINMA guidelines for enquiries regarding the regulatory framework for ICOs of 16 February 2018, an update and supplement to said guidelines focusing on issuances of "stable coins" of 11 September 2019, FINMA guidance 02/2019 regarding payments on the blockchain of 26 August 2019 and FINMA guidance 08/2023 regarding staking services). These various guidance papers published by FINMA generally emphasise the technology-neutral and principle-based nature of Swiss financial regulation. This provides some flexibility to explore innovative business models but requires that projects be reviewed and evaluated on a case-by-case basis, often in a dialogue with the regulator. As far as projects relate to the issuance, trading, custody, or other activities relating to blockchain tokens, FINMA has provided a general classification of crypto tokens into three categories – taking a substance-over-form approach – to enable a structured analysis of proposed business models under applicable financial regulation. Specifically, FINMA distinguishes between payment tokens (pure "cryptocurrencies"), utility tokens and asset tokens, acknowledging that hybrid forms and transformations from one category into another along the timeline are possible. See the comments on DLT regulation in the Introduction above.

Implementation of the Basel III requirements

Switzerland has largely implemented the core requirements of Basel III in the CAO, the LiqO and various FINMA circulars. These requirements first applied exclusively to systemically important financial institutions, and were then extended to all banks.

Capital requirements: On 1 July 2016, the amended CAO entered into force, implementing the adjusted regulations of Basel III on credit risk capital requirements for derivatives, fund investments and securitisations for banks. The amendments introduced definitive rules on derivative positions *vis-à-vis* central counterparties and revised the capital requirements for all types of bank claims *vis-à-vis* all types of investment funds, as well as the capital adequacy rules on securitisation positions in the banking book.

On 1 January 2018, new rules introducing a leverage ratio and a new risk diversification provision in line with Basel III were implemented in the CAO. The changes included the introduction of an unweighted capital adequacy requirement based on the leverage ratio of

3% for all non-SIBs, and up to 10% for SIBs as an additional safety net. The provisions on risk diversification stated, *inter alia*, that risk concentrations may generally only be measured according to core capital (Tier 1) and that banks are restricted in their use of models for determining risk concentrations.

On 1 January 2019, further amendments to the CAO entered into force, introducing gone-concern capital requirements for domestically focused SIBs ("**D-SIBs**": PostFinance AG; Raiffeisen; and Zürcher Kantonalbank).

On 1 January 2020, further amendments to the CAO entered into force. On the one hand, they grant relief to small, liquid and well-capitalised banks and securities dealers by introducing simplified requirements for the capital adequacy, while on the other hand they require parent entities of entities with systemically important functions (*e.g.*, UBS AG), and Swiss entities of SIBs that perform systemically important functions and are therefore vital for the financial group's functioning, to provide for sufficient capital available in the event of a financial crisis.

On 4 July 2022, the Swiss Federal Council opened the consultation process to further amend the CAO with the proposed amendments mainly requiring higher-risk transactions to be backed by more capital than lower-risk transactions. At the same time, FINMA opened the consultation process and introduced five new FINMA ordinances to align the Swiss supervisory regime with the final Basel III. The amended CAO and FINMA ordinances are expected to enter into force on 1 January 2025.

Liquidity requirements: Under the LiqO (as in force since 2013), banks have to appropriately manage and monitor liquidity risks. It was thus possible to transpose part of the international liquidity standards of Basel III into Swiss law. In a further step, the revised LiqO, which entered into force on 1 January 2015, has also adopted the new quantitative liquidity requirements in accordance with the international liquidity standards. In particular, a liquidity coverage ratio has been introduced for short-term liquidity, requiring banks to provide for sufficient high-quality liquid assets. A bank should, *inter alia*, be able to survive for at least 30 days in the event of a liquidity stress scenario, with client deposits being withdrawn or difficulties with securing refinancing on the capital market. To reflect the changes made to the LiqO, FINMA revised its Circular 2015/2, which entered into force on 1 January 2018. Circular 2015/2 has been revised one more time and now includes provisions on the net stable funding ratio; the new provisions entered into force on 1 January 2021.

Additionally, the new FINMA Circular 2023/01 "Operational risks and resilience – banks" entered into force on 1 January 2024, replacing the previous FINMA Circular 2008/21 "Operational risks – banks" and the Swiss Bankers Association's "Recommendations for Business Continuity Management (BCM)" and transposing the Basel Committee's principles for the sound management of operational risk and operational resilience. The circular takes into account the advancing technological developments and clarifies FINMA's supervisory practice with regard to the management of operational risks, particularly in connection with information and communication technology, handling critical data and cyber risks.

Administrative assistance

The implementation of the FinMIA also entailed several changes in other areas, *e.g.*, with regard to administrative assistance, where FINMA is not required to inform the relevant customer prior to transmitting the information to the requesting authority if the purpose of the administrative assistance and the effective fulfilment of the requesting authority's tasks were to be jeopardised by the prior notification (art. 42*a* (4) of the revised FINMASA, which entered into force on 1 January 2016).

AEOI and tax compliance

In response to the criticism of the Swiss financial centre, Switzerland adopted a "White Money Strategy", which led to the adoption of the AEOI in tax matters and extended the AML framework to taxation fraud. This strategy was heavily influenced by the recommendations of the FATF and the Global Forum in connection with international AML standards, as well as the pressure of the OECD to adopt the AEOI in tax matters with countries abroad.

Against this background, a legal foundation for introducing the AEOI in Switzerland was created with the AEOI-Act that entered into force on 1 January 2017. Under the AEOI-Act, financial institutions subject to the AEOI-Act must collect specific data from 2017 onwards and submit it to the Swiss Federal Tax Administration, which, in turn, exchanges the data with the tax authorities of the partner states. In view of the AEOI's activation with 38 states on 1 January 2017, Swiss financial institutions started to collect relevant data, and Switzerland exchanged data with most of the 38 partner states for the first time at the end of September 2018. Ever since, Switzerland has adopted the AEOI with more than 100 partner states. On 1 January 2021, new provisions of the AEOI-Act came into force to implement the recommendations of the Global Forum in Switzerland.

Furthermore, the recommendations of the FATF also influence the revision of the AMLA and prompted a first revision that came into effect on 1 January 2016, implementing, *e.g.*, new regulations in connection with business relationships and transactions with politically exposed persons. On 1 January 2022, amendments to the AMLA entered into force. They, *inter alia*, codified existing practice and case law, *e.g.*, the obligation to regularly check that information is up to date and specified reporting duties. The country review of the FATF also led to a revision of the Ordinance of FINMA on Combating Money Laundering and Terrorist Financing in the Financial Sector of 3 June 2015, which addresses shortcomings identified in the FATF country review. The amendments entered into force on 1 January 2020.

The Swiss Federal Council adopted the federal law on the implementation of the recommendations of the Global Forum on 21 June 2019, which entered into force on 1 November 2019. The bill aims, in addition to changes to corporate law, to facilitate the exchange of tax-related information.

Implementation of the Foreign Account Tax Compliance Act

On 2 June 2014, the agreement between Switzerland and the US on cooperation to simplify the implementation of the Foreign Account Tax Compliance Act ("**FATCA**") entered into force. Under this agreement, the implementation of the FATCA in Switzerland was based on the so-called "Model 2", which means that Swiss financial institutions disclose account details directly to the US tax authority, with the consent of the US clients concerned. However, in October 2014, the Swiss Federal Council approved a mandate for negotiations with the US on switching to "Model 1", which might lead to the application of the AEOI between Switzerland and the US. It is still unclear at the present time when there will be a corresponding agreement between Switzerland and the US. On 20 September 2019, the amendment protocol to the double taxation agreement between Switzerland and the US entered into force. Under the protocol, the US tax authority IRS can, for cases from 30 June 2014, request information in aggregated form as a group request under the FATCA on all accounts that Swiss financial institutions have reported to IRS.

Disclosure of climate-related financial risks

FINMA revised Circulars 2016/1 and 2016/2 to include new requirements of disclosure of climate-related financial risks, which entered into force on 1 July 2021. For financial

institutions, the repercussions of climate change can entail significant longer-term financial risks. These risks do not represent a new risk category (*i.e.*, climate-related financial risks can be assigned to, and mapped in, traditional risk categories) but they are new risk drivers. In the area of disclosure of climate-related financial risks, FINMA has identified a targeted need for regulatory action in the balance sheets of its supervised entities and is setting out the corresponding regulatory detail accordingly. Financial institutions must describe the main climate-related financial risks and their impact on their business strategy and model as well as financial planning. Furthermore, the process for identifying, assessing and managing climate-related financial risks and quantitative information must be disclosed. The disclosure requirements are principles-based and aligned with the internationally recognised framework of recommendations of the Task Force on Climate-related Financial Disclosures ("**TCFD**").

Bank governance and internal controls

Key requirements for governance of banks

In order to obtain and maintain a banking licence, Swiss banks must, *inter alia*, comply with specific governance requirements as outlined in particular in the BankA and BankO, and further specified in guidelines and publications of FINMA, in particular FINMA Circular 2017/1 "Corporate governance – banks" ("**Circular 2017/1**"), which entered into force on 1 July 2017. It remains to a large extent in line with the former FINMA guidance, except for a number of changes in specific areas. A significant change introduced by Circular 2017/1 is a shift from a "comply or explain" approach to a more differentiated approach, allowing FINMA to apply the requirements of Circular 2017/1 to the extent they are proportionate. This allows FINMA to consider on a case-by-case basis the characteristics of each bank in terms of size, complexity, structure, and risk profile. On 1 January 2020, some amendments to Circular 2017/1 entered into force, providing certain relief for small banks.

Good reputation and guarantee of proper business conduct

Persons entrusted with the bank's administration and management must enjoy a good reputation and guarantee proper business conduct (art. 3 (2)(c) BankA). Furthermore, qualified shareholders of a bank (*i.e.*, persons holding at least 10% of the capital or voting rights or that otherwise have a significant influence on the bank) must guarantee that their influence will not have a negative impact on the bank's prudent and solid business activity (art. 3 (2)(c^{bis}) BankA).

Separation of board of directors and executive management

The governance of Swiss banks is characterised by a strict separation between the board of directors, which is responsible for oversight, and the executive management.

A bank's board of directors as a body and each board member must meet specific conditions, including the following:

- To comply with the independence requirement, the board members have to structure their personal and business relationships in such a way as to avoid possible conflicts of interest with the bank. In particular, at least a third of the board members must be independent (Circular 2017/1 N 17 *et seq*.). FINMA may, in justified, exceptional cases, grant exceptions. This might be relevant in financial groups, in particular.
- The board of directors as a whole must have adequate management expertise and the required knowledge and experience in the banking and financial services sector. It must be sufficiently diversified to ensure that all key aspects of the business, including finance, accounting, and risk management, are adequately represented (Circular 2017/1 N 16).

- The board of directors must comprise at least three members. However, the actual number of directors required depends on the size, complexity, and risk profile of the bank (art. 11 (1) BankO and FINMA explanatory notes to the draft Circular 2017/1 N 3.2.2). In practice, a board generally has at least five members.

Committees of the board of directors

The larger and more complex banks, which belong to supervisory categories 1 to 3 (out of five), are required to establish an audit and a risk committee, irrespective of the total number of members of the board of directors. However, banks in supervisory category 3 may combine the two committees (Circular 2017/1 N 31).

A majority of the members of both committees must be independent and the chair of the board of directors may not be a member of the audit committee or chair the risk committee. Furthermore, each committee must have sufficient knowledge of and experience in the areas for which they are responsible (Circular 2017/1 N 33).

Internal audit function

The board of directors, in principle, has to establish an internal audit function that directly reports to the board or one of its committees, typically to the audit committee. The internal audit function works independently from the daily business processes and, in particular, provides an important basis for the assessment of whether the bank has implemented an adequate and effective internal control system (Circular 2017/1 N 82 *et seq.*).

Mandatory management functions

Banks in supervisory categories 1 to 3 have to implement the role of an independent chief risk officer ("**CRO**"), who has to be a member of the management body if the bank is systemically relevant. Such CRO may be responsible also for other independent control functions (*e.g.*, the compliance function) even in the case of SIBs (Circular 2017/1 N 67 *et seq*.).

Remuneration of a bank's employees

As a general rule, a bank's remuneration system must not offer any incentives for an employee to disregard the bank's internal control mechanisms. In particular, the remuneration system for employees of the internal audit function, the compliance function, and the risk function may not contain incentives that could lead to a conflict of interests. Therefore, their remuneration (among others, through salaries and bonuses) may not depend on the performance of individual products and transactions.

FINMA Circular 2010/1 "Remuneration schemes" ("**Circular 2010/1**") outlines minimum standards for remuneration schemes of banks and other financial institutions. In particular, it includes the requirement of a remuneration scheme to be simple, transparent, implementable, and oriented towards the long term. Circular 2010/1 mandatorily only applies to banks of supervisory category 1 (*i.e.*, banks belonging to UBS group) and the two largest insurance groups, being Zurich and Swiss Re (see Circular 2010/1 N 6 and 7). However, it applies as a non-binding code of best practice to all other institutions. In addition, FINMA may, in justified cases, require such other institutions to mandatorily implement Circular 2010/1 in full or in part, if appropriate in the light of the circumstances (Circular 2010/1 N 9).

On 1 January 2014, the Ordinance against Excessive Compensation of 20 November 2013 ("**OaEC**") implementing the so-called "Say-on-Pay Initiative" entered into force, toughening the formal corporate governance regime for listed companies. Among others, it prohibits severance payments (golden parachutes), advance payments, and similar extraordinary payments to directors or senior managers. Furthermore, the aggregate compensation of directors and the senior management is subject to the approval of the general meeting of

shareholders. In the course of the revision of the company law, the provisions of the OaEC have been incorporated into the CO generally unchanged with an effective date of 1 January 2023, and the OaEC was repealed.

Scope and requirements for outsourcing of functions

All significant functions of a bank may, in principle, be outsourced, except for the direction, supervision and control by the supreme governing body, central executive management functions, and functions that involve strategic decision-making (FINMA Circular 2018/3 "Outsourcing"). In addition, decisions on entering or terminating a business relationship may not be outsourced. Furthermore, banks of supervisory categories 1 to 3 are required to have an autonomous control body in the form of a separate risk control and compliance function. Operational risk management and compliance tasks may be outsourced by banks of all supervisory categories. The bank must keep an inventory of the outsourced functions.

Furthermore, the bank, its audit firm, and FINMA, must have the contractual right to verify the service providers' compliance by inspecting and auditing all information relating to the outsourced function at any time, unrestrictedly.

Accounting rules

Value adjustments for default risks in banking are to be calculated in future on the basis of expected losses. For this change, FINMA adopted a new FINMA ordinance on accounting and a revised FINMA circular (Circular 2020/1 "Accounting – banks"), which both entered into force on 1 January 2020.

Bank capital requirements

In order to obtain a banking licence from FINMA, a bank must have a fully paid-in share capital of at least CHF 10 mn. (art. 15 (1) BankO). However, in principle, FINMA requires a bank to have additional capital of at least CHF 10 mn. but usually more (which might be contributed, *e.g.*, in the form of a subordinated loan as well), depending on the intended scope of the bank's business activities.

In addition to the statutory capital requirements, banks are also subject to regulatory capital requirements based on the Basel III Framework. The CAO specifies in more detail the regulatory capital required by Swiss banks, particularly depending on the bank's size and scope of business. The required capital comprises, in principle, the following parts:

- *Minimum required capital*: A bank must hold at least 8% of the risk-weighted positions as minimum required capital, whereof at least: (i) 4.5% must be held in the form of common equity Tier 1 ("**CET 1**") capital (CET 1 ratio); and (ii) 6% must be held in the form of Tier 1 capital (Tier 1 capital ratio) (art. 42 (1) CAO).
- *Capital buffer*: A bank must, in principle, hold a capital buffer between 2.5% and 4.8% of their risk-weighted positions, in particular, in the form of CET 1 capital, depending on the supervisory category of the bank (art. 43 (1) and appendix 8 CAO; art. 2 (2) and appendix 3 BankO).
- *Countercyclical buffer*: Upon request of the SNB, the Swiss Federal Council may, if necessary, require the banks to hold a countercyclical buffer of a maximum of 2.5% of their risk-weighted positions in Switzerland in the form of CET 1 capital to: (i) enhance the banking sector's resilience against the risk of excessive credit growth; or (ii) counteract excessive credit growth (art. 44 CAO). Currently, the Swiss Federal Council has activated the countercyclical buffer to counteract the risk of a real estate bubble fuelled by cheap mortgage loans, and requires banks to hold a countercyclical buffer of 2% of their risk-weighted positions whereby a residential property in Switzerland acts as real security (in accordance with art. 72 CAO).

- *Extended countercyclical buffer*: Banks with (i) a balance sheet of at least CHF 250 bn., of which the total foreign commitment amounts to at least CHF 10 bn., or (ii) a total foreign commitment of at least CHF 25 bn., have to hold an extended countercyclical buffer in the form of CET 1 capital. This buffer amounts to the weighted average of the countercyclical buffers that apply in the member states of the BCBS where the bank's relevant receivables from the private sector originate, but in no case more than 2.5% of the risk-weighted positions (art. 44*a* CAO).
- *Additional capital*: FINMA may require a bank to hold additional capital if the *minimum required* capital and countercyclical buffer do not sufficiently cover the risks of a specific bank (art. 45 CAO).
- *Leverage ratio*: A bank must also maintain a 3% minimum leverage ratio based on the un-risk-weighted assets and Tier 1 capital (art. 46 CAO and Circular 2015/3).
- *Additional requirements for SIBs*: In addition to the above-mentioned requirements that apply to all banks, SIBs have to comply with additional requirements; *e.g.*, they must have sufficient own funds to be able to continue their business activities even in the event of major losses (going-concern capital requirements), or they have to permanently hold additional funds to ensure a possible restructuring and winding-up (gone-concern capital requirements) (art. 124 *et seq*. CAO). G-SIBs are required to hold 100% of their going-concern capital requirement as TLAC. With effect from 1 January 2019, the gone-concern capital requirements also apply to D-SIBs. The new requirements are based on the going-concern capital requirements but, unlike for G-SIBs, which need to reflect 100% of their going-concern capital, this reflection amounts to only 40% in case of D-SIBs, subject to further rebates for state-owned D-SIBs, as the domestically focused banks are less interconnected internationally and are less systemically important. The revised CAO adjusts the gone-concern capital requirements for G-SIBs: the holding company of a financial group remains required to hold 100% of their going-concern capital as gone-concern capital; however, an operative parent entity of an entity with systemically important functions (*e.g.*, UBS AG) will require an additional 30% of the consolidated group going-concern capital as gone-concern capital. In contrast, the Swiss subsidiaries with systemically important functions (*i.e.*, UBS Switzerland AG) will only be required to hold 62% of their going-concern capital as gone-concern capital.

Rules governing banks' relationships with their customers and other third parties

Regulations applying to the bank's dealing with third parties

Banking and securities dealer activities

In Switzerland, the primary law governing the relationship between banks or securities dealers and their clients is the private civil law laid down in the CO. In many instances, a banking or securities dealing relationship is subject to the principles of the law of mandate of the CO. Under such provisions, an agent, *inter alia*, has to act faithfully and diligently (art. 398 (2) CO).

The nature of the legal duties owed by, and customs of, banks have been developed through court practice and by professional standards established by recognised SROs.

The FinSA provides for rules of conduct that apply to all financial service providers. Under this legislation, financial service providers are required to provide extensive information on themselves, the services and products they recommend, as well as the risks and costs they entail. Furthermore, depending on the type of client and service they offer, they are subject to further requirements to ensure the suitability or appropriateness of their offering. The

implementation of these rules comes together with extensive documentation and record-keeping obligations as well as organisational requirements and, unless an exemption applies, an obligation to join an ombudsman organisation. In particular, client advisors need to have the requisite knowledge and expertise to comply with their duties under the rules of conduct and carry out their business. Furthermore, client advisors of Swiss unregulated financial service providers and foreign financial service providers who perform services in Switzerland are required to register with a register of advisors unless an exemption applies. Furthermore, rules of SROs recognised by FINMA as minimum standard requirements applicable to certain financial institutions specify these duties. These self-regulatory rules include, among others, the Code of Conduct for Securities Dealers and the Portfolio Management Guidelines of the SBA. In connection with management, sales or custody of collective investment schemes, these rules are further implemented through the self-regulatory standards set forth in the Code of Conduct of the Swiss Funds & Asset Management Association ("**SFAMA**") (SFAMA merged with Asset Management Platform Switzerland to form the new Asset Management Association Switzerland ("**AMA**")), which is also recognised by FINMA as a minimum standard requirement. In view of the new regulatory framework, AMA revised its self-regulation materials with an effective date of 1 January 2022.

Rules applying to the general terms and conditions of banks

The use of general terms and conditions ("**GTC**") to govern the relationship between the bank and its clients is widespread in the Swiss banking industry. However, Swiss law does not regulate the GTC of banks specifically. Accordingly, the question of whether GTC are valid must be established on the basis of the Swiss private law, particularly the general contract law provisions of the CO and art. 8 of the Federal Act against Unfair Competition of 19 December 1986, which prohibits the use of GTC that, to the detriment of consumers and contrary to the requirement of good faith, provide for a significant and unjustified imbalance between contractual rights and contractual obligations. Furthermore, specific regulations prohibit banks from including certain terms in their GTC with customers. For example, a right to use client securities may not be included in GTC. Against this background, the use of GTC might, in a typical business-to-customer relationship, be more limited in the banking industry.

Mechanisms for addressing customer complaints against banks

General remarks

Under Swiss supervisory law, FINMA's mandate includes the protection of creditors, investors, and policyholders. However, client protection is understood collectively and, therefore, FINMA does not adjudicate or even intervene in a dispute between a client and a bank. Furthermore, there are no explicit regulatory rules on handling complaints, although arguably the appropriate internal organisation of a bank requires the implementation of a complaints procedure. Disputes between a client and a bank are thus the remit of the ordinary courts, subject to the mediation by the Swiss Banking Ombudsman if the bank is a member of the SBA. However, the FinSA aims to facilitate access to justice by clients of financial service providers, among others, by requiring financial service providers to join an ombudsman organisation.

Swiss Banking Ombudsman

As part of its self-regulatory role, the SBA established a separate and independent institution, the Swiss Banking Ombudsman. Members of the SBA are required to submit to the authority of the Swiss Banking Ombudsman.

The Swiss Banking Ombudsman is an independent and neutral mediator whose services are free of charge for the banking customer. He is competent to approach specific complaints raised by banking customers against banks based in Switzerland but has no power to decide. Consequently, he mainly acts as a mediator in disputes to avoid costly and lengthy legal proceedings. The parties are not bound by his proposal but may choose either to accept it or to take other steps, such as starting a lawsuit.

Changes of the enforcement of client's rights according to the adopted FinSA

In order to facilitate the enforcement of rights for banking clients, the FinSA introduces several changes to the enforcement of Swiss banking clients' rights such as, among others, an extensive documentation duty that requires financial service providers to document their services in an appropriate manner, and a right of a client to request the delivery of copies of these documents free of charge.

Furthermore, financial service providers are required to join an ombudsman's office, which offers a simple and informal process to settle disputes between clients and financial service providers. For members of the SBA, however, this is not a major change as the SBA is now a recognised ombudsman's office under the FinSA (see above).

Outlook

More generally, the government announced that it is generally considering introducing a scheme for collective enforcement of claims in the Swiss Civil Procedure Code. This Swiss form of class action would not be limited to suits against banks and financial institutions but should be generally available for all types of civil disputes. This would further facilitate the enforcement of clients' rights and reduce the risk of high procedural costs.

Swiss depositor protection scheme

Deposits of Swiss banks are, in particular, protected by the following measures:

(a) Client deposits of Swiss banks are, in principle, privileged claims in case of bankruptcy of a bank up to CHF 100,000 (art. 219 (4)(f) 2nd class DEBA in conjunction with art. 37*a* (1) and art. 37*b* (1) BankA). However, the law further distinguishes between certain types of accounts. For example, deposits for vested benefit schemes are treated separately from other bank accounts and may benefit from privileged status in an additional protected amount of up to CHF 100,000 (art. 37*a* (5) BankA).

(b) Furthermore, client deposits of a bank or securities dealer located in Switzerland are protected to a maximal amount of CHF 100,000 per depositor. This depositor's guarantee in case of bankruptcy of a bank is ensured by the Swiss depositor protection scheme ("***esisuisse***"), which requires that all Swiss banks and branches of foreign banks must have their preferential deposits protected by *esisuisse*.

(c) Finally, client custody assets of Swiss banks and securities dealers are deemed by law, in principle, as segregated client assets. Consequently, they will be segregated in case of an insolvency of a bank or securities dealer (art. 37*d* BankA).

On 17 December 2021, the Swiss Parliament adopted a partial revision of the BankA to better protect customers under the deposit guarantee scheme in the event of bankruptcy of a bank. Banks' contribution obligation will be increased to the sum of 1.6% of all system-wide secured deposits, not falling below CHF 6 bn. Consequently, the contribution obligation will be dynamically adjusted to the respective level of secured deposits. The revised provisions entered into force on 1 January 2023.

One of the main purposes of deposit insurance is to quickly provide affected bank customers with sufficient funds, of a maximum of CHF 100,000 per customer and bank, to settle their

financial obligations. Against this background, while not regulated under the current law, a new pay-out period of seven days to the client shall be implemented as of 1 January 2028.

Restrictions on inbound cross-border banking activities

The Swiss approach to inbound cross-border banking services is rather liberal. Banking activities on a pure cross-border basis only (*i.e.*, without any actual or deemed local physical presence) from abroad into Switzerland are, in principle, not subject to a banking licence requirement. Consequently, a foreign banking institution may, in principle, freely offer banking services to Swiss-based customers if it does not establish a physical presence in the meaning of art. 2 (1) FBO-FINMA (*i.e.*, a representative office or a branch) and does not inaccurately represent that it is based or regulated in Switzerland.

However, this changes to a certain extent under the FinSA, which extends the scope of Swiss financial market regulation to financial services carried out "for clients in Switzerland". In other words, the commercial provision of financial services to clients in Switzerland on a cross-border basis is subject to the FinSA. This does not trigger a licensing obligation, but requires, in addition to complying with the rules of conduct and organisational duties provided for by the FinSA, the client advisors of foreign service providers to register themselves with a client advisor registry and, as previously mentioned, the financial service provider to join an ombudsman organisation.

Furthermore, the public offering of shares or units of collective investment schemes, and the placement of certain financial products in Switzerland, are subject to restrictions, licence or prospectus requirements. Furthermore, certain activities in connection with the sale and purchase of interests in collective investment schemes constitute a financial service under the FinSA instead of the previous regime on the regulation of distributors.

Regulatory framework on AML

Money laundering is subject to criminal sanctions under art. 305*bis* of the Swiss Criminal Code of 21 December 1937 ("**SCC**"). Money laundering in the meaning of the SCC includes any act suitable to conceal or disguise the identification of the origin or impede the tracing or the forfeiture of assets that have been obtained through serious crimes and certain tax offences.

Prudentially supervised financial institutions, such as banks and securities dealers, as well as other persons or entities who, on a professional basis, accept or hold third-party assets or who assist in the investment or transfer of such assets, including activities such as (independent) asset management and certain types of credit/lending business, trade finance including factoring with right to recourse, payment services, trading activities, *etc*., are subject to additional regulatory requirements (art. 2 (2) and (3) AMLA). Financial intermediaries that are not otherwise regulated (*e.g.*, by FINMA through holding a banking or securities dealer licence) have to join a recognised SRO, which will review their compliance with Swiss AML rules on a regular basis (art. 14 AMLA).

A major part of the AMLA provisions deal with the due diligence duties in connection with a financial intermediary's handling of third-party assets, including the due identification of the contractual party and the due determination of a potential beneficial owner, whereas, among others, these duties are further specified in the CDB 20.

Regulatory framework on sanctions

The Swiss sanctions regime is mainly governed by the Embargo Act ("**EmbA**"). Based on the EmbA, the Swiss Federal Council may issue ordinances, which impose certain compulsory measures (*i.e.*, sanctions in Swiss legal terms). These compulsory measures can

restrict transactions involving certain goods and services, payment and capital transfers or the movement of persons. By enacting such ordinances, Switzerland implements sanctions ordered by the United Nations, the Organization for Security and Co-operation in Europe or by Switzerland's most significant trading partners (*e.g.*, the European Union, the United States, *etc*.). The aim of the sanctions is to secure compliances with international law, mainly in the area of human rights.

Switzerland is, in principle, not obliged to take over sanctions of the European Union. The Swiss Federal Council decides on a case-by-case basis whether to adopt EU sanctions in full, in part or not at all. So far with regard to the Russian invasion of Ukraine, the Swiss Federal Council has committed itself to fully adopting the EU sanctions packages.

Banks must ensure that they comply with the sanctions regime. In particular, compulsory measures such as freezing of funds and other assets, transaction bans, investment restrictions and prohibition of provision of financial services have to be implemented by banks immediately in the daily business. Especially if assets, securities, funds, monies, cryptoassets, letters of credit and any kind of service regarding the capital market are within the scope of sanctions, banks' business activities may be restricted to a broad extent. FINMA informs on its website about the latest sanctions that are important for financial intermediaries. Violation of the sanctions regime is punishable and may lead to a fine of up to CHF 1 mn.

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Taiwan

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Introduction

Taiwan has a highly competitive banking landscape with 39 domestic banks and 31 local branches of foreign and Mainland Chinese banks to date. While not immune to the global financial crisis after Lehman Brothers collapsed in 2008, which prompted regulators worldwide to continually strengthen supervision of the financial sector and enhance the resilience of the domestic financial system, Taiwanese financial institutions were not significantly impacted by the recent bank failures in the U.S. and Europe, such as Silicon Valley Bank, Silvergate Bank, and Credit Suisse in 2023. Compared to those failed banks, Taiwanese domestic banks operate with distinct characteristics: relying on stable personal and corporate deposits as their main funding source; primarily focusing on loan portfolios for asset allocation, which demonstrates their financial stability; and featuring high-quality assets and relatively low liquidity risk. Moreover, the Central Bank of the Republic of China (Taiwan) (CBC) has implemented a more moderate interest rate policy compared to the U.S., which further reduces systemic issues that could pose a risk to Taiwan's financial system during the global financial crisis.

Notably, the Financial Supervisory Commission (FSC), an independent regulatory authority governing the financial services industry in Taiwan, has proactively aligned the local banking regulations with the global battle against money laundering by implementing various measures. In response to the swift evolution of fintech, the FSC has issued a roadmap for fintech development and adopted several key initiatives. For example, the FSC has introduced the "Guidelines on Data Sharing among Financial Institutions", advocated for open banking, eased restrictions on financial institutions outsourcing cloud services to third parties, and established "Guidelines for Managing Virtual Asset Service Providers (VASPs)", among others. These initiatives aim to optimise the legal framework, enhance resource utilisation, drive technological progress, and foster inclusivity in the fintech sector. Currently, the FSC is assessing the need for a dedicated financial technology bureau to regulate and oversee disputes arising from fintech activities.

Due to the escalating political tensions between the U.S. and Mainland China as well as the ongoing cross-strait issue between Taiwan and Mainland China, Taiwan's economy and its banking industry might face intensified challenges in the coming years. Some international financial institutions have opted to or are assessing whether to exit the Taiwan market (or at least the retail banking market) to redeploy resources to other jurisdictions, while some may be hesitant to enter into the Taiwan market considering the heightened uncertainty in cross-strait relations.

Regulatory architecture: Overview of banking regulators and key regulations

Regulators: the FSC and the CBC

The FSC and the CBC are the major authorities regulating banks in Taiwan.

The FSC regulates the financial markets (including fintech) and financial institutions in Taiwan through its subordinated bureaus, including the Banking Bureau, the Securities and Futures Bureau, the Insurance Bureau and the Financial Examination Bureau. While the Banking Bureau focuses on the banking sector, determining and implementing the policies for the banking industry, the Financial Examination Bureau is in charge of financial examination of all financial institutions regulated by the FSC. As per local practice, the Examination Bureau conducts financial examinations every two years, for which the Examination Bureau may appoint its staff, professionals (e.g., attorneys or accountants), authorised organisations or the FSC officials to examine a bank's business, financial records and so forth. In addition, the Examination Bureau can request a bank to submit its financial reports, property inventories or any other documents it deems necessary for examination purposes.

The CBC plays a crucial role in setting and conducting monetary policies to manage the availability of money and credit. It oversees and regulates foreign exchange activities and business operations, and also conducts examinations on banks to ensure their compliance.

Besides the regulatory authorities above, the Bankers Association of the Republic of China (Taiwan) (Bankers Association), a self-regulatory organisation, was founded in 1983 to help the government implement its financial policies, spur economic development, and coordinate relations among members in the banking industry so as to generate benefits that can be shared among them.

Key regulations

The principal laws and regulations governing the Taiwanese banking sector include the following:

- The Banking Act primarily governs the banking industry, covering a wide range of aspects, such as the establishment, suspension and dissolution of banks, requirements for banks to comply with capital adequacy and maintenance of financial structure, the scope of banking businesses and limitations on banking activities, rules governing banking managers and officers, a deposit insurance mechanism, and various regulations specific to different types of banking institutions; for example, commercial banks, trust and investment companies and foreign banks operating within Taiwan.
- The Financial Holding Company Act of Taiwan (FHCA) regulates licensed financial holding companies that have controlling shareholdings in financial institutions, including banks, insurance companies and securities firms. The main goal of the FHCA is to optimise the benefits of consolidating financial institutions and strengthen the oversight of cross-sector operations by outlining provisions regarding the establishment, transformation, spin-offs, business operations and supervision of financial holding companies.
- The Central Bank of the Republic of China (Taiwan) Act sets out general rules as well as the authority and functions of the CBC. The CBC is responsible for the following tasks:
  (1) regulating monetary and credit policies by adjusting liquidity through open market operations or modifying interest rates or reserve rates;
  (2) managing official foreign exchange reserves by governing banks' business operations involving foreign exchange through the implementation of the Regulations Governing Foreign Exchange Business of Banking Enterprises, which define the scope of foreign exchange business, establish requirements for managing foreign exchange business, and ensure administration and supervision by the FSC; and
  (3) issuing currency to facilitate financial transactions and financial stability.

- The Consumer Protection Act sets forth the fundamental rules and obligations for the protection of the interests and rights of consumers, and the Financial Consumer Protection Act (FCPA) specifically focuses on the protection of consumers engaging with banks and other financial institutions. Among other matters, the FCPA outlines regulations with respect to the advertising of financial products and services, consumer agreements, and the procedures for resolving disputes between financial institutions and consumers.

Recent regulatory themes and key regulatory developments in Taiwan

Current regulatory focus of examination

The FSC has identified six key areas of focus for examination in 2024. These areas include "Corporate Governance", "Fraud Prevention", "Protection of Financial Consumers' Rights and Interests", "Risk Management of Real Estate Credit", "Cybersecurity Management", and "Virtual Asset Service Providers (VASPs)", among which the FSC's main focus is as follows:

- Fraud Prevention: in response to public concerns on the prevalence of fraud, the FSC plans to increasingly scrutinise account-opening operations and the management of high-risk automated businesses, such as internet banking and ATMs, and strengthen the education of bank staff.
- Protection of Financial Consumers' Rights and Interests: in addition to the protection of credit card holders' personal data, the FSC has expanded its focus to examination of financial consultants or customer relationship managers selling any financial products that are not approved by the FSC and any mis-selling issues derived therefrom.
- Cybersecurity Management: with the rapid evolvement of fintech and electronic payments, the FSC proactively enhances cybersecurity management, including information and communication system and service supply chain risk management for credit cooperatives, a type of banking institution.

Outsourcing

To promote the adoption of cloud computing, cloud storage, AI, and other emerging technologies by financial institutions, the FSC made significant amendments to the Regulations Governing Internal Operating Systems and Procedures for the Outsourcing of Financial Institution Operation in August 2023. These changes aim to enhance digital transformation and business opportunities in the financial services sector. Key points include, among others: a more lenient measure on the prior approval requirement – banks no longer need to apply for prior approval of outsourcing for credit card issuance, loan marketing, and accounts receivable collection; and, where there is already a cross-border outsourcing or cloud-based outsourcing approved by the FSC, banks can handle similar projects without the need for a separate application for approval from the FSC.

Despite the fact that many outsourcing businesses are exempt from further reporting to the FSC, financial institutions remain responsible for the operations of the outsourcing organisation and the protection of customer interests. Banks are also required to ensure that the FSC has inspection rights to oversee the operations.

Cybersecurity

The growing complexity of information systems and service supply chains in the financial industry have increasingly exposed financial institutions to security risks. Therefore, the Bankers Association, at the request of the FSC, published the "Financial Institutions' Risk Management Guidelines for Information Communication Systems and Service Chain" (Supply Chain Guidelines) in April 2023, which consist of five key points:

(i) financial institutions shall conduct thorough analysis and planning for security issues related to supply chain information before engaging in any outsourcing activities;
(ii) banks are required to implement relevant measures to assess and select suppliers based on their security capabilities, which further reduces the risk of cybersecurity breaches;
(iii) clear provisions regarding cybersecurity shall be included in the entrustment contracts or any related documents with suppliers;
(iv) financial institutions shall adhere to specific principles set forth in Article 7 of the Supply Chain Guidelines throughout the duration of the contract with the supplier to ensure ongoing security; and
(v) necessary compliance measures shall be followed in the event of a service change or termination of the contract with the supplier.

The implementation of the Supply Chain Guidelines is expected to provide clear instructions on the information security measures that financial institutions shall adopt to minimise cybersecurity risk in relation to the management of the supply chain.

Open banking

In recent years, Taiwan's financial landscape has witnessed a transformative shift fuelled by the pursuit of innovation and increased competition. As part of this evolution, open banking has emerged as a focal point in reshaping the financial sector. The FSC encourages banks to voluntarily open up their application programming interfaces (APIs) for programmatic access by third-party financial service providers (TSPs), with the aim of providing TSPs with open access to consumer banking, transaction and other financial data from banks and non-bank financial institutions through the use of APIs. The FSC adopts a three-phase approach for open banking, which is reviewed on a rolling basis.

- Phase I (*public information inquiry*) mainly allows banks to offer access to non-transactional financial information on "product and service data" to TSPs, such as deposit interest rates, foreign currency exchange rates, branch and ATM locations, and financial products comparisons. No personal data is involved.
- Phase II (*customer information inquiry*) focuses on information on financial transactions, such as bank savings account balance and transaction details. Since this type of information involves personal data protection, customer interests, and standards for the management of TSPs, the FSC designated the Bankers Association and the Financial Information Service Co., Ltd. to produce guidance on institutional and technical standards for banks and TSPs to follow.
- Phase III (*transaction information*) mainly involves the process of banking transactions and payments. After customers give consent for TSPs to consolidate their personal accounts across banks, they may make a debit, payment, adjustment, or disbursement of account funds through an account-linked app.

Due to the sensitive nature of the transactions and payments data involved in Phase III, it is expected that the FSC will impose stricter requirements on cybersecurity and qualifications of TSPs. Banks will also have higher standards when selecting a TSP to serve as a transaction service platform. In addition to security concerns, other factors such as incentives for open banking and consumer protection will be taken into consideration.

Bank governance and internal controls

Overview of bank governance

In the realm of bank governance, the criteria for corporate governance in Taiwanese banks generally align with those governing other Taiwanese corporations as outlined in the Taiwan Company Act. Banks are required to convene shareholders' meetings annually,

conduct daily operations under the guidance of the board of directors and be supervised by the supervisors or audit committee and remuneration committee composed of independent directors. Since all Taiwanese banks are public companies or are deemed public companies, they are further required to comply with the Securities and Exchange Act of Taiwan and the related regulations issued by the FSC in respect of the corporate governance of, and public disclosure by, a public company. In addition, to ensure sound business operation, Taiwanese banks are required to establish proper internal audit and control systems, operation strategies, risk management policies, operation plans, risk management procedures and execution guidelines, among others.

Requirements of board members and senior managements

Under the Guiding Principles for the Practice of Banks in Corporate Governance, the structure of the board of directors shall be based on the company's business development and the shareholdings of its major shareholders. The number of directors shall be determined to be more than seven, taking into account the practical operational needs. Specifically, the number of independent directors of a public bank shall not be less than two and not less than one-third of the number of directors. Independent directors shall face restrictions on shareholdings and concurrent positions. It is not advisable for independent directors to serve as directors or supervisors in more than four listed or over-the-counter companies at the same time.

The Regulations Governing Qualification Requirements and Concurrent Serving Restrictions and Matters for Compliance by the Responsible Persons of Banks govern the designation of the responsible persons of a bank (including board members and senior managers). Generally, the responsible persons of a bank shall have good moral character and full competence serving in their positions, and must not have been sentenced to imprisonment for certain crimes.

Directors and supervisors

Directors of a bank are elected by the shareholders. Although it is not required to obtain prior approval from the FSC to be nominated or elected as a director of a bank, the FSC has prescribed relevant requirements to ensure that the chairperson of the board and the directors are capable of managing and operating a bank. One of the FSC's main focuses in the supervision of chairpersons and directors is the restriction on holding concurrent positions. The chairperson may not concurrently act as the general manager of the same bank or the chairperson of another financial institution (bank, financial holding company, insurance company, securities firm, etc.), nor act as the chairperson, general manager or equivalent role of a non-financial institution unless otherwise approved by the FSC. If a chairperson is allowed to hold concurrent positions in other companies, he or she must ensure that all positions are managed effectively and are not in conflict of interest. Except for banks that are 100% owned by the government or a single corporate shareholder, at least two of the directors of the bank must meet any of the following qualifications:

(i) at least five years' banking experience and having served as a vice manager or higher or an equivalent position in the bank's head office, with a good performance record;
(ii) five years' experience of working in financial administration or management and having held the position of civil service recommended appointment grade 8 or higher or equivalent, with a good performance record;
(iii) three years' banking experience and having served as a manager or higher or an equivalent position in the bank's head office, with a good performance record; or
(iv) other experience sufficient to demonstrate the professional knowledge and management competency to conduct banking business in a sound and efficient manner (in case of any doubt regarding competence, the bank may seek approval from the FSC prior to the election).

The minimum number of directors required to meet qualifications would increase based on the total number of directors and the assets held by the banks.

Senior managers

The general manager of the bank must meet any of the following qualifications:

(i) a bachelor's degree or equivalent with at least nine years' banking experience, and having served at least three years in a management position, with a good performance record;
(ii) at least five years' banking experience and having served as a vice general manager or higher or an equivalent position for at least three years, with a good performance record; or
(iii) other experience sufficient to demonstrate the professional knowledge and management competency to conduct banking business in a sound and efficient manner.

The relevant qualification documents shall be submitted to the FSC for approval before the appointment of the general manager of a bank. As for other senior managers (including deputy general managers, associate managers, managers of head office or branch or the equivalents), they are subject to other less stringent qualifications in relation to experience and expertise.

The FSC may request any necessary documents and information, or designate a person to explain whether the responsible person meets the regulatory criteria.

There is no mandatory restriction on the bonuses and remuneration paid by a bank to its directors, officers or employees. However, bonuses and remuneration are required to be reviewed and approved by the remuneration committee of the bank. Taiwanese banks are also required to set up a sales personnel remuneration system and have it approved by the board of directors. Also, according to the Guiding Principles for the Practice of Banks in Corporate Governance promulgated by the FSC, a bank shall take the following into consideration, *inter alia*, when reviewing the performance of its directors, officers and employees and determining payment of bonuses and remuneration:

(i) the risks associated with their performance (that may be realised in the future);
(ii) the criteria and arrangement for determination and payment of bonus and remuneration should not have the effect of encouraging the bank's directors, officers and employees to proceed with risky transactions;
(iii) a significant portion of the bonus and remuneration should be deferred or paid in the form of the bank's equity; and
(iv) the amount payable under any golden parachute arrangement should be based on the performance that has been delivered by the relevant directors, officers or employees.

Internal controls

According to the Banking Act and the Implementation Rules of Internal Audit and Internal Control System of Financial Holding Companies and Banking Industries, a bank shall establish an internal audit system and internal control system comprising three main elements to ensure effective corporate governance: a self-inspection system; a legal compliance system; and a risk management mechanism.

The internal control system of a bank shall be approved by its board of directors and cover all banking activities, incorporating the five major components as follows:

(i) "control environment": as the basis for the design and implementation of an internal control system, this component encompasses the integrity and ethical values of the bank, the supervision responsibilities of the directors and supervisors or audit committee, the organisational structure, the assignment of authority and responsibility, human resources policies, performance measurements, awards and discipline, and the code of conduct for all directors and employees;

(ii) "risk assessment": the prerequisite of this component is the confirmation of goals of the bank, which shall link to each level of the financial holding company and the banking sector. The results of risk assessment can assist the bank in designing, correcting and implementing the necessary controls in a timely manner;
(iii) "control operations": this component further implements proper policies and procedures at all levels, business processes, and subsidiaries of the bank based on the risk assessment results to control risks;
(iv) "information sharing and communication": this component is designed to ensure effective communication of information within and outside the financial holding companies and the banking sector; and
(v) "monitor": this component means to continuously assess the presence and effectiveness of the internal control system. Any findings of deficiencies by the internal control system shall be reported to the appropriate management levels and addressed in a timely manner for improvement.

To implement the internal control system, a bank shall establish an internal audit unit and have sufficient and competent personnel as full-time internal auditors performing internal control duties independently and impartially. The internal audit unit is directly under the board of directors and is required to report its audit matters to the board of directors and audit committee at least every six months.

According to the Banking Act, a bank that fails to establish or diligently implement the internal control and audit systems should be subject to an administrative fine of between NTD 2 million and NTD 50 million.

Bank capital requirements

The principal legislation governing the capital adequacy of a bank is the Regulations Governing the Capital Adequacy and Capital Category of Banks, which implement various elements of the Basel III framework, including the adoption of improving capital quality and introducing liquidity standards. In November 2023, the FSC amended the calculation method of Regulatory Capital to Risk-weighted Assets, which will come into effect on January 1, 2025 to align with the finalisation of post-crisis reforms under the Basel III framework.

Minimum capital requirement

The minimum paid-in capital required to establish a commercial bank in Taiwan is NTD 10 billion, which shall be paid in cash. The promoters of the bank shall subscribe up to 80% of the total paid-in capital of the bank and the remaining shares shall be publicly offered.

For a branch of a foreign bank in Taiwan that intends to engage in retail deposit business, it shall allocate a minimum operating capital of NTD 250 million, subject to certain exceptions.

Capital adequacy requirement

The current capital adequacy requirements are generally in line with the standards under the Basel III framework:

- Common Equity Tier 1 Ratio (i.e., net Common Equity Tier 1 divided by total risk-weighted assets): 7%;
- Tier 1 Capital Ratio (i.e., net Tier 1 Capital divided by total risk-weighted assets): 8.5%; and
- Total Capital Adequacy Ratio (i.e., aggregate amount of net Tier 1 Capital and net Tier 2 Capital divided by total risk-weighted assets): 10.5%.

Liquidity coverage ratio (LCR)

To enhance banks' short-term liquidity recovery ability, the FSC and the CBC implemented the LCR framework in 2015. The LCR is calculated by dividing a bank's high-quality liquid assets by its total net cash flows over a 30-day period. Since January 1, 2019, banks incorporated under the laws of Taiwan must maintain an LCR of at least 100%.

The LCR requirement is not applicable to a branch office of a foreign bank in Taiwan. However, a foreign bank applying to establish a branch office in Taiwan must specify the liquidity risk management framework adopted by the head office and the liquidity risk management measures applicable to the Taiwan branch.

Leverage ratio

To align with the Basel III framework, the FSC introduced the leverage ratio, which has been used as a measure to address the limitations of the Bank Capital Adequacy Ratio and prevent banks from engaging in excessive leverage since 2013.

Under the Regulations Governing the Capital Adequacy and Capital Category of Banks, the leverage ratio is calculated by dividing the net Common Equity Tier 1 by the total risk amount, and it is mandatory for a bank to maintain a leverage ratio of at least 3% and disclose it accordingly.

Total loss-absorbing capacity (TLAC)

In response to the current practice of domestic banks investing in TLAC eligible debt instruments issued by Global Systemically Important Banks (G-SIBs), the FSC has made amendments to the capital accrual regulations, which will be implemented from 2024 with the aim of enhancing the capital quality and risk-taking capacity of banks.

Domestic Systemically Important Banks (D-SIBs)

A bank that is designated a D-SIB in accordance with regulations is subject to stricter capital standards. Currently, the FSC has designated six banks as D-SIBs in Taiwan: CTBC Bank; Cathay United Bank; Taipei Fubon Commercial Bank; Mega International Commercial Bank; Taiwan Cooperative Bank; and First Commercial Bank.

These designated banks must allocate an average of 2% of additional statutory capital requirement and 2% of internal management capital requirement over a four-year period. In addition, they are required to report their contingency measures to deal with business crises to the FSC and must conduct and successfully pass an annual stress test for a period of two years.

Rules governing banks' relationships with their customers and other third parties

Nature of the banking regimes

Under the Banking Act, banks are classified into three categories: commercial banks; banks for special business purpose; and trust and investment companies. To date, commercial banks are the primary institutions in the banking industry and engage in various financial activities. In addition to traditional banking business, including deposit-taking and credit services, a commercial bank may invest in securities, handle domestic and foreign remittances, provide guarantees, act as an agency bank in related banking business and conduct other business upon the approval of the FSC, such as proprietary trading activities, trust enterprise business, insurance agent or broker business, financial advisory services, electronic payment business and so forth.

Customer protection

According to the FCPA, Taiwanese banks are generally required to thoroughly conduct know-your-customer (KYC) processes and assess the suitability of financial products for different types of customers. In general, banks refrain from offering customers financial products that are not aligned with the customers' risk tolerance level. Banks in Taiwan are also required to provide customers with comprehensive product information, including the structure, risks and scenario analysis, etc. by a prospectus, a summary of major terms and conditions and a risk disclosure statement, all of which should be in Chinese unless the customers are professional investors. Any misleading information in the advertisement or marketing materials to such customers or obviously unfair provisions in the transaction documents may result in an administrative fine and other sanction imposed by the FSC or could potentially invalidate the relevant transactions. The FCPA and related regulations provide further protection to bank customers who are not professional investors or high-net-worth individuals, including more requirements on due sale process and information disclosure, alternative dispute resolution and punitive damages.

Financial Ombudsman Institution (FOI) for addressing customer complaints

FOI was established and funded by the government in accordance with the FCPA. FOI's primary objective is to establish a reliable alternative dispute resolution mechanism for handling disputes between financial consumers and financial institutions, including cases of false advertisement of financial products, failure to fully repay loans, and claims for enforcement by financial institutions even after debts have been settled, etc.

Before seeking a review, customers must first file a complaint with the financial institution involved in the dispute. If the financial institution fails to respond within 30 days or if the response is unsatisfactory, customers may then apply to FOI for further review. Upon receipt of the application, FOI will assess the case and determine whether mediation is appropriate. If mediation is not pursued or is not substantiated, the case will undergo a preliminary examination by three members, and a report will be prepared and forwarded to the committee. Within three months, the committee is expected to reach a formal decision on the case, with the possibility of a two-month extension if necessary. If both the applicant and the assessed financial institution agree to the decision, the assessment will be deemed final and, upon court approval, will hold the same effect as a civil final judgment. However, if either the applicant or the assessed financial institution is unsatisfied with the decision, each may still seek relief through general civil litigation.

Compensation schemes

The Central Deposit Insurance Corporation (CDIC) was established on September 27, 1985 by the Ministry of Finance (MOF) and the CBC, as the sole and exclusive deposit insurance organisation in Taiwan. The CDIC implements a deposit insurance mechanism pursuant to which the CDIC will provide compensation to depositors within the maximum insured amount of NTD 3 million in order to protect the rights and interests of depositors and to maintain financial stability in the event of a financial institution being ordered to cease operations by the FSC. Deposit insurance premiums are paid to the CDIC by the financial institutions duly authorised to participate in deposit insurance, rather than by depositors themselves.

According to Article 12 of the Deposit Insurance Act, deposit insurance covers various types of deposits in Taiwan (including checking accounts, demand deposits, time deposits, deposits required by law to be deposited in certain financial institutions and any other deposits approved by the FSC). However, it is important to note that deposits received by Offshore Banking Units (OBUs) and deposits held by overseas branches established by domestic banks in foreign countries or Mainland China are excluded from the deposit insurance coverage.

Inbound cross-border banking activities

An overseas bank must first obtain prior approval from the FSC to establish and operate a branch office in Taiwan prior to conducting any business in Taiwan. Alternatively, the bank may set up a representative office in Taiwan after receiving approval from the FSC. However, the activities of the representative office are limited to collecting commercial and market information and facilitating business communication.

In general, the FSC prohibits domestic banks or branches of overseas banks from providing financial services in Taiwan on behalf of unlicensed overseas banks. A domestic bank that engages in such activities would be deemed in violation of the Banking Act.

Anti-money laundering (AML)

In Taiwan, the Investigation Bureau under the Ministry of Justice (IBMOJ) and the FSC are the primary regulators for AML and Countering Terrorism Financing (CTF). The FSC has promulgated regulations that specifically address AML and CTF in the banking sector, including the Regulations Governing Anti-Money Laundering of Financial Institutions, as well as the Regulations Governing Internal Audit and Internal Control System of Anti-Money Laundering and Countering Terrorism Financing of Banking Business and Other Financial Institutions.

"KYC Requirements" and "Suspicious Activity and Transaction Reporting" are key components of the implementation of AML and CTF measures.

For "KYC Requirements", a bank must conduct due diligence on both new and existing customers, taking a risk-based approach. The measure includes properly identifying and verifying the identity of the customers and beneficial owners, with records of all relevant information retained. When onboarding a juristic person, a bank shall understand its business nature, equity structure and its controlling person. When a customer is identified as high risk or as having specific high-risk factors, it becomes imperative to adopt enhanced verification measures. As for existing customer due diligence, a bank must regularly update all information at least once a year to ensure that it aligns with the bank's risk profile and shall understand the source of funds when necessary.

For "Suspicious Activity and Transaction Reporting", a bank shall report transactions exceeding NTD 500,000 and all suspicious transactions (including attempted transactions) to the IBMOJ, using the prescribed Suspicious Activity Report (SAR) form. However, there are exceptions to the requirement for transactions exceeding NTD 500,000 that involve funds deposited into accounts opened by government agencies, public institutions, schools, and certain funds as well as transactions between financial institutions. The SAR should contain customer information, transaction details, a statement explaining the reason for suspicion, and warning signs of money laundering activities. Regarding suspicious transactions, if a transaction triggers red flags, it shall be reviewed based on a risk-based assessment to determine whether it is a suspicious transaction. If the financial institution determines that the red-flagged transaction is not related to any AML or CTF activity, it is not required to report it to the IBMOJ. However, records of the determination and assessment shall be retained. The Bankers Association has enclosed a list of red flags for suspicious money laundering and terrorism financing transactions, but the list is not exhaustive in its coverage. A bank shall select or create suitable red flags based on its assets scale, geographic areas, business profile, customer-base profile, characteristics of transactions, and internal risk assessments or information on daily transactions to identify potential money laundering or terrorism financing red flag transactions.

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Introduction

Banks continue to operate in a challenging environment. In particular, economic growth has slowed as higher interest rates seek to control inflation. Whilst UK banks can profit from higher interest rates, they will also be wary of an increase in borrower defaults.

When borrowers struggle to service their debts, banks need to be particularly mindful of their regulatory obligations, including the requirement to treat customers fairly. A package of rules surrounding a new "consumer duty" has focused minds on how banks deliver good outcomes for retail customers.

Banks also face tighter standards around how they identify and manage risks relating to environmental, social and governance ("**ESG**") issues, including greenwashing. Separately, UK banks are adjusting their compliance procedures to reflect IT developments. For example, the use of encrypted messaging apps by bank staff has been in the spotlight following high-profile enforcement action in the US.

Incoming legislation is laying the groundwork for future regulatory reforms that allow for more proportionate and responsive rules. This includes deregulation in targeted areas (such as the cap on banker bonuses and wholesale market reforms) and new regulation in others (such as ESG and cryptoassets). UK banks with EU affiliates will keep a close eye on how their respective regulatory regimes are continuing to evolve and diverge.

Regulatory architecture: Overview of banking regulators and key regulations

<u>Which bodies are responsible for regulating banks in the UK?</u>

There are two key regulators in the UK. The Prudential Regulation Authority ("**PRA**") is responsible for the financial safety and soundness of banks, whilst the Financial Conduct Authority ("**FCA**") is responsible for how banks treat their clients and behave in financial markets.

Prudential issues for banks such as capital and liquidity fall squarely within the PRA's remit, whereas conduct issues such as mis-selling and market abuse are matters for the FCA. Both the PRA and FCA are interested in bank governance and systems and controls. This is because the ways in which banks organise their affairs and control their activities are relevant both to the financial health of a bank and the way it treats its clients and conducts itself in markets.

The PRA is part of the Bank of England. The Bank of England also supervises financial market infrastructure such as clearing houses (e.g. LCH) and payment systems (e.g. VISA). A separate Payment Systems Regulator also oversees payment systems, with a particular focus on competition and innovation.

What are the key legislation and regulations applicable to banks in the UK?

The legislative framework for UK bank authorisations is set out in the Financial Services and Markets Act 2000 ("**FSMA**"). FSMA prohibits any person from carrying on regulated financial services business without having the relevant permissions.

The Financial Services and Markets Act (Regulated Activities) Order 2001 is the key secondary legislation that specifies the vast majority of financial services business that is regulated in the UK. Licensable business includes, among other things, deposit-taking, securities and derivatives business, activities relating to investment funds, consumer credit and residential mortgage activities, and insurance underwriting and distribution.

Payment services are licensable under separate legislation (the Payment Services Regulations 2017 – "**PSRs**"), although licensed banks are automatically treated as being permitted to provide payment services in the UK.

Banks are required to comply with a wide range of law and regulation, including the PRA Rulebook, the FCA Handbook, and various pieces of primary and secondary legislation, much of which derives from the UK's historic membership of the EU.

Some of these regulatory requirements apply to all UK banks (including most requirements relating to prudential regulation, governance and systems and controls) whereas other requirements are triggered by carrying out certain activities or providing particular products and services (various conduct of business rules).

The Financial Services and Markets Act 2023 ("**FSMA 23**") provides for a designated activities regime to sit alongside the Regulated Activities Order. Its purpose is to impose requirements relating to certain financial markets activities that are carried out by both regulated and unregulated firms. This will likely include certain areas of regulation that are currently covered by former EU law (e.g. regulation relating to short selling, over-the-counter ("**OTC**") derivatives, securitisation, prospectuses and benchmarks). Any rules made by HM Treasury or the FCA under this regime would only apply to the designated activity and not to the wider activities of the firm.

To what extent do supra-national regimes or bodies influence UK regulation?

For many years until the beginning of 2021, the UK was bound by EU regulatory requirements relating to financial services. This was an inevitable consequence of the UK's membership of the EU and subsequent transitional arrangements relating to its withdrawal. EU requirements have shaped the UK regulatory regime in various ways, including in the following areas:

- prudential regulation – e.g. the Capital Requirements Regulation and Directive ("**CRR**" and "**CRD**");
- investment/markets business – e.g. the Markets in Financial Instruments Regulation and Directive ("**MiFIR**" and "**MiFID**"), the Short Selling Regulation ("**SSR**") and the Market Abuse Regulation ("**MAR**");
- central clearing of derivatives – e.g. the European Market Infrastructure Regulation ("**EMIR**"); and
- retail disclosures – e.g. the Regulation on Packaged Retail and Insurance-Based Investment Products ("**PRIIPs**").

As a general matter, EU law applying in the UK at the end of the Brexit transition period (31 December 2020) was retained in UK law. This means that the UK left the EU with carbon copies of directly applicable EU law transposed onto its statute books, subject to certain technical amendments that were needed to make the law operate effectively in the UK.

The UK Government has committed to promoting global standard-setting via international sources (e.g. the Financial Stability Board and G20).

Are there any restrictions on the activities of banks in the UK?

Regulatory permissions

Banks can only carry out activities for which they hold the appropriate regulatory permissions. These are sorted by activity type (e.g. dealing, arranging, advising, consumer lending), product type (e.g. shares, bonds, derivatives, funds) and customer type (e.g. retail, professional and eligible counterparty).

Before granting regulatory permissions, the PRA and FCA will want to understand the business plan of the bank and the resources it has available in the UK (e.g. front-line staff, operational infrastructure and compliance oversight) to execute against that business plan.

If the PRA or FCA become particularly concerned about aspects of a bank's business, they have the power to impose limitations on the type or quantum of activities that it can carry out, pending resolution of the relevant issues.

Ring-fencing

In the aftermath of the financial crisis, the UK introduced a ring-fencing regime, requiring the structural separation of certain investment banking activities from retail banking activities. The key objectives were, broadly, to make big retail banks less likely to fail and to ensure that, if they do fail, state support can be directed at saving the retail bank within a broader group without deploying taxpayers' money to rescue an investment bank within the same group. The UK ring-fencing regime is primarily set out in FSMA, certain secondary legislation (the "Core Activities Order" and the "Excluded Activities Order"), and the PRA Rulebook.

The regime applies to UK-incorporated banks with a certain amount of "core deposits", which generally includes deposits from retail and small corporate clients. The threshold is currently £25 billion of core deposits but the Government plans to increase this to £35 billion. Building societies are excluded from the regime but are subject to other restrictions on the activities that they can undertake under the Building Societies Act 1986.

Where ring-fencing applies to a UK banking group, only the ring-fenced banks within the group can accept "core deposits". The ring-fenced banks are also subject to general prohibitions on dealing in investments (e.g. securities, derivatives and investment funds) as principal and incurring an exposure to a "relevant financial institution" (e.g. making a loan to another bank, securities firm or investment fund), subject to certain exceptions.

In 2023, the Government confirmed the near-term reform measures it would take in response to an independent review of the ring-fencing legislation, including changes that would allow ring-fenced banks to service smaller financial institution clients and establish branches outside the UK and EU. In 2024, the Government plans to set out proposals for longer-term reform, including aligning the ring-fencing and resolution regimes.

Recent regulatory themes and key regulatory developments

What has been the impact of Brexit?

For UK banks, the most significant impact of Brexit was the loss of their EU passporting rights. This means that they can only provide a limited range of products directly from the UK to clients based in the EU, e.g. products that are not regulated in the relevant EU jurisdiction or where there is a cross-border licence or exemption available in a specific EU jurisdiction. Incoming EU legislation known as CRD VI will restrict cross-border business further by closing national cross-border licences and exemptions and requiring non-EU firms to establish a branch before providing banking services in the EU.

As they are no longer treated as EU banks, UK banks also face other challenges under EU regulation. For example, UK banks have restricted access to EU financial market infrastructure as regulatory licensing constraints and requirements in rulebooks mean that, in some cases, only EU firms can be members of EU trading venues and clearing houses. There are also restrictions on the ability of UK banks to act as primary dealer for some EU Member State Government debt issuances, and a prohibition on UK banks providing direct electronic access to EU trading venues.

These challenges, and others, have led to many UK banks establishing or building out licensed EU affiliates that can benefit from EU passporting rights and operate free from the restrictions referred to above. Nonetheless, EU bank affiliates will not typically operate in isolation from the UK bank and the rest of the group of which they form part. The EU bank will, to the extent permitted by regulatory requirements (including expectations of the European Central Bank), transfer risk back to the UK bank and rely on some of the operational infrastructure and personnel of the UK bank pursuant to intra-group agreements.

<u>What ESG-related regulation applies to banks?</u>

The PRA has set out its expectations on banks for considering climate change risks in their governance arrangements and risk management practices. It has noted the challenges that banks face in this context, for example, when sourcing information on their counterparties' exposures or transition plans. Regulations require UK financial institutions (in addition to listed companies) to disclose information on these topics as well as analysis of their resilience to different climate scenarios. The largest UK banks have been subject to stress tests on these climate scenarios by the Bank of England.

The FCA is introducing disclosure rules for financial products to provide greater clarity to investors about sustainability. The proposals include a general anti-greenwashing rule applicable to all FCA-regulated firms, including banks. Another significant milestone will be the creation of a UK "taxonomy". This will establish the criteria for determining whether an economic activity is "environmentally sustainable" and will feed into future ESG regulation. An advisory group is advising the Government on adapting the EU's taxonomy for the UK.

Besides environmental matters, the UK regulators have consulted with the industry about introducing rules and guidance relating to diversity and inclusion in the financial sector. They also continue to emphasise the role of culture to reduce the potential for harm caused by inappropriate conduct.

<u>Are there recent developments regarding IT or cybersecurity?</u>

The UK regulators have introduced rules requiring banks to take a more systematic approach to operational resilience. The rules require banks to, for example, identify their important business services, map the resources necessary to deliver those services and set impact tolerances for disruption. 31 March 2025 is the longstop date for banks to make sure they can remain within their impact tolerances in the event of a severe but plausible disruption to operations.

The operational resilience regimes are complemented by standards on outsourcing and third-party risk management. The regulators will also use powers under FSMA 23 to impose resilience standards and testing requirements on third parties that are designated as being critical to the financial system, such as cloud service providers.

<u>How are UK regulators addressing new developments in fintech and digital ledger technology?</u>

The UK regulators are highly supportive of innovation in the financial services sector. This is evident from the large number of challenger banks and fintech firms that have received

authorisation in recent years and the FCA's regulatory sandbox, which allows firms to test innovative products in a controlled environment.

There has been a lot of focus on the regulatory characterisation of different types of digital assets. Security tokens and e-money tokens are regulated financial instruments, whilst other tokens such as utility tokens and exchange tokens (e.g. cryptocurrencies such as Bitcoin) generally fall outside the regulatory perimeter.

Derivatives linked to unregulated products are regulated. The FCA has banned regulated firms (including banks) from marketing, selling or distributing to retail clients derivatives and exchange-traded notes linked to cryptoassets.

Cryptoasset exchange providers and custodian wallet providers (including banks and other authorised persons providing those services) must register with the FCA for AML supervision.

The UK Government will use powers under FSMA 23 to create a regulatory regime for fiat-backed stablecoins. Specifically, the issuance and custody of fiat-backed stablecoins will become regulated activities and the use of these stablecoins in UK payment transactions will be brought into the scope of existing payments regulation. In 2024, HM Treasury is expected to publish draft legislation to introduce a more comprehensive regulatory regime for cryptoassets. Ahead of these changes, cryptoassets have been brought within the scope of the financial promotion restriction, which curtails who can market cryptoassets in the UK. The FCA treats cryptoassets as high-risk investments, meaning that onerous requirements apply to cryptoasset promotions, especially those that make direct offers to retail investors.

The FCA and PRA have been exploring the use of artificial intelligence ("**AI**") in financial services for several years. Most recently, a discussion paper invited feedback on the barriers firms face to the safe adoption of AI and machine learning technology. The FCA has also sought feedback on Big Tech's entry and expansion into retail financial services, including the potential competition impacts from the data asymmetry between Big Tech and financial services firms.

In response to the long-term trend away from cash and towards card and digital payments, FSMA 23 allows HM Treasury to impose requirements on the largest retail banks and building societies to protect access to cash across the UK. Looking further ahead, another potential alternative to cash would be a central bank digital currency ("**CBDC**"). No decision has been made on whether to introduce a UK CBDC, but the Bank of England and HM Treasury have moved beyond exploring the idea into designing the technology and policy requirements for a digital pound. If the case for a CBDC is made, the earliest launch date would be in the second half of the decade.

Are there plans for developments relating to the regulation of banks in the UK?

The Government plans to reshape the UK's regulatory framework via FSMA 23. The Act empowers HM Treasury to repeal retained EU law relating to financial services, allowing for its replacement by rules set and maintained by regulators. This will make it easier for obligations on firms to be waived or amended if appropriate, as there is much more flexibility to do this with regulatory rules as opposed to legislation.

HM Treasury and the regulators are taking a phased approach to achieve this "smarter regulatory framework", prioritising policy areas that can advance the Government's objective for a more competitive, open, technologically advanced and green financial services sector. Priority reforms include replacing the retained EU law on PRIIPs with a new UK retail disclosure framework for consumer composite investments. FSMA 23 has also made targeted changes to regulatory requirements in wholesale markets, such as removing the share trading obligation and double volume cap from UK MiFIR.

FSMA 23 and the Government's smarter regulatory framework programme enables further divergence from the EU's rulebook, primarily to avoid imposing regulation on UK firms that the Government and the PRA/FCA do not think is appropriate. It is notable in this context that FSMA 23 also gives the FCA and PRA a new secondary objective to act in a way that facilitates the long-term growth and international competitiveness of the UK economy.

Another significant regulatory change for banks is the introduction of the FCA's consumer duty. The duty includes a new principle requiring firms to deliver good outcomes for retail customers and rules requiring firms to act in good faith, avoid causing foreseeable harm, and enable and support customers to pursue their financial objectives. Additional rules specify the outcomes the FCA wants to see. These are intended to make sure that customers receive the support they need, communications they can understand, and products and services that meet their needs and offer fair value. The rules impact manufacturers and distributors of financial products.

Is there a recovery and resolution regime?

Shortly after the financial crisis, the UK introduced a domestic recovery and resolution regime under the Banking Act 2009. This gives the Bank of England powers to help resolve failing banks. The key strategies for resolving banks are bail-in (writing off debts to absorb losses), transferring critical functions to a bridge bank before being sold on, and putting the bank into a modified insolvency regime, which focuses on promoting financial stability and protecting depositors. The EU's Bank Recovery and Resolution Directive ("**BRRD**") was subsequently enacted and the UK regime was amended where necessary to ensure consistency with that Directive.

To support the Bank of England's resolution powers, banks are required to put in place a comprehensive resolution plan (also known as a "living will") detailing their key business lines and functions and how they could continue to function or be wound down in an orderly way.

More recently, the Bank of England initiated a Resolvability Assessment Framework. This places responsibility on banks to demonstrate to the Bank of England, and publicly, their preparedness for resolution. As part of this, there is a focus on identifying and mitigating any risks to a successful resolution. For example, banks are required to assess the extent to which their financial contracts would be subject to the risk of early termination by counterparties if the bank were to enter resolution.

Are there requirements to ensure through contractual means that recovery and resolution orders, such as bail-in, will be enforceable?

The bank recovery and resolution regime is supported by PRA rules regarding contractual recognition of bail-in. These rules require UK banks to obtain, for certain liabilities governed by non-UK law, the contractual consent of counterparties to have their claims bailed-in if the Bank of England exercises its bail-in powers in respect of the bank's liabilities. Such contractual consent is not needed where liabilities are governed by UK law since UK law will automatically recognise the Bank of England's bail-in powers.

Similarly, the PRA requires financial contracts (e.g. derivatives and repos) that are governed by non-UK law to include "contractual stay" provisions that prevent the counterparty from terminating in the event that the bank goes into resolution. Such contractual stay language is not needed where financial contracts are governed by UK law since the Bank of England's "general stay" powers will apply to those contracts by operation of law.

Are banks and financial institutions subject to rules on derivatives trading?

UK banks are subject to various rules on derivatives trading, including:

- conduct of business rules ("**COBS**") in the FCA Handbook that derive from MiFID;
- a requirement under UK MiFIR to trade certain interest rate swaps and credit default swaps on a trading venue;
- mandatory clearing, margining and reporting requirements for OTC derivatives under UK EMIR; and
- restrictions under UK MAR and SSR, as well as obligations under the Disclosure Guidance and Transparency rules ("**DTR**").

Bank governance and internal controls

Does UK regulation require board members to have specific expertise, or for a certain proportion of the board to be independent of management?

The Senior Managers and Certification Regime ("**SMCR**") requires most board members and other senior managers (e.g. heads of business lines and key functions) to obtain regulatory approval prior to commencing a senior management function at a bank.

As part of this process, the relevant bank, and the regulators, will consider whether the individual is "fit and proper" to carry out the role. This assessment will have regard to, among other things, the professional experience of the candidate and any issues relating to their personal integrity.

The PRA generally expects a bank board to include directors with significant financial services experience and has a strong preference for the chairman and non-executive directors to be independent. The regulators can call individual candidates for interview where appropriate.

In 2023, HM Treasury and the regulators conducted a review that sought feedback on the effectiveness of the SMCR.

Does UK regulation require certain committees to be maintained by all banks?

UK banks are generally required to maintain various committees that oversee certain areas of the bank's operations; for example, an audit committee, a nominations committee and a risk committee. Exceptions can apply for banks that are less significant in size and scale.

Does UK regulation require banks to comply with rules regarding the remuneration of certain categories of staff?

Senior managers and other "material risk-takers" who affect the bank's risk profile are subject to remuneration restrictions. These include requirements to pay a certain proportion of bonuses in shares or other non-cash instruments, deferral of some bonus payments, and provisions to allow banks to claw back bonuses where appropriate. A cap on bonuses was removed in 2023. Removing the cap is intended to alleviate the pressure on banks to maintain higher salaries (which represent a fixed cost) and give them more flexibility to provide a greater proportion of overall remuneration in the form of bonuses.

What are the key requirements governing the organisation of banks' internal control environment?

The SMCR has placed a greater emphasis on senior managers' individual accountability for the operation of a particular business area or function, and for the compliance of that area with applicable regulation. In other words, regulatory compliance cannot simply be left to the control functions, such as compliance and risk, although those functions play a critical role.

Individual role profiles and management responsibilities maps are used to document who is responsible for what, and how the overall governance structure works, including hard reporting lines within a legal entity and matrix reporting lines on a group or functionalised basis.

Does UK regulation require banks to have a dedicated compliance function, risk function or internal audit function?

The UK regulators expect that the business lines within a bank should assume primary responsibility for identifying and managing regulatory risk.

In this context, the business is often referred to as the "first line of defence". However, the compliance and risk functions (the "second line of defence") have an important role to play in ensuring that the business manages risk effectively, and the internal audit function (the "third line of defence") provides a further check on the business, as well as the compliance and risk functions.

In large banks, compliance and risk will typically be separate functions, and internal audit should always maintain independence from the business, compliance and risk, to ensure it can provide objective assessment and challenge.

What requirements apply to the outsourcing of bank functions?

Banks are generally permitted to outsource functions, either to a group entity or a third-party supplier, subject to various regulatory restrictions. These include, among other things, that the bank maintains sufficient substance and expertise to effectively oversee and control the outsourcing, that the bank retains its regulatory responsibilities to clients and the regulators, and that the documentation of outsourcing arrangements includes various contractual provisions that protect the bank.

Bank capital requirements

What regulatory capital and liquidity requirements apply to banks in the UK?

UK banks are subject to rigorous regulatory capital rules. The amount of capital that they need to hold will broadly be determined by the size of their balance sheet and the value and riskiness of their exposures. In particular, banks will be required to hold capital against the following risks:

- Credit risk: where banks lend money to clients, they are exposed to the risk that those clients might default on their obligations to repay the money to the bank. To mitigate this risk, banks are required to sort each type of loan into various risk categories, depending on the type and perceived creditworthiness of the borrower, and having regard to the benefit of any credit risk mitigation, such as security or guarantees. The riskier a borrower is perceived to be (having regard to any applicable credit ratings), the more capital the bank will need to hold against its loan to that borrower.
- Market risk: where banks underwrite issuances of securities, or hold positions in equities, fixed income instruments, funds or derivatives, they are exposed to the risk that the value of those positions will move against them, thereby causing the bank to suffer a loss. Banks are therefore required to calculate the value, nature and riskiness of their positions, and to hold capital against those. In this context, positions are generally assessed on a net basis (e.g. certain short positions in a particular instrument can be offset against long positions in the same instrument).
- Operational risk: there is a lot that can go wrong when running a bank. IT systems can fail, front-line staff could be accused of mis-selling products, and the bank may incur

the expense of dealing with regulatory investigations, enforcement action or litigation. These are just some of the risks inherent in the operations of a bank, and banks will need to hold an appropriate amount of capital against such risks.

The default means for calculating regulatory capital requirements for credit and market risk is known as the standardised approach. However, banks with a proven track record may apply for regulatory permission to use an internal model for calculating their capital requirements. This allows those banks to use their own data and systems to adopt a more nuanced (and generally less capital-intensive) approach to assessing their regulatory capital requirements.

New and growing banks have historically found it challenging to obtain approval to use an internal model and consider that this puts them at a disadvantage when compared to the incumbents. However, the PRA plans to help challenger banks by introducing what it calls a "strong and simple" regime that will streamline the capital and other prudential requirements applicable to new and growing banks.

Banks are also subject to rigorous liquidity rules. Whilst regulatory capital is concerned with the solvency of banks on a longer-term balance sheet basis, liquidity is concerned with ensuring that banks have enough cash (or assets they can quickly convert to cash) to meet their obligations as they fall due. To this end, the Liquidity Coverage Ratio requires banks to envisage a 30-day period of stress, and to ensure that they hold sufficient high-quality liquid assets to enable them to meet their liabilities under this scenario. In this context, a bank's obligations could include repayment of its own debts to creditors, and its obligations to provide funding under committed but undrawn facilities. Separately, the Net Stable Funding Ratio requires banks to ensure that their assets are funded by capital and other liabilities that are deemed to be sufficiently stable. A key aim of these requirements is to ensure that banks are not overly reliant on short-term inter-bank funding, which can be withdrawn with limited notice.

Do these regulatory capital and liquidity rules derive from national law, supra-national regulations or international standards?

The Basel Committee on Banking Supervision ("**BCBS**") sets global standards for bank capital and liquidity, which are periodically updated and strengthened. These have been implemented at EU level via the CRR and CRD. As the UK was required to comply with EU regulatory standards until the end of 2020, the UK's regulatory capital and liquidity regime is largely the same as the EU's, although the UK now has freedom to determine its own prudential rules and is expected to deviate from the EU rules in some areas.

For example, under the EU's CRD V, non-EU-headquartered banking groups (e.g. US-, Asian- and UK-headed groups), with at least €40 billion of assets in the EU, may be required to hold all their EU banks and investment firms beneath a common EU Intermediate Parent Undertaking ("**IPU**"), which will be subject to EU consolidated supervision. The EU's IPU is relevant to UK banks with significant EU operations, but the UK is not proposing to implement an equivalent IPU regime in the UK.

By contrast, the UK has chosen to implement an EU-led initiative to require bank holding companies to obtain regulatory approval as Financial Holding Companies ("**FHCs**"). Relevant FHCs need to comply with various requirements relating to their directors and governance, as well as the prudential rules that apply on a consolidated group basis.

The UK has committed to introducing new BCBS standards known as Basel 3.1. The UK has chosen to delay implementation to 1 July 2025, which aligns with the approach taken by the US. The PRA's approach strives for full implementation of Basel 3.1 with minimal deviations.

<u>What is the impact of international initiatives on bank capital and liquidity?</u>

Since the global financial crisis of 2008, there has been a drive to:

- increase the quantity and quality of regulatory capital held by banks, and to require systemically important banks to maintain other liabilities that could be bailed-in if needed (loss-absorbing capacity);
- ensure that banks have sufficient liquid assets to enable them to pay creditors and meet other commitments during periods of stress; and
- ensure that banks are not over-leveraged by limiting the extent to which they can fund their assets by debt (which needs to be repaid to creditors) as opposed to equity (which does not need to be repaid to shareholders).

This global drive, led by the BCBS, has led to UK banks being in a better position to withstand shocks than was the case going into the 2008 financial crisis.

Rules governing banks' relationships with their customers and other third parties

Different regulatory requirements apply to different types of products, services and activities. There is not space for a comprehensive analysis in this chapter, but the below should help identify the key rules that may apply to a range of selected products and activities.

<u>What regulatory regimes apply to the following?</u>

Deposit-taking activities

For retail deposit-taking business, including current and savings accounts, the Banking Conduct of Business Sourcebook applies. Where a bank is providing payment services, which will be the case where a bank is providing a current account or a credit card, the PSRs apply.

Lending activities, including the substitution of LIBOR

Where a bank is providing credit to consumers (for example, via a personal loan, overdraft or credit card), applicable regulation includes the Consumer Credit Act 1974, secondary legislation under that Act, and the Consumer Credit rules in the FCA Handbook. For residential mortgage lending, the relevant rules are set out in the Mortgage Conduct of Business Sourcebook.

By contrast, wholesale/corporate lending is largely unregulated in the UK and there is no specific rulebook for these products. However, the UK regulators have required banks to move away from using LIBOR and have set out various expectations on banks relating to the fair treatment of customers in this context.

Investment services

For investment services such as brokerage, trade execution and advice on securities and derivatives, there are comprehensive conduct rules set out in various rulebooks. The most significant are the COBS in the FCA Handbook (this transposes the relevant requirements of MiFID II) and UK MiFIR.

Proprietary trading activities

Where a bank is engaged in proprietary trading, it should have regard to a range of regulatory requirements. These include, among others, UK MAR, UK SSR, DTR, COBS, PRA and FCA expectations regarding the oversight of algorithmic trading functions, and relevant prudential and structural requirements (e.g. ensuring that positions are supported by sufficient regulatory capital, and that trading is consistent with the ring-fencing rules, where applicable).

Are there any financial services-specific mechanisms for addressing customer complaints in the UK?

If a customer has a complaint about a financial product or service that has not been resolved by the bank to the customer's satisfaction, the customer can refer the complaint to the Financial Ombudsman Service ("**FOS**").

Referring complaints to the FOS is free for the customer but can be expensive for banks. Aside from the risk of being required to compensate customers, banks must (except for limited case allowance per year) pay to the FOS a fee of £750 for each case that the FOS considers, regardless of whether the FOS upholds the claim or not.

This may create an incentive for banks to settle complaints before customers refer them to the FOS, although it should be noted that the FOS is significantly cheaper than court proceedings, all other things being equal. The FOS has launched an action plan to improve its service, which includes taking a more robust and proactive approach to preventing complaints arising and resolving problems more efficiently.

Are there any compensation schemes that cover customers in the case of failure of UK banks?

Deposits held at UK banks by retail and corporate customers are generally protected by the Financial Services Compensation Scheme ("**FSCS**") up to £85,000 per customer, per bank. Temporary high balances that result from certain protected arrangements (e.g. home purchases or sales, or a pay-out from life insurance) can be protected up to £1 million for up to six months.

Other products, such as insurance and pensions, may also benefit from FSCS protection, although the protection limits and eligibility criteria differ by product and need to be carefully examined on a case-by-case basis.

What restrictions apply to overseas banks providing cross-border services into the UK?

Banks based outside of the UK, and which do not have a UK place of business, are able to provide certain cross-border products and services to UK clients without triggering a UK licensing requirement. This is based on a mixture of the UK's characteristic performance test and its overseas persons exemption ("**OPE**").

For example, the UK's characteristic performance test effectively provides that deposit-taking and custody services are provided at the location where the accounts are located and the assets held. Therefore, if an EU bank is providing an EU-based bank or custody account to UK clients, the EU bank should not generally be regarded as carrying out the regulated activity of accepting deposits or providing custody services in the UK, and therefore should not need a UK regulatory licence to offer these services to UK clients.

Where the characteristic performance test dictates that an activity is regarded as being carried out in the UK even though it is provided by an offshore bank on a cross-border basis, an exemption is required to avoid triggering a UK licensing requirement for that offshore bank. The UK's OPE has, broadly, the effect of allowing offshore firms without a UK place of business to provide various investment services (e.g. securities and derivatives dealing or underwriting) to professional UK clients on a cross-border basis without triggering a UK licensing requirement. This exemption has earned the UK a reputation for having a liberal cross-border licensing regime in respect of such business.

However, the characteristic performance test and OPE do not provide a solution for all cross-border services, so a case-by-case assessment is necessary. In addition, firms must also consider the UK restrictions on making financial promotions.

What is the regulatory framework on anti-money laundering in the UK?

The UK has a comprehensive financial crime regime. This includes, among other things, the Proceeds of Crime Act 2002, the Terrorism Act 2000, the Money Laundering Regulations 2017, comprehensive guidance from the Joint Money Laundering Steering Group, and requirements in the Systems and Controls section of the FCA Handbook.

Most notably, banks need to develop and maintain appropriate systems and controls that enable them to fulfil their obligations relating to client due diligence and ongoing monitoring.

In recent years, banks have been subject to increasing levels of regulatory scrutiny relating to those systems and controls, and in some cases, this has led to enforcement action and criminal proceedings followed by fines and public censure.

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Notes

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- Recent regulatory themes and key regulatory developments
- Bank governance and internal controls
- Bank capital requirements
- Rules governing banks' relationships with their customers and other third parties

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