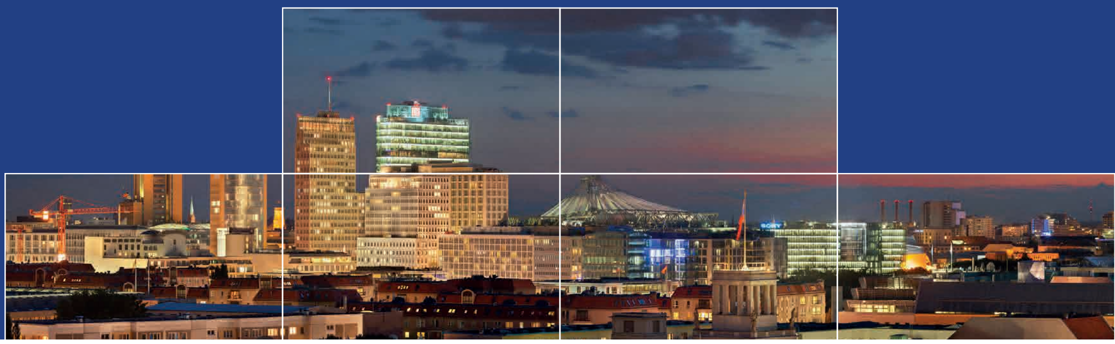
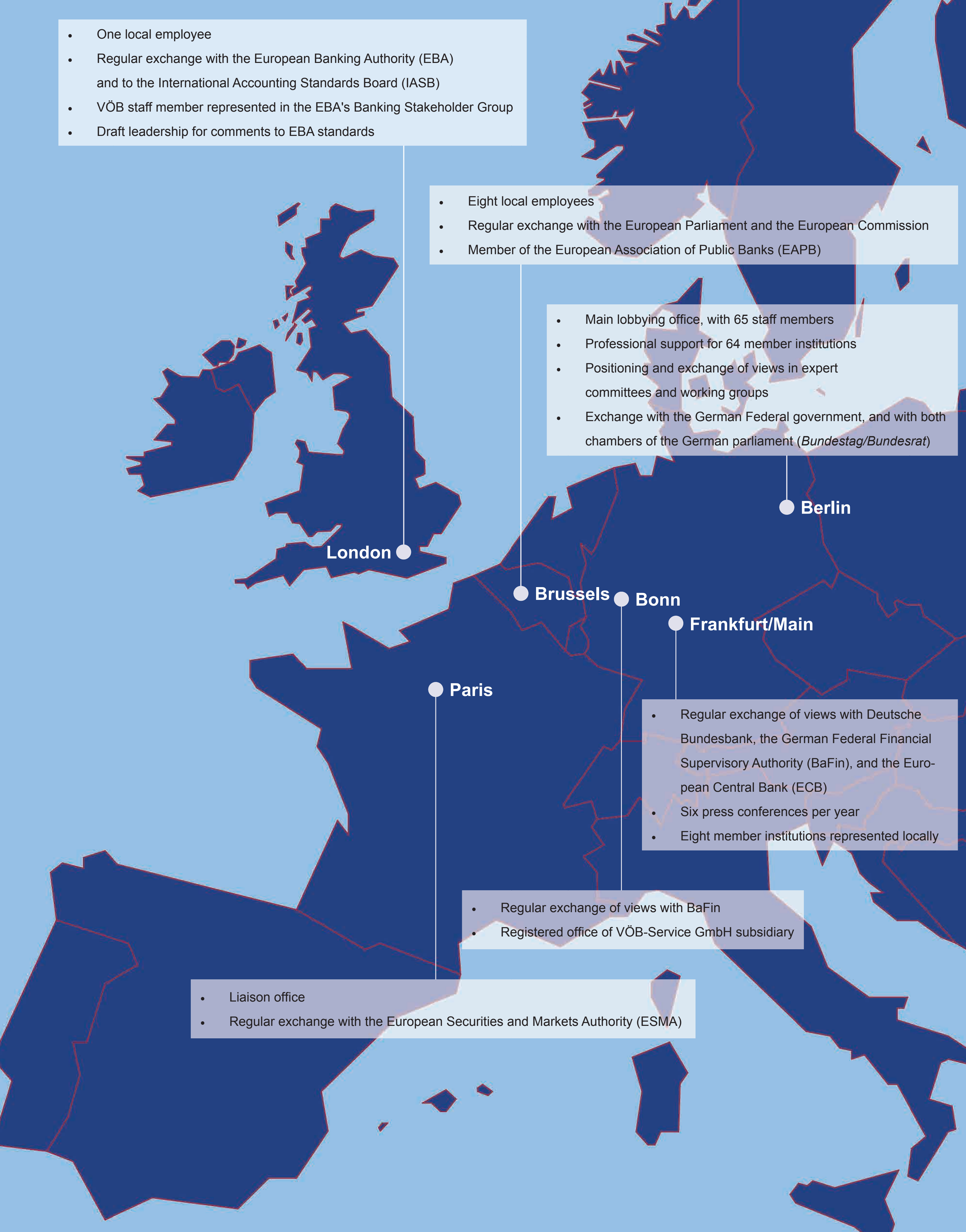


Current positions on the regulation of banks and the financial markets

- Summer 2015 -

Bundesverband
Öffentlicher Banken
Deutschlands

VÖB in Europe



Current VÖB positions on the regulation of banks and the financial markets

Dear readers,

As the leading association of public-sector banks in Germany, we focus on factual information in our dialogue with politicians, regulators, administrators and the media. In this manner, it is our intention to successfully represent the joint interests of our 64 member institutions, on a national and international level. We want to participate in ongoing discussions, and thus contribute to the strong performance of Germany's financial markets. At the same time, our goal is to facilitate decision-making processes of politicians and regulators by providing explanations to current financial market issues, helping to find appropriate decisions.

With this publication – "Current positions on the regulation of banks and the financial markets" – we regularly offer information on progress made with key legislation initiatives and regulatory topics, expressing our clear-cut opinion. In the current edition, we discuss the ongoing consultation process for Capital Markets Union. We take a detailed look at the implementation of the Deposit Guarantee Scheme Directive in Germany, and consider the latest trends concerning the EU Regulation for the Separation of Banking Operations. We also cover the review of authority levels granted to European regulators. Regulations governing banks' remuneration systems must also be adjusted to European requirements: we discuss the current regime, and our related positions.

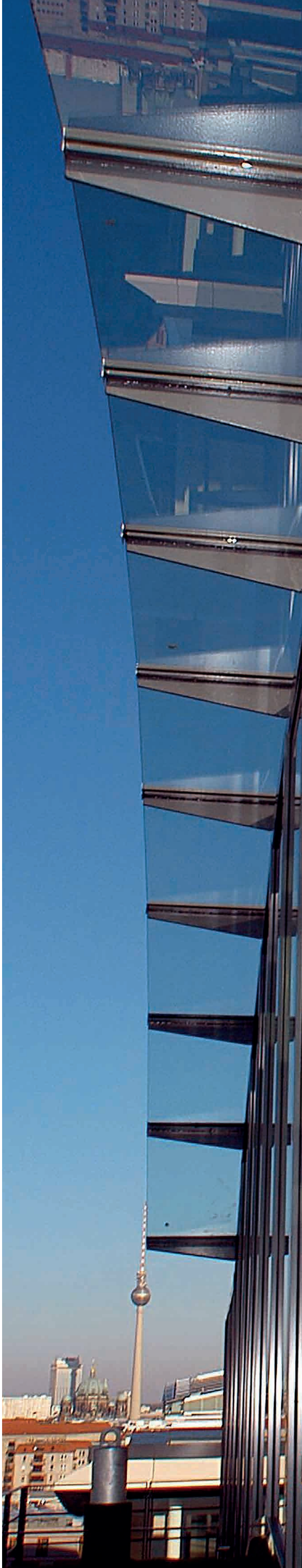
As VÖB, we represent the interests of 64 member institutions whose capital is held, fully or in part, by the public sector – including the Landesbanken, as well as promotional and development banks owned by the Federal Republic of Germany or the German Federal States. Extraordinary membership is open to all institutions that share the interests and objectives of public-sector banks. VÖB's member institutions have aggregate total assets of € 2,686 billion; they account for a 35 per cent share of the German banking market of (2013 financial year). Employing some 76,000 people, public banks honour their responsibility towards SMEs, other enterprises, the public sector, and retail customers; they are deeply rooted in their respective home regions, all over Germany. With a 46 per cent market share, VÖB member banks are market leaders in local authority financing; in addition, they provide some 23 per cent of all corporate lending in Germany.

Yours sincerely,

Liane Buchholz

Prof Dr Liane Buchholz
Managing Director

Our topics



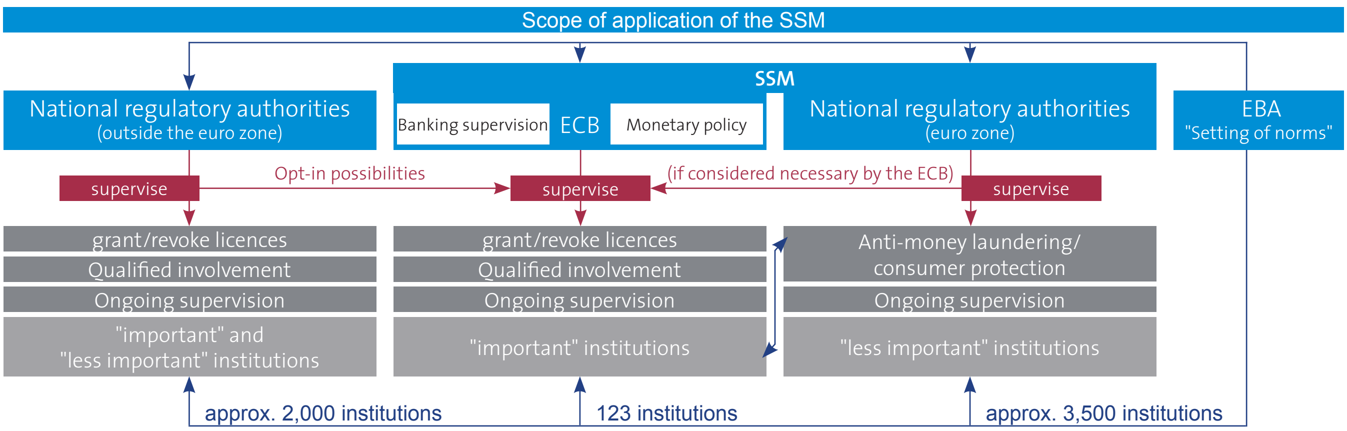
1. Supervision by the ECB (SSM)

Clearly distinguish supervisory from regulatory authorities – consider the special features of promotional and development banks – limit costs – safeguard legal certainty

Within the framework of the European Single Supervisory Mechanism (SSM), the European Central Bank (ECB) assumed direct supervision of 123 systemically important euro zone banking groups on 4 November 2014 – including 21 German institutions, of which 13 are VÖB members.

ECB will redelegate current supervisory duties to national supervisory authorities for "less important" institutions. The key objectives of the SSM are to harmonise and simplify banking supervision. A separate SSM Framework Regulation sets out the specifics of cooperation between the ECB and national competent authorities. Costs incurred as a result of the ECB's supervision will be allocated to all supervised institutions, pursuant to an SSM Fee Regulation. In order to ensure a uniform application of EU supervisory law, the ECB's practical approach to supervision has been defined in a "Supervision Manual". The ECB has assumed the function of a supervisor, whilst the European Banking Authority (EBA) will be defining the rules.

In order to ensure democratic control and accountability, the ECB has entered into "intra-institutional agreements" with the EU Parliament and the EU Council, which include provisions to safeguard access to information as well as rights of inspection.



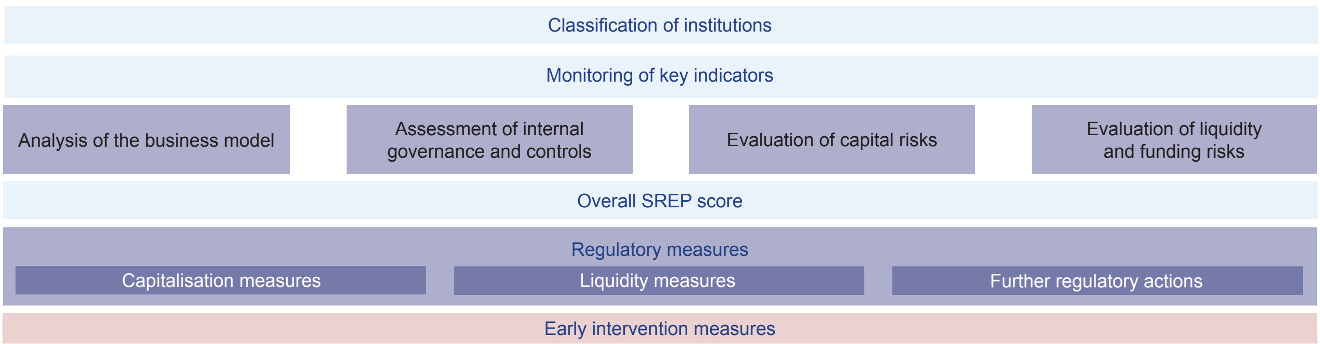
OUR POSITION

- We welcome the introduction of an effective and uniform future supervision of all 'systemically important' banks in the euro zone. At the same time, we criticise the lack of integration of key EU member states outside the euro zone (the United Kingdom and others).
- We demand a clear separation of duties amongst the ECB, national regulatory authorities and the EBA, concerning the setting of rules and supervision, in order to avoid a duplication of tasks.
- We demand that the special features enshrined in the business models of promotional and development banks be taken into account – as laid down in the German government's coalition agreement.
- We call upon the ECB to take the special characteristics of national banking structures into appropriate consideration when exercising regulatory options in banking regulations.
- We demand that the 'principle of proportionality' be taken into account – i.e. a qualitative supervision that is commensurate with the respective institution's size, business focus, and risk profile.
- We call for an adequate limitation of the costs incurred for national and European supervision.
- We demand that institutions preparing their financial statements in accordance with local GAAP should not be pushed towards implementing a parallel IFRS framework, which requires extensive resources.

2. Supervisory Review and Evaluation Process (SREP)

Maintain regulation based on principles in the second pillar

On 19 December 2014, the EBA published its final guidelines concerning the Supervisory Review and Evaluation Process (SREP). To some extent, these guidelines have already been incorporated into the ECB's Banking Supervision Guidelines, and will thus have outstanding importance for future regulatory practice. Competent authorities are supposed to incorporate these guidelines into their regulatory practice by 1 January 2016. In accordance with these guidelines, and in line with the concept of proportionality, institutions will be classified using four categories (size, structure and the institution's internal organisation; as well as the type, scope and complexity of business activities). The purpose of this classification is to reflect the risk the institution poses to the financial system. What is new about this approach is that analysis will focus on the business model. Depending on their respective classification, institutions will be subject to different levels of supervision. From a practical point of view, this will impact the monitoring frequency of certain key indicators, the assessment of various core businesses, as well as the regular supervisory dialogue. Supervisors will focus their assessments on internal governance and controls, material risk exposures, as well as on equity and the liquidity base. The competent supervisory authority will evaluate each individual component, using a scoring system, and will then aggregate these results to achieve an overall score. Scores must be suitable to provide an indication of the institution's ability to survive, and also an indication of the necessity of any regulatory action or early intervention measures.



OUR POSITION

- We welcome the clarifications, contained in the final version, concerning the principle of proportionality and the readiness to maintain a dialogue with the institutions.
- In our opinion, requiring regulatory capital – in addition to requirements under pillar 1 – to cover add-ons for risks covered under pillar 2 (which relate to economic capital), is inappropriate. Such an approach would render any sensible risk management or capital backing requirements, designed to fit the institution's specific situation, impossible.
- For the purposes of the second pillar, we consider a principles-based (qualitative) regulatory approach to be superior to a rules-based (quantitative) approach.
- Despite the clarification achieved, however, we are sceptical as to how regulatory action to analyse the business model can be distinguished from senior management's entrepreneurial responsibility.
- We are concerned that the SREP process is geared towards peer-group benchmarking, and is not flexible enough. This will not be sufficient to take an institution's specific characteristics into account, in which case the freedom of methodological choice is unnecessarily restricted.
- We see an urgent need for a review of whether existing and planned national requirements concerning SREP (MaRisk; BAIT) are compatible with the European rules and regulations, in order to prevent additional burdens from being placed upon German institutions.

3. Revision of authority levels granted to European regulators

Exercise stricter control over 'soft legislation' by financial markets supervisors – safeguard legal certainty

The three European financial markets supervisory authorities – EBA, ESMA and EIOPA – were established for the purposes of standard-setting, developing and specifying European Level I legal acts. Amongst other things, this is designed to ascertain coherent European regulations.

For this purpose, in addition to legally binding technical standards, the authorities also prepare recommendations ("technical advice") to the European Commission concerning delegated acts and implementation regulations, as well as Q&A lists, guidelines, and opinions.

Whilst technical standards have legally binding effect (and hence, must be adopted by the European Commission), it is guidelines issued by the regulatory authorities in particular which cause uncertainty amongst market participants. Some guidelines provide indications without sufficient authorisation contained in the respective legal acts. Other communications issued govern material facts which are politically relevant, and should thus be ruled upon by legislators. ESMA's comments on specific measures concerning commission-based investment advice are an example where the existing framework was exceeded. Likewise, the EBA regularly exceeds its mandate when setting standards: instead of stipulating details and applying the law, the authority increasingly takes *de facto* legislative action. A current example is the EBA's "Final Guidelines on Special Disclosure Rules for Large Institutions": according to these guidelines, the relevant disclosure obligations are not limited to systemically important banking groups, but shall also apply to other large entities which exceed an aggregate exposure of €200 billion. This concerns disclosure rules which already apply before an institution is even classified as systemically "important".

Event though the recommendations and guidelines published by regulatory authorities are not legally binding, market participants in fact feel forced to act in line with these proposals. This factual pressure is especially due to the fact that in practice, national supervisory authorities must either comply with the guidelines, or explain any deviations thereto (the principle of "comply or explain").

OUR POSITION

- We welcome the work carried out by the European financial markets supervisors to specify uniform standards at a European level (after consultation with market participants), since this serves the creation of legal certainty and clarity.
- At the same time, we draw attention to these authorities' legal status (as agencies) and their mandate: we demand refraining from misusing guidelines as a 'back door' to enforce legal policy aims.
- We demand that material political issues be finally resolved at Level I.
- We welcome a common policy approach taken by the regulatory authorities, which avoids divergence of regulation for financial instruments subject to various authorities.
- However, in view of the increasing – and increasingly extensive – activities of European authorities, we advocate implementing European administrative practice with clearly-defined requirements and standards. Given that guidelines are not legally binding, there is no possibility to take direct action against them – a situation that is unsatisfactory, both in legal and political terms.
- We demand that guidelines be subject to effective parliamentary control. We expect the EU Parliament and the Council to deal with the quasi-legislation practiced by the authorities in more detail, and also to bring guidelines under the control of the Parliament and the Council.

4. New capital requirements: on the way to 'Basel IV'?

No further increase to capital requirements – maintain internal risk-measurement procedures

The Basel Committee on Banking Supervision is currently preparing an extensive review of the standardised approaches for measuring counterparty credit, market, and operational risks. Following criticism of credit assessments prepared by rating agencies, in the wake of the financial markets crisis, the proposed revision of the Credit Risk Standard Approach primarily turns away from using external rating grades. According to these plans, future capital requirements for credit risk exposure is set to be linked to other borrower-specific features: for instance, the proposed risk drivers for loans to banks are asset quality and capitalisation, whereas the borrower's sales revenues and leverage are set to be used as the risk drivers for loans to companies. The proposed methodology would significantly increase the average capital requirement for credit risk exposures.

Likewise, capital requirements to cover operational risks are set for an increase: the Basel Committee has proposed a new standardised approach that would replace the existing Basic Indicator Approach and Standardised Approach. As a consequence, banks that conduct leasing business or sell their products on a commission basis would see their capital requirements for operational risks multiply.

The Basel Committee is also conducting a consultation for a fundamental review of the trading book. Specifically, the proposals concern the boundary between the banking book and the trading book, a revised standardised approach for measuring market risk, as well as a methodology for internal models that is based on the Expected Shortfall. The Basel Committee has carried out a quantitative impact study for its reform package in the spring of 2015. Furthermore, the Committee is considering applying the capital requirements determined in line with the standardised approaches as a floor for those institutions that use internal methods to determine their capital requirements. The purpose of this floor is to compensate for alleged imprecision of internal methods, and to prevent any potential underestimation of risk exposures. To date, using bank-internal models has led to lower capital requirements compared to the roughly-calibrated standardised approaches. This competitive incentive to come up with the best internal model would disappear if the Basel Committee's plans were to be realised.

OUR POSITION

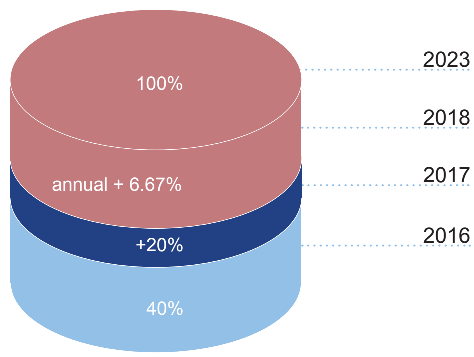
- Against the background of a dramatic increase in capital requirements following the financial markets crisis, as well as the fact that economic policy requires a boost to lending, we reject any further systematic tightening of the Credit Risk Standard Approach.
- We demand a sufficient transitory period for conversion to the new CRSA risk parameters. A grandfathering rule should be available for existing loans.
- Looking at the new standardised approach for operational risk, we disagree with a gross view of the services component, since it would discriminate against banks whose main source of income is not in the lending business.
- Even though the proposal of the Basel Committee is already viable, thanks to numerous improvements, we continue to see a need for adjustments to the revised trading book rules. Calculation duties must also be practicable for institutions with a smaller trading book. In any case, the quality of the new rules should prevail over the target date for adoption.
- We reject the application of standardised approaches as a floor for capital requirements determined using internal methods. This would strongly reduce the incentives for using internal methods, which involve considerable efforts – yet internal methods provide for more precise risk measurement than the coarse standardised approaches.

5. Bank levy and Resolution Fund

Ensure adequate specification of national and European resolution mechanisms, and of the bank levy

The EU Bank Recovery and Resolution Directive (BRRD) has been implemented into national law, with effect from 1 January 2015, through the German BRRD Implementation Act. The material provisions of the EU Regulation establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms (the "SRM Regulation") will become effective from 1 January 2016. Institutions' individual contributions will be levied annually by their respective supervisory authority. FMSA will assume this task vis-à-vis German banks in 2015; the SRB will take over from 2016 onwards. Each institution's contribution is made up of a basic levy, plus a risk-adjusted amount In the meantime, implementation regulations supplementing the BRRD and the SRM Regulation were published in the EU Official Journal in January. These regulations specify the calculation of the basic levy and its risk adjustment through risk indicators and their weighting. In some respects, the Regulation makes reference to CRR parameters which institutions were not able to report as at the 31 December 2013 reference date, since the CRR was not yet in force at that date. Against this background, the German Ministry of Finance published a draft bill for adjustments to the Restructuring Fund Regulation ("*Restrukturierungsfondsverordnung*") at the end of February 2015; the government draft was already published in April 2015. The relevant parameters for determining contributions largely relate to existing national regulatory parameters. New indicators which do not have a national equivalent – including the MREL ratio, the NSFR and the LCR – will not be incorporated for 2015 contributions. Given the weighting of these indicators (which will not be used), the remaining indicators within the respective risk array will have a correspondingly higher weighting. Moreover, the SRM Adjustment Act was submitted in March; in particular, this act will bring about adjustments to the German Act on Restructuring and Resolution, the German Banking Act, the Restructuring Fund Act, and the Financial Markets Stabilisation Fund Act, bringing them into line with the requirements of the SRM Regulation and the Delegated Regulation for the European bank levy.

Transfer of national funds to the European Single Resolution Fund:



OUR POSITION

- We advocate an appropriate specification of 'substitute' parameters for missing CRR parameters, within the framework of adjusting the Restructuring Fund Regulation.
- We also promote an appropriate specification for the contractual recognition of temporary suspension rights (recognising the suspending effect), as well as the protection of a liability cascade for bail-ins, within the scope of the SRM Adjustment Act.
- We demand that the tax treatment of contributions to the bank levy be handled uniformly throughout Europe – failure to do so would hold the threat of competitive distortions, due to the different tax deductibility of contributions.

6. Deposit-protection schemes

No tightening of Directive requirements

The lower chamber of German parliament (the *Bundestag*) passed the bill implementing the European Directive on Deposit Guarantee Schemes on 26 March 2015; the upper chamber (the *Bundesrat*) will decide in early May 2015. The Act is expected to come into force no later than on 3 July 2015.

The Directive harmonises the rules governing deposit-protection schemes in the European Union, to a large extent. In addition to the minimum deposit protection of €100,000 per client and bank – which has been in force since the end of 2010 – binding pre-financed funds are being introduced, which are based on risk-oriented contributions. Moreover, the disbursement deadline (in the event of the scheme being drawn upon) is shortened to seven days, and new, uniform information duties imposed upon institutions and deposit-protection schemes. Compared to the current situation in Germany, the scope of protected depositors will be extended.

The structure of German deposit protection remains in place: the system combining statutory compensation facilities (VÖB's EdÖ and EdB schemes) and voluntary funds for securing customer deposits (maintained by the Association of German banks and VÖB) on the one hand, and protection schemes of joint-liability groups (the Cooperative Financial Network and the Savings Banks Finance Group) on the other hand, continues to be permissible. The allocation of responsibilities and powers of a compensation scheme to VÖB's EdÖ and EdB schemes, by way of regulations issued by the German Federal Ministry of Finance, remains in place. The Directive has introduced an extensive duty for all banks to ensure protection through membership in a deposit-protection system. In future, all institutions must be members of a recognised institutional protection scheme. Alternatively, BaFin has the power to assign an institution to a statutory protection scheme.

For deposit-protection schemes, implementing the Directive involves considerable adjustment efforts. This includes the need to set aside significant funds for the purpose of covering potential customer claims: by 3 July 2024, the schemes will need to have cover funds in place amounting to 0.8 per cent of deposits covered at the banks belonging to the respective deposit-protection scheme. Institutions' payment obligations may account for up to 30 per cent of a scheme's available financial resources. Further details regarding such payment obligations will be stipulated in EBA guidelines. In September 2014, the EBA submitted a draft that considerably exceeds the requirements set out in the Directive. EBA guidelines for the calculation of contributions are set to become binding in July 2015 at the latest.

OUR POSITION

- We reject any additional tightening of EU requirements through the use of stricter national regulations. For instance, we cannot understand why banks' national and European information duties vis-à-vis customers should double. Duplicated confirmation duties concerning protected and unprotected deposits, as resolved by the German Bundestag, contravene the objective of European harmonisation.
- We continue to advocate that contributions to deposit protection schemes in Germany be determined on a risk-adjusted basis. In this context, the requirements under existing rules governing contributions to statutory deposit-protection schemes should be left unchanged, to the extent possible.
- We reject an extension of the German Federal Audit Office's audit authorities to include the budget and financial management of deposit-protection schemes. Any such audits should be limited to the investment of available funds and the management of available financial resources with regard to depositor compensation.
- There should be a cap on the maximum annual burden placed upon institutions through special contributions and allowances.
- We call upon EBA to refrain from exceeding the requirements of the Directive concerning payment obligations, and to permit a practicable specification of payment obligations in its final guidelines.

7. European Capital Markets Union

Ensure a level playing field, observing the specific features of national financial markets – use the opportunity to establish a European capital markets culture designed for the long term

It is the political goal of the present European Commission to establish the EU as a stable economic area that is ready for the future. To support this political goal, the EU Commission plans to establish a European Capital Markets Union, covering all of the EU's 28 member states – creating a single market. To gain an overview, the structure of European Capital Markets Union can be split into three areas:

firstly, an integrated market infrastructure, designed to stimulate cross-border movements of capital, representing uniform European regulation and supervision;

secondly, promotion of capital markets-based equity and debt instruments which are highly correlated to the real economy; and

thirdly, a stronger involvement of private capital in the long-term financing of companies and infrastructure projects.

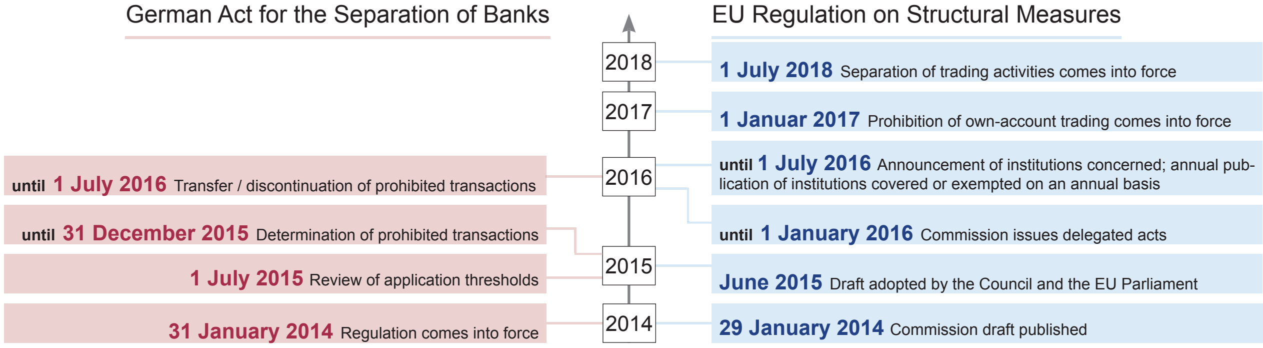
The consultation process for the green paper, which was published on 18 February, will conclude on 13 May 2015; the action plan which will follow the consultation process is scheduled for the summer of 2015. Key measures set out in the green paper include developing an EU framework for high-quality securitisations as well as European securities standards for covered bonds and private placements. The Prospectus Directive is being revised, with a focus on improved financing conditions especially for SMEs. At the same time, a solution is to be found for Europe-wide access to SME company and credit data. Further initiatives in the green paper include remedying the fragmentation of tax and insolvency laws, to promote cross-border flows of capital, and enhancing investor protection in order to stimulate the retail segment. A proposal for the regulation of long-term investment funds (ELTIFs) is designed to promote long-term investments.

OUR POSITION

- We generally welcome the plans by the EU Commission to create a comprehensive Capital Markets Union encompassing all EU member states. Besides improved access to capital and an integrated market infrastructure, additional structural reforms are required to address existing structural deficits in the European Union.
- We recommend focusing on establishing a stable, market-stimulating environment that ensures sustainable, balanced competition between the credit and capital markets, and a stabilising diversity of business models.
- In our opinion, a stable business environment and long-term legal certainty are key success factors for European Capital Markets Union – and for financial market stability in general.
- In line with EU company law, we propose a legal framework for accounting, insolvency and tax law that embodies freedom of choice, incorporating tried-and-tested national legal frameworks across Europe as well as individual needs, thus preserving the principle of subsidiarity.
- Looking at infrastructure financing, we believe building up institutionalised cooperation schemes with long-term investors – such as insurance companies or retirement benefit schemes – looks promising, and would also cover the urgent financing needs for smaller and local infrastructure projects.
- When establishing European frameworks for certain types of securities or transactions, we emphasise the importance of incorporating national standards acknowledged and appreciated by investors, thanks to a high degree of legal certainty and established business practice. Developing a European securitisation framework – with regulatory emphasis on a 'high-quality' ABS segment – in the near future would be desirable.
- We consider cooperation schemes between the public sector and private partners to be a suitable way of providing a comprehensive 'life-cycle' concept (incorporating planning, construction and operation), going beyond pure financing.

8. EU Regulation on Structural Measures

The EU proposal goes way too far, incurring additional risks and costs – unclear distinction vs. German Act for the Separation of Banks



The German Act for the Separation of Banks (Trennbankengesetz) of 2013 provides for the transfer or outsourcing of "prohibited transactions" by 1 July 2016. The scope of prohibited transactions covers own-account trading, loans to hedge funds, as well as so-called high-frequency trading.

To implement the recommendations of the Liikanen Group, at the end of January 2014 the EU Commission submitted proposals for EU-wide requirements for the separation of banking operations. At the core of this Regulation on structural measures improving the resilience of EU credit institutions is the prohibition of proprietary trading, investments in certain alternative investment funds, and the potential transfer of additional trading activities onto legally separate trading units. The rules are designed to apply to those banks determined as global systemically important, as well as to banks with total assets in excess of € 30 billion over three consecutive years whose trading activities exceed € 70 billion or 10 per cent of total assets. The Commission's proposals continue to be discussed in depth in the European Parliament as well as in the Council; trilogue negotiations are scheduled to start in the autumn of 2015.

OUR POSITION

- We demand that the tried-and-tested universal banking system be kept intact. We reject any requirements for a separation of banking activities, given the absence of any evidence for the stabilising effect of such measures. We expect that such measures would lead to additional costs – for example, for providing a one-stop banking service to the real economy –
- We advocate a harmonised entry into force of German and European rules for the separation of banking activities, in order to prevent planning uncertainty concerning fundamental structural or business policy decisions. The scope of application, the extent of intervention and related sanction, as implied by the EU proposals, go way beyond the scope recommended by the Liikanen Group, and also beyond German law.
- We are concerned by the fact that the EU proposal provides for a plethora of powers, for the EU Commission and the EBA, to subsequently flesh out material items of the regulations, and that the ECB will be given extensive discretion in connection with the separation of trading activities.
- We criticise the fact that the EU proposal (i) does not provide for a risk-oriented calculation of the application threshold; (ii) fails to provide an exemption for transactions conducted within a joint liability scheme and (iii) that large-exposure rules will be tightened significantly.
- We are worried by the definitions of prohibited transactions, as proposed by the EU. These fail to incorporate the short-term nature of such transactions; they provide for a *de facto* prohibition of alternative investment funds, and refer to financial parameters from the trading book to derive risk exposures.
- We criticise the option, contained in the EU proposal to exempt institutions subject to similar national rules from the separation requirements, would exclusively apply to the United Kingdom.

9. Regulation of shadow banks

Avoid additional burdens for banks – do not threaten banks' funding

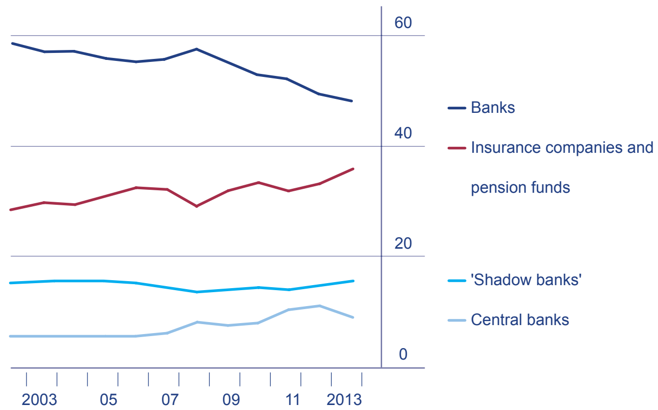
The G20 nations have been focusing on the regulation of the 'shadow banking system' since 2008; in 2010 they entrusted the Financial Stability Board (FSB) with the preparation of proposals for the regulation of the shadow banking system. This needs to be seen in the context of presumed growth in the shadow banking system and concerns about potential contagion of the banking sector. Despite a slight increase in 2013, the size of the shadow banking system in the euro zone has remained relatively constant since 2008.

Whilst the FSB has identified securities lending and repos as material business activities, these are not 'shadow banking' business per se. Since the financial markets crisis, regulated market participants have been placing short-term funds on a collateralised basis only (that is, by way of repos or securities lending). Although we generally welcome transparency concerning these types of transactions, any new regulations should be targeted precisely, to avoid excessive burdens on the banking sector – which is already strongly regulated. Existing reporting requirements and specific money-market issues must also be taken into consideration. The FSB plans to conclude its work for reporting and transparency of securities financing transactions by the end of 2015.

Based on the FSB's proposals, the European Commission already presented its own draft regulation for reporting and transparency of securities financing transactions in January 2014. According to this draft, reporting is required regardless of whether the transactions were concluded in the interbank market, between banks and non-banks, or amongst non-banks. Trilogue negotiations between the Council, the EU Parliament and the EU Commission commenced in April 2015.

As a matter of principle, regulating shadow banks through indirect regulation of banks will not work: such an approach will lead to unnecessary duplication (or even triplication) of regulations – which will ultimately be damaging to the real economy as well.

Market share in financial transactions within the euro zone (per cent)



OUR POSITION

- We advocate creating an appropriate differentiation concerning the concept of 'shadow banks'. The current, undifferentiated concept does not provide for clear distinction between regulated banking business (such as funding) and unregulated capital markets business.
- In this context, we demand that the banking sector – which is already subject to extensive regulation – will not incur any excessive burdens through new 'shadow banking' regulations. Any risk of activities moving to unregulated areas should be avoided.
- We expect existing reporting and transparency requirements to be taken into account in a differentiated manner, so as to avoid any unnecessary double regulation.
- Whilst we generally support the initiative taken by the European Commission to enhance the transparency of the shadow banking system, we reject any attempt to 'overtake' global regulation standards, since this will only lead to a duplication of efforts required for implementation and adjustment.

10. Leverage Ratio

Analyse the impact of the Leverage Ratio – prevent false incentives

Pursuant to the European Capital Requirements Regulation (CRR), banks have been obliged to report their Leverage Ratio to banking supervisory authorities since 2014. The non-risk-weighted Leverage Ratio expresses the ratio of a bank's regulatory capital to its business volume. The purpose of this volume-driven, non-risk-weighted capital ratio is to provide a 'backstop' to risk-weighted capital requirements. Against this background, the Basel Committee on Banking Supervision as well as EU authorities, have initiated a comprehensive parallel run, designed to check this ratio (and the appropriateness of a minimum level of three per cent), by 2017.

Irrespective of this, the European Central Bank already disclosed Leverage Ratio figures as at 31 December 2013, as part of its publication of Comprehensive Assessment results. Regardless of the fact that at this point, the Leverage Ratio was not a binding parameter – neither for the purposes of banking regulation nor for the purposes of internal management – all public-sector banks in Germany achieved a ratio above three per cent.

To remedy the shortcomings identified in a report by the European Banking Authority (EBA), and in view of the second wave of revisions by the Basel Committee, the method and frequency for calculating the Leverage Ratio on a EU level were once again significantly revised – with the objective of safeguarding comparability in the context of disclosure requirements, set to commence in 2015. However, the EU Commission has failed to finalise technical standards for reporting and disclosure of the ratio prior to the first reporting date in 2015.

Moreover, the EBA has been mandated to analyse the impact and effectiveness of the Leverage Ratio until October 2016. This report shall be accompanied by a legislativ proposal on, the introduction of an appropriate number of levels of the Leverage Ratio levels which is, depending on the respective business model. In this context, standards would also need to be developed for calibrating such levels, including additional adjustments concerning the capital measure as well as calculations of business volume.

OUR POSITION

- We demand a comprehensive analysis of the impact of the Leverage Ratio, particularly in view of the threat of a less preferential treatment of low-risk business, with further adjustments to be taken. Portfolios classified as low-risk in relation to risk-weighted capital requirements will be particularly affected.
- Against the background of the revision frequency and the growing complexity of the Leverage Ratio, we consider the uninterrupted continuation of the review process for the Leverage Ratio to be important, as conducted both by the Basel Committee and on an EU level.
- Our concern is that promotional loans designed to promote political goals may require multiple levels of capital backing (if they are passed through to borrowers, as is commonly the case). With respect to business originated within joint-liability groups or claims against the public sector, the Leverage Ratio would no longer function as a 'backstop' – instead, it would limit as a 'front stop'. Therefore, promotional loans and lending business within joint-liability groups, as well as sovereign and municipal finance, should not be considered when calculating the Leverage Ratio.
- We criticise the pre-emptive disclosure of the Leverage Ratio by the ECB, since it impedes the creation of trust in the published ratios. The basis of calculating the Leverage Ratio has clearly changed – most recently in 2014, which has considerably restricted comparability of ratios amongst banks as well as over time. The self-disciplinary market effects, expected to occur upon disclosure, are also distorted in 2015.

11. Financial transaction tax

Damage to the financial markets, compromising competitiveness – without any stabilising effects

Eleven EU member states plan to introduce a financial transaction tax, within the scope of Enhanced Cooperation. Negotiations have been ongoing for almost three years. According to the plans, the tax will be levied on all exchange and over-the-counter trades (in bonds, equities and derivatives), with a minimum tax rate of 0.1 per cent (0.01 per cent for derivatives). In this context, the definition of 'financial institutions' is wide, and also encompasses businesses outside the financial sector as well as trading activities with private individuals. The tax will also be due on trades in financial instruments issued in a member state that has acceded to Enhanced Cooperation (the so-called 'issuance principle'). Likewise, financial institutions outside these countries will be subject to the tax if they trade with a financial institution domiciled in a participating member state (the 'country of domicile principle'). At the beginning of May 2014, the EU member states involved declared their plan to introduce the tax at the beginning of 2016 – in a step-by-step approach where equities and certain derivatives would be taxed initially.

In a new initiative proposed in January 2015, the finance ministers of France and Austria proposed to maximise the assessment basis for the tax, and to agree upon a low tax rate. They said that special attention was needed regarding technical aspects, in order to reduce the risk of a relocation of the financial sector. The launch date is still set for 2016; to date, the states have yet to agree upon a specific model for the tax.

The following member states of the European Union want to introduce a joint financial transaction tax, within the scope of Enhanced Cooperation:

- *Germany*
- *France*
- *Austria*
- *Belgium*
- *Spain*
- *Estonia*
- *Greece*
- *Italy*
- *Portugal*
- *Slovakia*
- *Slovenia*

OUR POSITION

- We expect a financial transaction tax to have a strangling effect upon bank funding.
- We fear damage to the financial markets, a competitive weakening of financial marketplaces, and further bureaucratic burdens.
- We do not anticipate any stabilising effects for the financial markets.
- We doubt whether this tax would be compatible with European law.
- In our view, Enhanced Cooperation is the wrong way to introduce such a tax, since this approach will lead to competitive distortions. If introduced at all, such a tax should be incorporated throughout the EU, or preferably on a global scale.
- We anticipate that market participants will price in the financial transaction tax as another cost factor – meaning that ultimately, the financial transaction tax will be paid by savers and customers of banks and insurance companies.
- We expect the financial transaction tax to have unquantifiable risks for the financial markets, and for the economies of participating EU member states. For this reason, we reject the financial transaction tax, in line with the position taken by the German banking sector.

12. Regulation of remuneration systems

Preserve the principle of proportionality – permit exceptions

Banking regulators have focused on banks' remuneration systems for several years. The first wave of regulations in Germany – driven by the financial markets crisis – reached its preliminary conclusion in October 2010, when the German Regulation on Remuneration in Financial Institutions (*Institutsvergütungsverordnung* – "InstVergV") came into force. The InstVergV was amended with effect from 1 January 2014, following the adoption of further European requirements. These amendments had a major impact on the structure of banks' remuneration systems.

Based on the Capital Requirements Directive (CRD IV), the European Banking Authority (EBA) has now presented draft guidelines for sound remuneration policies: this draft provides for further tightened remuneration requirements. Through a changed approach in applying the principle of proportionality, the EBA believes that as a rule, all institutions must comply with European remuneration rules, thus removing any justification for a general exemption of certain institutions or employees from the application of certain rules. According to the EBA, institutions should only be able to have recourse to the principle of proportionality when specific rules are implemented.

This principle was implemented in the German InstVergV through a distinction of general vs. special requirements. Whilst the general requirements apply to all institutions, special – and stricter – requirements only apply to "significant" institutions, and only to senior management and so-called risk takers within these institutions. As a consequence of this changed EBA interpretation, the differentiation between "non-significant" and "significant" institutions – and the associated general exemptions of "non-significant" institutions from the scope of application of strict remuneration rules – might no longer be in line with the EBA's view concerning the principle of proportionality.

The consultation process for EBA's guidelines will run until the beginning of June 2015. It is fair to expect another revision of the InstVergV, in order to incorporate the EBA requirements.

Classification of institutions, in accordance with the German Regulation on Remuneration in Financial Institutions ("InstVergV")

Institutions with total assets of less than EUR 15 billion (generally "non-significant"):	**Institutions with total assets in excess of EUR 15 billion (generally "significant"):**
General requirements for remuneration systems apply	*Special requirements for remuneration systems apply – in particular:* - *Identifying risk takers* - *Requirements for the variable remuneration of senior management and risk takers* - *Appointment of a Remuneration Officer*

OUR POSITION

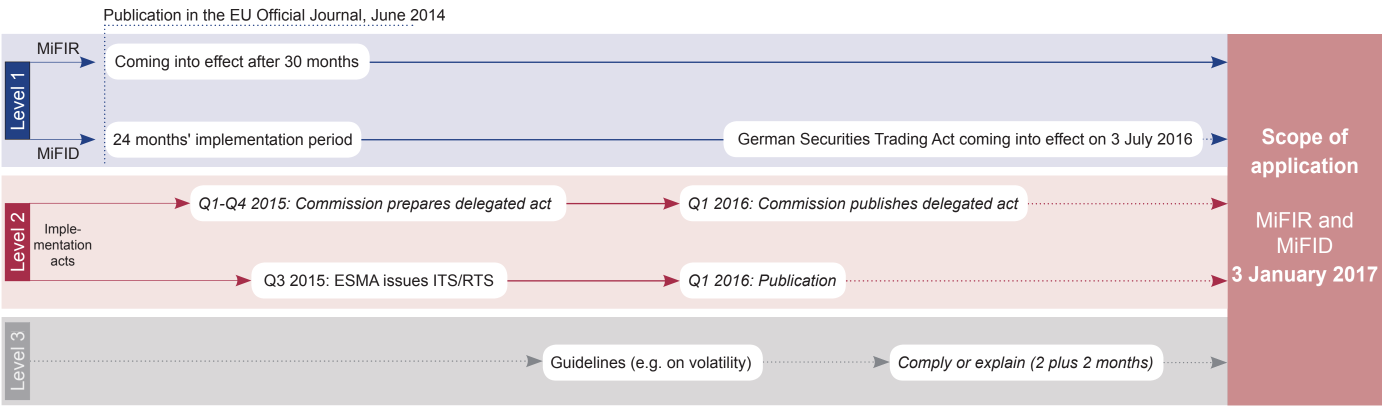
- We advocate maintaining the principle of proportionality, in line with the existing approach.
- By differentiating between "non-significant" and "significant" institutions, the German Regulation on Remuneration in Financial Institutions has adequately implemented the principle of proportionality, as required by European legislation.
- We do not believe it would be appropriate to require all institutions to identify risk takers, and to comply with special requirements for the payment of variable remuneration. The solution found in the InstVergV – which only requires "significant" institutions to identify risk takers – is in line with the principle of proportionality.
- We call for exemptions to the application of special remuneration rules to remain permissible. Therefore, we advocate a European regulation that continues to permit the application of particularly strict requirements for remuneration systems to be adhered to by "significant" institutions only.

13. Implementation of MiFID II

Implement MiFID II in a reasonable and targeted manner

Following adoption of an amended Markets in Financial Instruments Directive (MiFID), the European Securities Markets Authority (ESMA) published a catalogue of measures with 2,069 pages, designed to enhance investor protection and providing a new framework for trading venues.
The objective of these very detailed regulations is to achieve a high degree of harmonisation across Europe. The German market is characterised by numerous small to medium-sized banks, whose business is predominantly domestic. It is therefore vital to consider the principle of proportionality.
Regulation has a very high impact on the provision of investment advice in Germany. Besides fee-based advice, the traditional, inducement-based form of providing advice should continue to exist, in the interests of consumers.

The requirement of regular reporting between potentially all issuers and distributors in the global market for the entire time an instrument is ourstanding, even when only executing an order on secondary markets, would require to establish of a new infrastructure with countless bilateral channels of communication between issuers and distributors that does not exist at present. The current proposals regarding systematic internalisers (SI) in bonds hold the threat for many German banks being seen as 'quasi market-makers', due to the extremely low thresholds – this does not correspond with the business models of these banks. ESMA has commenced a consultation process for initial Level III measures before the work on Level II measures has been completed. The current draft guidelines should provide more specific details regarding the criteria applied to the experience and expertise of investment advisors.



Updated: April 2015; assumptions are shown in italics, or using dotted lines

OUR POSITION

- We support the current practice of offering investment advice to broad levels of the population and would like to see this to continue.
- We advocate a strict observation of the principle of proportionality. The proposed regulations should be examined as to whether they preserve or counteract the merits of existing, tried-and-tested business models and market structures.
- We would like to point out that duties similar to those of market-makers require trading activities competing with exchanges, as well as significant trading volumes. This needs to be reflected in appropriate threshold values.
- We do not anticipate any benefits for investors from regulation in greater detail – but we do anticipate burdens for consumers and institutions alike.

14. EU Payment Services Directive (PSD 2)

Protect data security and banking secrecy, to safeguard the reputation of online banking services

The purpose of the EU Commission's draft revision of the Payment Services Directive is to promote competition in payment services, by opening the customer-bank interface for payment initiation services and account information services provided by so-called third-party service providers. The associated provisions under civil law will create requirements that are politically questionable; which would threaten the integrity of systems used in online banking payments infrastructure, and would bring about severe competitive disadvantages for account-keeping banks. For instance, the plan is to allow third-party service providers to initiate transfers on behalf of the payer (particularly via online banking), and to gain full access to the payer's account information. Payers would be allowed to pass on their credentials (including PIN and TANs) to such third-party providers.

The EU Parliament adopted its position, on the basis of the ECON recommendation, in April 2014. The Council adopted the general discussion regarding the dossier, and trilogue negotiations between the Council, the Parliament and the European Commission commenced in February 2015. Besides payment initiation services, the specific details of account information services – as well as third-party card issuer services – are likely to still be the subject of ongoing trilogue discussions.

During the course of trilogue negotiations, we have informed MEPs and representatives of the Latvia Council Presidency of our positions, together with colleagues from the German Banking Industry Committee. In particular, we referred to the extensive impact of granting account access to third parties, and to the essential importance of the right to restitution within the scope of direct debit procedures used by consumers in Germany. Moreover, we have sent letters to the German Federal Minister of Finance, the Minister for Economic Affairs and Energy, and the Minister of Justice and Consumer Protection, particularly highlighting the serious economic and legal risks that would materialise if legislators were to permit the passing-on of credentials to third parties.

OUR POSITION

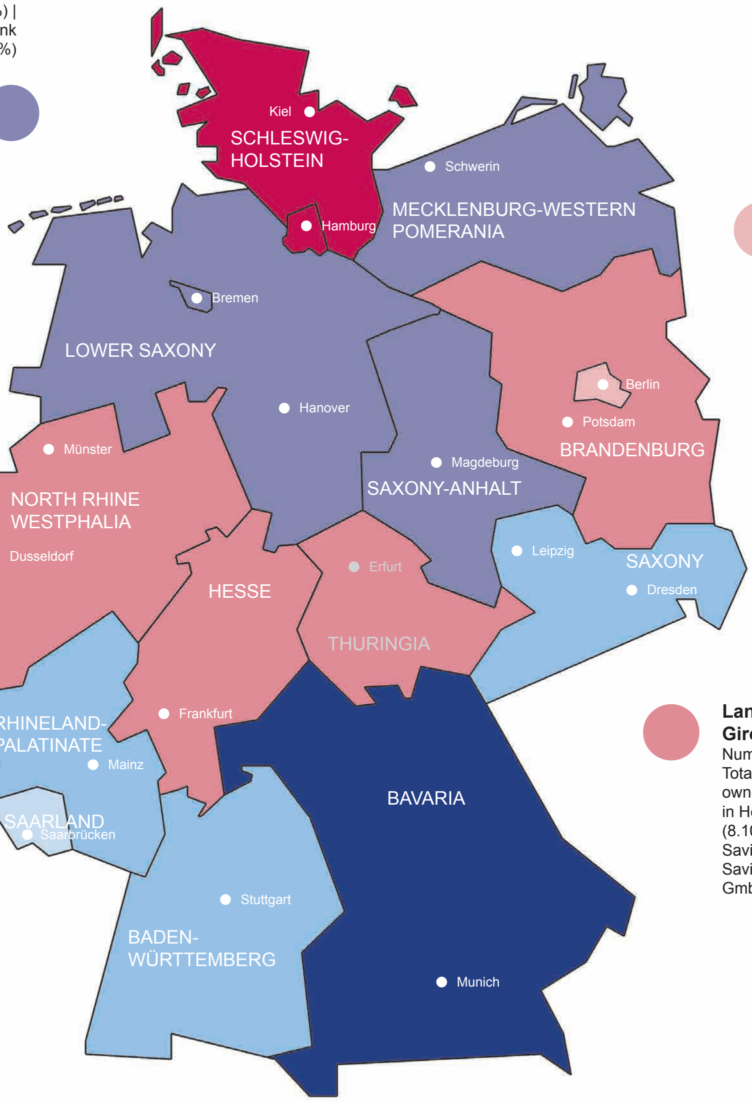
- We demand that any access by third-party service providers should only take place under the involvement of payer and bank. This is because the customer-bank interface in online banking belongs to both contractual parties – this is the only way to safeguard data protection, banking secrecy and IT security. Moreover, the use of the account-keeping bank's infrastructure by third-party service providers should not necessarily be free of charge.
- We call upon the parties to the trilogue negotiations to take note and consider our positions, especially concerning the security technology aspects of PSD II.
- To prevent reputational damage to banks, we are in favour of organised maintenance and development of the technical procedures, including control by the banking sector of orderly implementation and compliance with rules and regulations. Control exercised by regulatory authorities will not be sufficient, since this would only set in once a bank has already suffered reputational damage for its online banking business.

Landesbanken in Germany – employees, total assets and ownership structure

NORD/LB Norddeutsche Landesbank Girozentrale (including Bremer Landesbank)
Number of employees: 7,590
Total assets: € 200.8 billion
ownership structure: State of Lower Saxony (59.13%) | State of Saxony-Anhalt (5.57%) | Lower Saxony Savings Banks Association (26.36%) | Saxony-Anhalt Savings Banks Investment Association (5.28%) | Mecklenburg-Western Pomerania Savings Bank Investment Association (3.66%)

HSH Nordbank AG
Number of employees: 3,389
Total assets: € 109.02 billion
ownership structure: HSH Finanzfonds AöR (65%) | City of Hamburg (10.8%) | State of Schleswig-Holstein (9.58%) | nine trusts advised by J. C. Flowers & Co. LLC (9.31%) | Schleswig-Holstein Savings Banks Association (5.31%)

Bremer Landesbank Kredit-anstalt Oldenburg - Girozentrale (wholly-owned subsidiary of NORD/LB)
Number of employees: 1,084
Total assets: € 32 billion
ownership structure: NORD/LB (54.83%) | City of Bremen (41.20%) | Lower Saxony Savings Banks Association (3.97%)



Landesbank Berlin AG
Average number of employees 4,510 (annual average)
Total assets: € 70.3 billion
ownership structure: Landesbank Berlin Holding AG (100%)

Landesbank Hessen-Thüringen Girozentrale
Number of employees: 6,282
Total assets: € 178 billion
ownership structure: Association of Savings Banks in Hessen and Thuringia (68.85%) | State of Hesse (8.10%) | State of Thuringia (4.05%) | Rhineland Savings Banks Association (4.75%) | Westfalen-Lippe Savings Banks Association (4.75%) | Fides Beta GmbH (4.75%) | Fides Alpha GmbH (4.75%)

SaarLB Landesbank Saar
Number of employees: 520
Total assets: € 16.72 billion (HGB)
ownership structure: State of Saarland (75.9%) | Saarland Savings Banks Association (25.1%)

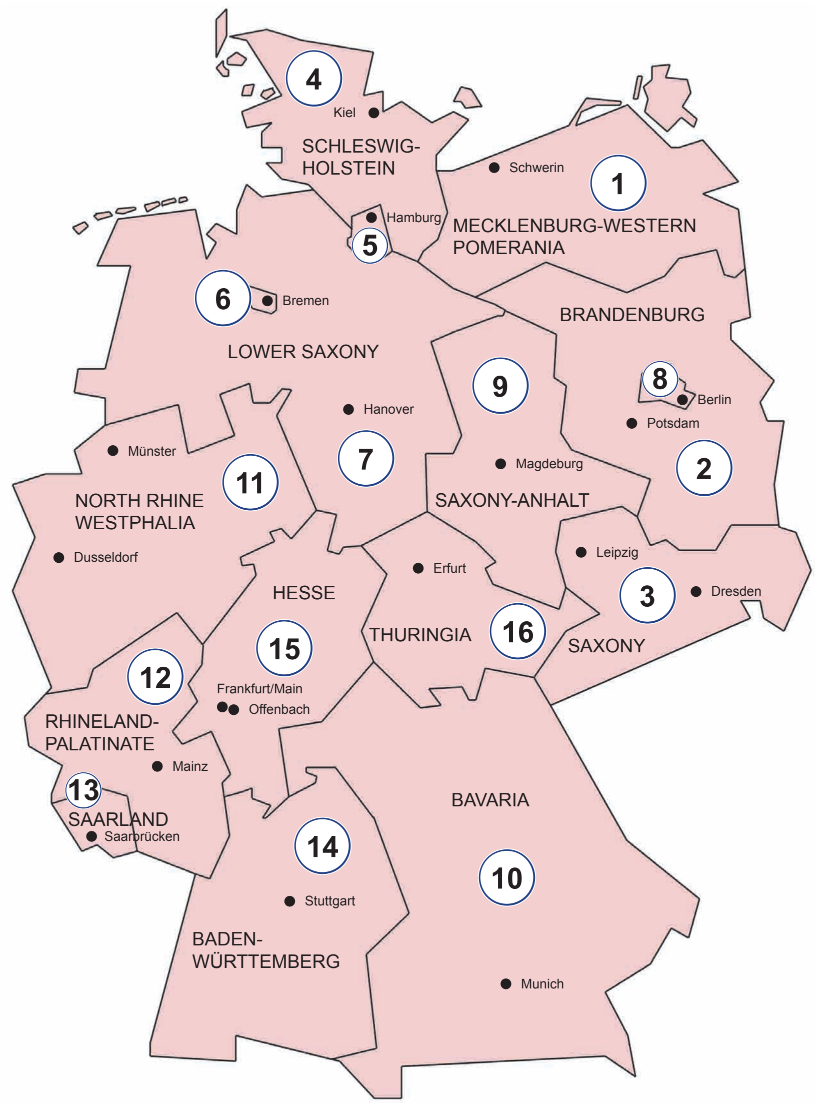
Landesbank Baden-Württemberg
Number of employees: 11,308
Total assets: € 273.5 billion
ownership structure: Baden-Württemberg Savings Banks Association (40.534118%) | State of Baden-Württemberg (24.988379%) City of Stuttgart (18.931764%) | Landesbeteiligungen Baden-Württemberg GmbH (13.539374%) | L-Bank – Baden-Württemberg State Bank (2.006365%)

BayernLB
Number of employees: 8,568
Total assets: € 255.6 billion
ownership structure: State of Bavaria (75%) | Bavaria Savings Banks Association (25%, held indirectly via BayernLB Holding AG)

Source
Landesbanken annual reports 2013 (consolidated financial statements), unless stated differently / Association of German Public Banks (Bundesverband Öffentlicher Banken Deutschlands – VÖB)

Updated: May 2014

Promotional and development banks at Federal and State level – employees, total assets and ownership structure



1 **Landesförderinstitut Mecklenburg-Vorpommern – Division of NORD/LB (Schwerin)**
Number of employees: 258
Total assets: € 2.374 billion
Legal form: legally dependent, but commercially and operationally independent division of NORD/LB

2 **Investitionsbank des Landes Brandenburg (Potsdam)**
Number of employees: 516
Total assets: € 13.4 billion
ownership structure: State of Brandenburg (50%) | NRW.BANK (50%)

3 **Sächsische Aufbaubank – Förderbank (Dresden)**
Number of employees: 1,002
Total assets: € 8.22 billion
ownership structure: State of Saxony (100%)

4 **Investitionsbank Schleswig-Holstein (IB.SH) (Kiel)**
Number of employees: 535
Total assets: € 18 billion
ownership structure: State of Schleswig-Holstein (100%)

5 **Hamburgische Investitions- und Förderbank (Hamburg)**
Number of employees: 230
Total assets: € 4.839 billion
ownership structure: City of Hamburg (100%)

6 **Bremer Aufbau-Bank GmbH (Bremen)**
Number of employees: 54
Total assets: € 1.272 billion
ownership structure: WFB Wirtschaftsförderung Bremen GmbH (100%)

7 **Investitions- und Förderbank Niedersachsen – NBank (Hannover)**
Number of employees: 451
Total assets: € 5.86 billion
ownership structure: State of Lower Saxony (100%)

8 **Investitionsbank Berlin (Berlin)**
Number of employees: 658
Total assets: € 20.47 billion
ownership structure: State of Berlin (100%)

9 **Investitionsbank Sachsen-Anhalt – institution of NORD/LB (Magdeburg)**
Number of employees: 363
Total assets: € 2.05 billion
Legal form: public sector institution with limited legal capacity

10 **LfA Förderbank Bayern (Munich)**
Number of employees: 322
Total assets: € 22.145 billion
ownership structure: State of Bavaria (100%)

Bayerische Landesbodenkreditanstalt (Munich)
Number of employees: 209
Total assets: € 24.63 billion
Legal form: legally dependent, but commercially and organisationally independent institution established within Bayerische Landesbank

11 **NRW.BANK (Dusseldorf/Münster)**
Number of employees: 1,256
Total assets: € 145.3 billion
ownership structure: State of North Rhine-Westphalia (100%)

12 **Investitions- und Strukturbank Rheinland-Pfalz (ISB) (Mainz)**
Number of employees: 315
Total assets: € 10.01 billion
ownership structure: State of Rhineland-Palatinate (100%)

13 **SIKB Saarländische Investitionskreditbank AG (Saarbrücken)**
Number of employees: 66
Total assets: € 1.461 billion
ownership structure: State of Saarland (51.02%) | SaarLB Landesbank Saar (19.34%) | Deutsche Bank Privat- und Geschäftskunden AG (11.82%) | Volksbanken-Beteiligungsgesellschaft mbH (10.08%) Commerzbank AG (4.33%) | UniCredit Bank AG (3.27%) | Others (0.14%)

14 **L-Bank, Baden-Württemberg State Bank (Karlsruhe, Stuttgart)**
Number of employees: 1,252
Total assets: € 70.7 billion
ownership structure: State of Baden-Württemberg (100%)

15 **Wirtschafts- und Infrastrukturbank Hessen – legally-dependent institution within Landesbank Hessen-Thüringen Girozentrale (Offenbach)**
Number of employees: 415
Total assets: € 14.5 billion
Legal form: legally dependent, but commercially and organisationally independent institution established within Landesbank Hessen Thüringen Girozentrale

16 **Thüringer Aufbaubank (Erfurt)**
Number of employees: 368
Total assets: € 3.876 billion
ownership structure: State of Thuringia (100%)

! **promotional and development banks at Federal level**

KfW Banking Group, Frankfurt/Main
Number of employees: 5,522
Total assets: € 476.4 billion
ownership structure: Federal Republic of Germany (80%) | German Federal States (20%)

Landwirtschaftliche Rentenbank (Frankfurt/Main)
Number of employees: 257
Total assets: € 78.3 billion
ownership structure: direct federal institution under public law

Source Annual reports 2013 of promotional and development banks (consolidated financial statements), unless stated differently / Association of German Public Banks (Bundesverband Öffentlicher Banken Deutschlands – VÖB)

Updated: August 2014

Glossary

BRRD	EU Bank Recovery and Resolution Directive
COREP	Common Reporting Framework
CRD	EU Capital Requirements Directive
CRR	EU Capital Requirement Regulation
EAEG	German Deposit Guarantee and Investor Compensation Act
EBA	European Banking Authority
EDB	Entschädigungseinrichtung deutscher Banken GmbH
EDÖ	Entschädigungseinrichtung des Bundesverbandes Öffentlicher Banken Deutschlands GmbH
EIOPA	European Insurance and Occupational Pensions Authority
ESMA	European Securities and Markets Authority
FINREP	Financial Reporting Framework
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
LCR	Liquidity Coverage Ratio
MiFID	EU Markets in Financial Instruments Directive
MiFIR	EU Markets in Financial Instruments Regulation
MREL	Minimum Requirement for own Funds and Eligible Liabilities (within the scope of BRRD)
NSFR	Net Stable Funding Ratio
SRB	Single Resolution Board
SREP	Supervisory Review and Evaluation Process
SRF	Single Resolution Fund
SRM	Single Resolution Mechanism
SSM	Single Supervisory Mechanism

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