Amendments to the Banking Act caused by the Fourth Financial Market Promotion Act

The Fourth Financial Market Promotion Act, which entered into force on 1 July 2002, pursues multiple objectives. Its initial aim is to enhance investor protection by increasing market integrity and market transparency. The reform of legislation governing stock exchanges and securities trading is intended to give stock exchanges and their market participants greater room for manoeuvre and thus improve their competitive position in Europe and internationally. Other measures are designed to combat money laundering and the financing of terrorism more effectively. Lastly, the Fourth Financial Market Promotion Act has changed numerous rules governing prudential supervisory legislation. The primary reason for amending the Banking Act was to implement the 1997 Basel Core Principles for Effective Banking Supervision and the Electronic Money Directive. Other regulatory measures were taken at the same time, such as harmonising the respective rules for monitoring holders of qualified participating interests in the Banking Act and the Insurance Supervision Act as well as modernising the legislation governing loans of DM 3 million (€1.5 million) or more. The ongoing refinement of prudential supervisory legislation is intended to strengthen the operational framework of the financial sector and thus the international competitiveness of Germany as a financial centre.

Implementation of prudential supervisory projects

The Fourth Financial Market Promotion Act, like its predecessors, amended the Banking Act with a view to implementing various prudential supervisory projects. The primary aim of this new act is to implement the Core Principles for Effective Banking Supervision published in 1997 by the Basel Committee on Banking Supervision. The International Monetary Fund (IMF) and the World Bank monitor each member country's compliance with these principles in their Financial Sector Assessment Programs (see box on page 17). In addition, Council Directive 2000/46/EC on the taking up, pursuit and prudential supervision of the business of electronic money institutions (E-Money Directive) needed to be translated into German law. Furthermore, the respective provisions in the Banking Act and the Insurance Supervision Act *(Versicherungsaufsichtsgesetz)* governing the monitoring of shareholders were harmonised following a proposal from the Forum for Financial Market Supervision. At the initiative of the Deutsche Bundesbank, the regulations governing the reporting of loans of €1.5 million or more were modernised. Lastly, provisions for combating money laundering and the financing of terrorism were included in the Banking Act in the wake of the terrorist attacks in New York City and Washington D.C. on 11 September 2001.

Implementation of the Core Principles

Principles for effective banking supervision

The standards set by the Core Principles for Effective Banking Supervision had already been met for the most part by the provisions of earlier versions of the Banking Act or European prudential supervisory legislation. A case in point is the requirement contained in the first principle, which calls for operational independence for agencies involved in banking supervision. However, the task of completing implementation, covering the margins of banking supervision as well, remained to be tackled, especially as a Financial Sector Assessment Program (FSAP) is scheduled to be conducted in Germany next year. The amendments to the Banking Act (BA) necessitated by the Core Principles relate to the provisions concerning loans to managers (section 15 BA),[1] particular organisational duties of institutions (section 25a (1) BA), grounds for refusing to grant a licence (section 33 BA) and the supervisory authorities' right to conduct audits (section 44 BA).

Loans to managers

There are special risks which arise from lending to persons who or enterprises which are particularly closely linked to the lending institution or financial services institution (eg managers, members of the supervisory board and their closest relatives as well as enterprises linked to these persons and the institution). The main danger is that decisions on loans to managers might be motivated by personal influence or subjective considerations, thereby causing conflicts of interest which would be damaging to the institution. Section 15 of the old version of the Banking Act countered this risk in its provisions on loans to managers and the like by requiring a unanimous decision by the managers and the consent of the supervisory board before such

1 Unless otherwise indicated, all references to the Banking Act are to the new version as amended by the Fourth Financial Market Promotion Act.

Core Principles for Effective Banking Supervision

Weaknesses in the banking system of one country can threaten financial stability both within that country and internationally. For that reason, the communiqué issued at the close of the Lyon G7 summit in June 1996 called for prudential supervisory measures to strengthen banking systems. In September 1997 the Basel Committee on Banking Supervision published its "Core Principles for Effective Banking Supervision", which were endorsed by the G10 central bank governors. The Basel Committee developed these principles in close cooperation with the supervisory authorities of non-G10 countries (Chile, China, the Czech Republic, Hong Kong, Mexico, Russia, Thailand, etc).

The Core Principles comprise 25 principles which have to be in place for a supervisory system to be effective. The principles relate to the legal and institutional preconditions for effective banking supervision (Principle 1), the licensing and structure of banks (Principles 2 to 5), the prudential regulations and requirements (Principles 6 to 15), methods of ongoing banking supervision (Principles 16 to 20), information requirements (Principle 21), the formal powers of supervisors (Principle 22) and cross-border banking (Principles 23 to 25). The Core Principles were supplemented by a methodology of assessing compliance with the Principles (Core Principles Methodology) published in October 1999.

The Core Principles are minimum requirements and, in many cases, may need to be supplemented by further measures designed to address certain circumstances and risks in the financial systems of individual countries. They are intended to serve as a basic reference for supervisory and other public authorities in all countries and internationally in order to find and eradicate any deficiencies quickly so as to improve financial stability at home and internationally. It is worth noting that, even if the Core Principles have been widely accepted, they have also been worded very vaguely in some places – not least because of the wide group of interested parties – and have left out some problems which even then were apparent, such as the issuance of electronic money or the formation of cross-sector financial conglomerates.

Upon a proposal by the Basel Committee, the International Monetary Fund (IMF), in a joint effort with the World Bank, introduced a Financial Sector Assessment Program (FSAP) in May 1999. This programme monitors compliance with not only the Core Principles but also the minimum requirements established by the International Organisation of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS) for the supervision of securities trading and insurance business as well as other international standards such as those on combating money laundering. Since another purpose of the FSAP is to identify weaknesses in the two-way interaction between the macroeconomic environment, on the one hand, and the structure and development of the financial sector, on the other, macroprudential indicators of economic and financial stability are analysed and subjected to a stress test or a scenario analysis. With the consent of the countries being monitored, a Report on Observance of Standards and Codes (ROSC) for those countries is published. By the end of 2001 the IMF, in cooperation with the World Bank, had already completed an FSAP for 32 countries (five advanced economies, ten transition countries and 17 developing countries), and another 22 programmes are scheduled to be completed this year.

Deutsche Bundesbank

loans could be granted. This approach has stood the test of time in supervisory practice. According to the amendment to section 15, which was designed to implement the Core Principles, loans to managers should be granted solely at prevailing market rates.

Non-market rates

The provisions on loans to managers accordingly needed further refinement. Now loans to managers, with the exception of staff programmes, may be granted only at prevailing market rates (section 15 (1) sentence 1 BA); if such loans are not granted at prevailing market rates, they must, by order of the Federal Financial Supervisory Authority (FFSA), be backed by liable capital. Moreover, the powers of the FFSA to intervene were extended to enable it to stipulate upper limits for loans to managers in individual cases, even retroactively. Loans to managers which exceed the upper limits must, by further order of the FFSA, be reduced to the upper limit; in the meantime they must be backed by liable capital (section 15 (2) BA). To ensure full compliance with the relevant Core Principle 10 without reintroducing the reporting requirement for loans to managers, which was abolished only in 1998, it will be necessary for the external auditors to outline the aggregate trend in loans to managers in their report on the annual financial statements.

Special organisational duties for banks and financial services institutions

The special organisational requirements for institutions introduced with the Sixth Act Amending the Banking Act (section 25a (1) BA) have been extended in two respects in the light of the Core Principles. Previously an institution only had to ensure its own enterprise's compliance with the rules set forth in section 25a (1) BA. Now, a parent or superordinated institution must ensure that these rules are being complied with by the group as a whole so that it can manage risk within that group. A clarifying addition to section 25a (1) number 1 BA requires institutions to have appropriate rules in place regarding the management, monitoring and inspection of compliance with legal regulations. Moreover, the special organisational requirements have been supplemented by the requirement to establish adequate internal safeguards against money laundering and fraudulent activities (section 25a (1) number 4 BA). The OECD's Financial Action Task Force on Money Laundering has drawn up a list of requirements which have since been fleshed out by the Basel Committee's supervisory principles entitled "Customer due diligence for banks" (BS/01/82). In reference thereto, the Core Principles call for banks to install security measures including strict "know your customer" rules, in order to prevent misuse with criminal intent, and for banking supervisors to monitor the adequacy of these measures. Institutions should have state-of-the-art technology at their disposal enabling them to monitor payment flows and financial transactions which have a criminal origination or are designed to launder money in the retail payment sector, too; in this way institutions can monitor suspicious business relationships using additional sources of information (often described as monitoring or screening). This applies even if dirty money has already been smuggled into the economy as book money and its trail is to be obscured through national or cross-border payment transactions. The extended organisational requirements are

rounded off by a provision giving the FFSA the power to issue orders to institutions in individual cases to take the measures required by section 25a (1) BA.

Licensing procedure for banks set up by foreign banks

According to Core Principle 3 the owner or parent institution of a bank that is to be newly established, if it is a supervised foreign bank, must obtain prior consent from the home country supervisor before the new bank can be licensed. This requirement has been implemented by section 33 (1) number 8 BA and, via section 53 (2a) BA, also governs the establishment of branches of enterprises domiciled in a country outside the European Economic Area (EEA). Within the framework of shareholder monitoring pursuant to section 2b BA, the aforementioned consent of the home country supervisor is not mentioned so as to ensure consistency with insurance supervision regulations (see page 25). A similar regulation for German institutions seeking to found or acquire a subsidiary outside the EEA or to establish a branch there, which is required by the Core Principles, has been implemented by extending the FFSA's powers to intervene in section 6 (3) BA. As long as the principle of due proportion is maintained, the FFSA is entitled to take measures necessary to prevent danger to an institution caused by the collapse of a subsidiary or branch or by the acquisition of a participating interest.

Employess required to give information

Last on the list of rules amended in the light of the Core Principles is section 44 (1) BA, which now gives the FFSA and the Bundesbank the right to obtain information from an institution's employees as well as its managers. Consistency with section 44c (1) BA has thereby been established. To achieve full compliance with the Core Principles, it will be crucial to ensure that the "Minimum requirements for the credit business of credit institutions", the announcement of which is currently still under discussion with the banking industry, are implemented quickly.

Implementation of the E-Money Directive

A second focal point of the legislative amendments was the need to implement the E-Money Directive. The Sixth Act amending the Banking Act, in line with a recommendation made by the European Monetary Institute, had already subjected prepaid card business and network money business to prudential supervision in Germany (section 1(1) sentence 2 numbers 11 and 12 of the old Banking Act). Whereas prepaid card business means the issuance of prepaid cards, network money business means the issuance of prepaid electronic payment units which may be used as payment media in lieu of cash or book money. In the past, an exception had been made only for those enterprises operating prepaid card business where the limited use and dissemination of such prepaid cards precluded any danger to payment systems.

E-money institutions as a new category of credit institution

The E-Money Directive has now led to the creation of a new category of credit institution under European law which is subject to less stringent supervisory rules as long as that enterprise confines itself to issuing electronic payment units (for various definitions of the

term "credit institution" see the table on page 21). In implementing the E-Money Directive, what were previously known as prepaid card business and network money business have been combined and are now called electronic money business (e-money business – section 1 (1) sentence 2 number 11 BA) since payment practice has shown that it is no longer possible to draw a clear line between the two formerly separate types of business. The new definition of e-money business is based on the definition contained in the E-Money Directive; however, by including the term "administration", it takes due account of the ancillary business in which e-money institutions are permitted to engage. The concept of electronic money now embraces all prepaid value units stored on electronic data media in the form of a claim on the issuing agency and which are accepted by third parties as a medium of payment without being legal tender. A definition of the term e-money institution (section 1 (3d) sentence 4 BA) was necessary for formal legal reasons.

European Passport for e-money institutions

The provisions of the "European Passport" apply to e-money institutions as well; ie e-money institutions based in the European Economic Area invoking their right to set up branches or subsidiaries in other EEA states or the freedom to provide services throughout the EEA are solely supervised by the prudential authorities in their home country (see the relevant amendments in sections 24a and 53b BA). Since that means German e-money institutions are in competition with similar institutions based in other EEA states, it was no longer possible to maintain the principle of full supervision of institutions even if they were to confine themselves to prepaid card business and network money business. Instead, prudential supervisory exemptions granted by the E-Money Directive to institutions issuing only electronic money had to be incorporated into the Banking Act.

Own funds requirements

The minimum initial capital for e-money institutions was set at €1 million by section 33 (1) sentence 1 number 1(e) BA. The own funds requirements which e-money institutions are required to meet on an ongoing basis derive from section 10 (10) BA, pursuant to which own funds must make up at least 2 % of the current amount or the average of the sum of the liabilities over the preceding six months on the basis of still-unused electronic money, whichever figure is higher.

Limitation of investment options

The investment limitations set out in Article 5 of the E-Money Directive in order to safeguard the liquidity of e-money institutions have to be included either in the regulation superseding Principle I on own funds pursuant to section 10 (1) sentence 2 BA or the regulation superseding Principle II on the liquidity of institutions pursuant to section 11 (1) sentence 2 BA. Pursuant to Article 5 of the E-Money Directive, such institutions may only invest in assets with a low credit risk and high liquidity, such as claims on zone A central governments and central banks or sight deposits held with zone A credit institutions. To hedge market risks arising from the issuance of electronic money and the permissible investment, e-money institutions may apply sufficiently liquid interest-rate and foreign-exchange-rate-related

Classification of institutions pursuant to section 1 of the Banking Act

<table>
<tr><td colspan="6">Institutions</td></tr>
<tr><td colspan="4">Credit institutions within the meaning of the Banking Act</td><td colspan="2">Financial services institutions within the meaning of the Banking Act</td></tr>
<tr><td>Deposit business and lending business</td><td>Electronic money business</td><td rowspan="3">Discount business
Safe-custody business
Investment fund business
Acquisition of claims
Guarantee business
Giro business</td><td>Principal broking services and/or underwriting business</td><td rowspan="2">Investment broking
Contract broking
Portfolio management
Own-account trading</td><td rowspan="3">Non-EEA deposit broking
Money transmission services
Foreign currency dealing
Credit card business</td></tr>
<tr><td>Deposit-taking credit institutions</td><td>Electronic money institutions</td><td>Securities trading banks</td></tr>
<tr><td colspan="3">Credit institutions within the meaning of EC law</td><td colspan="2">Investment firms within the meaning of the Investment Services Directive</td></tr>
</table>

Deutsche Bundesbank

off-balance-sheet instruments in the form of exchange-trade derivatives as long as they are subject to daily margin requirements and the complete elimination of market risks is intended and, as far as possible, also achieved. Since under Article 1 (5) sentence 2 of the E-Money Directive e-money institutions shall not have any holdings in other enterprises except where these enterprises perform operational or other ancillary functions related to electronic money issued or distributed by the institution concerned, such a restriction needed to be inserted into section 12 (3) BA.

Redeemability of electronic money

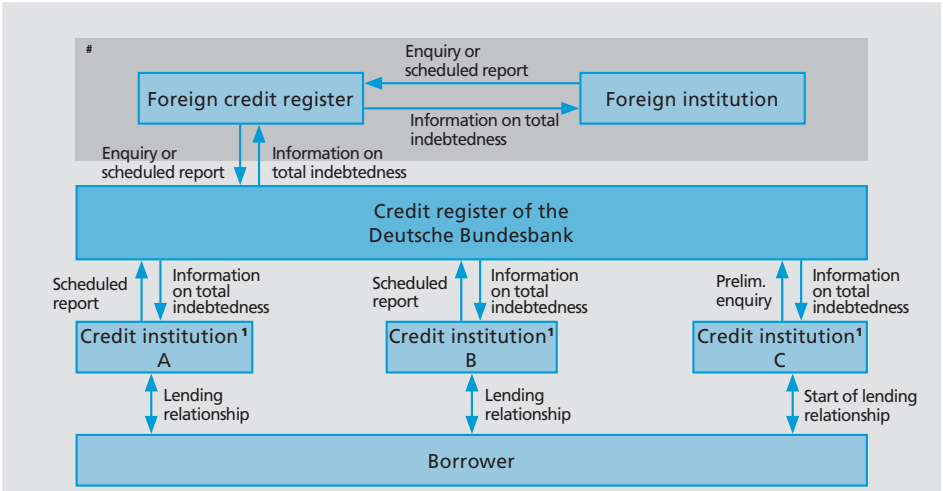
Article 3 was included in the E-Money Directive not least at the urging of the European national central banks, which feared that otherwise money would circulate completely beyond the control of central banks. It stipulates that holders of electronic money can demand its redemption at par value in coins and notes or by a transfer to an account if the minimum threshold of €10 is exceeded. This requirement, implemented as section 22a BA, made it the first civil-law consumer protection rule to be incorporated into the Banking Act, though compliance is to be monitored by the FFSA.

Modernising the procedure for loans of €1.5 million or more

Preventive prudential supervisory instrument

A third focus is on modernising the procedure for loans of €1.5 million or more, which is a tried and tested prudential supervisory instrument. The so-called credit register for loans of

Procedure for loans of €1.5 million or more and the planned cross-border exchange of information



Schematic presentation: once the legal basis has been created, concrete agreements on procedure still remain to be reached with foreign partner credit registers. — **1** Institutions subject to reporting requirements include not only credit institutions but also financial services institutions within the meaning of section 1 (1a) sentence 2 number 4 BA, financial enterprises within the meaning of section 1 (3) sentence 1 number 2 BA and the enterprises and agencies listed in section 2 (2) BA.

Deutsche Bundesbank

€1.5 million or more is located at the Deutsche Bundesbank's Central Office in Frankfurt. This credit register is one of the most important prudential supervisory instruments for identifying concentrations of risk within individual institutions and assessing the overall negative impact on the banking industry – and not only in cases of insolvency of major enterprises. It is also gaining increased importance for preventive supervision, too. In addition, the information stored in the credit register is valuable for institutions required to submit reports and for insurers because the feedback notification enables them to obtain an overview of the total indebtedness of their largest borrowers. The aim of amending the Banking Act in this connection is to open the way for the credit register to cooperate with similar foreign institutions and to simplify the technical procedure for submitting preliminary enquiries and reporting loans of €1.5 million or more. To add flexibility to the reporting procedure for loans of €1.5 million or more, the content, deadlines and routing of the reports are now to be determined by regulations rather than acts.

Cooperation with foreign credit registers

With regard to cooperation with other EU credit registers, the legal preconditions needed to be created so that Germany could participate in the envisaged expanded exchange of information between EU credit registers, including forwarding information to commercial banks. Some years ago the credit registers currently existing in the EU (Austria, Belgium, France, Germany, Italy, Portugal and Spain), in a first step towards closer cooperation, reached an agreement on the cross-border

Key amendments to section 14 of the Banking Act caused by the Fourth Financial Market Promotion Act

Area of regulation	Old rule	New rule
Cross-border exchange of data	International agreements or the entry into force of a European Community directive were required in the past before data could be passed on to companies participating in the reporting procedure and domiciled abroad. The exchange of information between EU credit registers was solely for prudential supervisory purposes.	In consultation with the Federal Financial Supervisory Authority and in accordance with section 4b of the Federal Data Protection Act *(Bundesdatenschutzgesetz)* the Bundesbank may provide foreign credit registers with data on borrowers stored with the Bundesbank even for the purposes of passing on such data to lenders located in the country in question. The Bundesbank can participate in the envisaged extended exchange of information between EU credit registers, including passing on data to commercial banks.
Pre-loan enquiries	For pre-loan enquiries to be legal, the potential loan (new loan or increase in an existing loan) had to be worth €1.5 million or more and the customer's consent was required. The single borrower unit's total indebtedness was notified only if all members of the single borrower unit had given their prior consent.	The term "customer" has been replaced by the term "borrower", which also encompasses the single borrower unit. Regardless of the amount of the potential loan, the (potential) borrower's or single borrower unit's indebtedness is notified to the reporting lender upon request (in the case of both existing and new borrowers). In the case of a potential borrower the lender must, if required by the Bundesbank, indicate the amount of the intended loan and the potential borrower's consent to such notification. This is designed to simplify the existing possibilities for making pre-loan enquiries, also in view of the envisaged extension of the international exchange of information between EU credit registers.
Contents and deadlines of reports; breakdown of notification	These areas were all explicitly governed by section 14 of the Banking Act.	Because the objective is to add flexibility to the reporting system, these areas are to be stipulated by a regulation pursuant to section 22 of the Banking Act.
Electronic data transmission	Section 14 of the Banking Act contained no rules on this area. Section 15 (3) of the Regulation governing large exposures and loans of DM3 million or more *(Grosskredit- und Millionenkreditverordnung)* stipulated that the institutions should provide reports using a paperless submission procedure.	Companies participating in the reporting procedure for loans of €1.5 million or more and the Bundesbank are permitted to submit the report, the routine notification and the ad hoc notification given because of a pre-loan enquiry by electronic data telecommunication. By opening up this legal requirement to the use of electronic data transmission, lenders required to submit reports are able to use modern methods of communication to generate and process reports quickly and cost-effectively.
Transitional arrangements		The contents and deadlines of the reports and the review period will remain unchanged until the legal regulation pursuant to section 22 of the Banking Act enters into force. The other changes entered into force on 1 July 2002.

Deutsche Bundesbank

exchange of information on the indebtedness of borrowers in specific cases, although up to now the exchanged information may only be used for prudential supervisory purposes and may not be forwarded to the lenders. To enable the enterprises subject to reporting requirements also to acquire information on their borrowers' liabilities abroad, there are plans to expand the existing cooperation and, in the future, to give commercial banks access to information on the indebtedness of their borrowers stored in foreign credit registers.

Working Group on Credit Registers

According to the strategy paper presented by the Working Group on Credit Registers, a subcommittee of the Banking Supervision Committee of the European System of Central Banks, information on borrowers' indebtedness exchanged between credit registers should in future be included in the feedback notification given to lenders if a borrower reported by the lender has taken out reportable loans in the other aforementioned countries as well.

Simplifying pre-loan enquiries

In connection with creating the legal basis for the envisaged expansion of the exchange of information, the possibility of making an enquiry to the credit register prior to granting a loan introduced by the Sixth Act amending the Banking Act in section 14 (2) sentence 4 BA needed to be simplified and adapted to European practice. In the wake of this simplification, the minimum lending amount of €1.5 million is no longer a precondition for submitting pre-loan enquiries to the credit register. Furthermore, the lender is no longer routinely required to confirm that the potential borrower has consented to the enquiry addressed to the credit register, and enquiries relating to single borrower units are also permitted. Previously, pre-loan enquiries to the credit register had been permitted only from an envisaged minimum lending amount of €1.5 million, and the lender needed to confirm the customer's consent to the enquiry in all cases. Consequently, institutions made very little use of the pre-loan enquiry. The abolition of the minimum lending amount for pre-loan enquiries addressed to the credit register in Germany is also designed to facilitate the envisaged extended exchange of information between EU credit registers, given that the reporting thresholds in other countries are considerably lower. The whole reporting procedure for loans of €1.5 million or more is presented schematically on page 22.

Content of reports defined by regulation

To enable the reporting procedure for loans of €1.5 million or more to be carried out more efficiently, the new Banking Act permits the use of electronic data transmission. Another means of streamlining the process is that now a regulation pursuant to section 22 BA can be used to determine the content and deadlines of the reports and the review period rather than the Act itself. A number of the envisaged improvements, however, can only be tackled over the next few years since they require comprehensive, time-consuming technical innovations. Details of the changes are contained in the box on page 23.

Harmonising shareholder monitoring practices among credit institutions, financial services institutions and insurance companies

Harmonising the rules in the Banking Act and the Insurance Supervision Act

At the first meeting of the Forum for Financial Market Supervision *(Forum für Finanzmarktaufsicht)* in December 2000 – attended by representatives of the former federal supervisory offices for banking, securities trading and insurance (which in the meantime have all merged to form the FFSA), the Federal Ministry of Finance and the Bundesbank – the Federal Insurance Supervisory Office proposed harmonising the respective rules for monitoring the shareholders of institutions in the Banking Act and the Insurance Supervision Act. The shareholder monitoring procedure is primarily intended to ensure that supervisory authorities are notified of any relevant changes in institutions' ownership. At the same time, however, the supervisory authorities are also to be given the possibility of blocking the acquisition of significant participating interests in institutions or companies by persons or enterprises who, by asserting their interests in the institution, jeopardise its solvency and thus may be classified as not trustworthy. The stiffer provisions in the Banking Act concerning shareholder monitoring introduced by the Third Financial Market Promotion Act of 27 March 1998 had not been matched in the Insurance Supervision Act. Since the insurance industry has shareholder monitoring problems similar to those in the banking industry – often involving the same people – it makes sense for the legal instruments to be the same. Although the amendments to the Banking Act caused by the Third Financial Market Promotion Act had largely been taken on board by the amendment of the Insurance Supervision Act of December 2000, the two acts had still not been completely harmonised. Only with Article 16 of the Fourth Financial Market Promotion Act has the process of making the necessary adjustments to the Insurance Supervision Act now been completed.

Tightening shareholder monitoring

To ensure that the trustworthiness of shareholders can be monitored on an ongoing basis, the new provisions now require all holders of qualified participating interests who are either legal persons or partnerships to report immediately each newly appointed legal representative or new general partner to the FFSA and the Bundesbank, together with the facts germane to assessing his trustworthiness, even without being asked to provide such information. Moreover, the Act spells out the fact that, in the case of legal persons and partnerships, not only the legal representative or general partner but also the legal person or the partnership itself may be considered untrustworthy. Moreover, the grounds for prohibiting the intended acquisition of a participating interest have been tightened in two areas. Firstly, a prospective purchaser is deemed not trustworthy if there are facts justifying the assumption that the resources he has raised to purchase the qualified participating interest have been acquired by an action constituting a criminal offence (section 2b (1a) sentence 1 number 1 BA). It does not matter whether the act was committed by the person himself or a third party. To that extent, if the trustworthiness of the acquirer of the participating interest cannot

be established beyond reasonable doubt, the acquirer will not receive the benefit of the doubt. Secondly, the grounds for prohibiting the integration of the institution into a corporate association if this would hamper effective supervision of the institution (section 2b (1a) sentence 1 number 2 BA) have been worded more precisely to specify that the hampering of supervision must be caused by the structure of cross-shareholdings or the inadequate economic transparency of the association. Commercial performance and soundness also have to be taken into consideration when assessing the economic transparency of a corporate association. Matching rules governing the licensing procedure were added to section 33 BA. In order to make it easier for the FFSA to monitor shareholders, it may now, as part of its right to perform audits pursuant to section 44b BA, have the documents submitted to it pursuant to section 2b (1) sentence 2 BA audited by an auditor of the FFSA's choice at the expense of the party required to submit said documentation. Lastly, the FFSA may now also receive information regarding the institution of tax evasion proceedings against holders of qualified participating interests (section 8 (2) BA).

Definition of a qualified participating interest

In order to harmonise the provisions governing shareholder monitoring, the definition of a qualified participating interest initially needed to be adjusted. For shareholder monitoring to be effective, participating interests held in trust must be ascribed to both the trustee and the trustor and a qualified participating interest in any enterprise on whose management a key influence may be exercised is considered to exist even if no formal equity is held.

Other amendments to the Banking Act

Principles I and II adopted as regulations

In addition to these focal points, the Fourth Financial Market Promotion Act envisages many amendments to individual items in the Banking Act. A significant change is that, in future, Principles I and II concerning the capital and liquidity of institutions will be adopted with the legal status of regulations. For one thing, it is doubtful whether the implementation of EC Directives by means of administrative orders is consistent with EC law. For another, the adoption of a regulation makes it possible to combat violations of principles adopted as regulations by means of administrative acts which can be founded directly on these principles. For the first time, investment companies which sell private pension plans that need to be certified by a public official are also subject to capital adequacy rules.

Distinction between trading book and banking book defined by regulation

The distinction between the trading book and the banking book will likewise be established in future by means of a regulation. This is intended to make it possible to adapt the regulations more speedily to amendments of EC Directives. The regulation which now needs to be issued will also require commodity spot and futures transactions pursuant to Directive 98/31/EC (CAD II), which had not yet been implemented in Germany, to be included in the trading book if all other conditions apply. Previously, section 1 (12) sentence 3 of the old Banking Act forbade the inclusion of such transactions.

FFSA's powers to issue orders extended

Last but not least, the FFSA's powers to issue orders have been extended so that it is now able to issue orders to put a stop to violations

of supervisory rules. Since majority opinion had already held that section 6 (1) BA entitled the FFSA to issue instructions to stop violations of the Banking Act, these supervisory rules had to be contained in other acts. These other supervisory standards are referred to in the list of acts in the revised section 36 (2) BA. This extended power to issue orders also encompasses financial holding companies and their managers. Other amendments to the Banking Act are contained in the list on this page.

Transitional arrangements

It was not possible to issue the legal regulations on the content, deadlines and review period of reports pursuant to section 14 (1) BA, on the rewriting of the Regulation governing large exposures and loans of three million Deutsche Mark or more, and on the distinction between the banking book and the trading book – all of which have been necessitated by the amendments to the Banking Act – concurrently with the Fourth Financial Market Promotion Act. For that reason, section 64f (3) to (5) BA envisages the continued application of the previous rules, such as those on reporting loans of €1.5 million or more, until the aforementioned new regulations enter into effect.

Tightening of money laundering rules

Combating money laundering

One major consequence of analysing the terror attacks in New York and Washington D. C. on 11 September 2001 was the realisation that combating international terrorism effectively needs to go hand in hand with combating the financing of terrorist groups and their

Other amendments to the Banking Act (BA) as a result of the Fourth Financial Market Promotion Act

- German Finance Agency *(Finanzagentur GmbH)* not considered a credit institution pursuant to section 2 (1) number 3a BA unless it accepts deposits or grants loans
- "Dependent agents" must take out liability insurance, section 2 (10) BA
- Information may be passed on to central banks, section 9 (1) number 7 BA
- The deduction requirement for subordinated liabilities pursuant to section 10 (6) number 5 (b) BA is now restricted to those comprising additional capital
- The provision of collateral has been extended to include short-term subordinated liabilities incurred by a subsidiary, section 10 (7) sentence 8 BA
- Exposures secured by collateral in the form of cash deposits or certificates of deposit are not considered loans within the meaning of section 18 BA and section 21 (4) number 2 BA
- "Two managers" principle has been introduced for financial services institutions which, in accordance with a certificate from the Federal Financial Supervisory Authority, pursuant to section 4 (1) number 2 of the Act governing the certification of contracts for pension plans *(Gesetz über die Zertifizierung von Altersvorsorgeverträgen),* are authorised to offer contracts for pension plans, section 33 (1) sentence 1 number 5 BA
- A special commissioner may be appointed to exercise powers incumbent upon the institution's governing bodies, section 36 (1a) BA
- The Federal Financial Supervisory Authority's powers to take action to stop unlawful business have been extended to companies involved in the preparation, conclusion and settlement of such transactions, section 37 (1) sentence 4 BA
- Supervisors' rights to gather information and conduct audits extended to cover outsourcing, section 44 (1) sentence 2 second clause BA
- German institutions are now required to tolerate audits by foreign supervisory authorities, section 44a (2) sentence 3 BA
- A branch may be liquidated only with the consent of the Federal Financial Supervisory Authority, section 53 (6) BA

Deutsche Bundesbank

members. Since terrorist groups rely on banks' payment systems to finance their activities, the money laundering rules were tightened to support efforts to combat terrorism. Besides the safeguards pursuant to section 25a (1) number 4 BA introduced because of the Core Principles, as well as the reversal of the burden of proof regarding the origin of funds for acquiring participating interests pursuant to section 2b (1a) sentence 1 number 1 BA and section 33 (1) sentence 1 number 3 BA, institutions have been instructed to enable the FFSA to automatically access account information (section 24c BA) in the context of combating money laundering. The package of measures adopted by the Federal Ministry of Finance on 5 October 2001 entitled *Finanzierungsströme des Terrorismus austrocknen – Stabilität der Finanzmärkte sichern* originally envisaged installing a central database at the FFSA to which credit institutions would have to supply information on all accounts and safe-custody accounts held in Germany. During the legislative process this plan was modified by the proposal to set up a system of automated access to account information. This automated access to information supplements the FFSA's unlimited right to obtain information pursuant to section 44 (1) BA, which also governs business relations with individual customers. Credit institutions are required to keep the following information about all accounts or safe custody accounts on file: the account or safe-custody account number, the date the account was opened or closed, the name of the holder and all parties entitled to access the account, those of any other authorised economic agents, and (in the case of natural persons) the date of birth. The FFSA must be given access to these data at all times. By virtue of Article 3 of the Money Laundering Act (Federal Law Gazette I No 57 of 14 August 2002), section 25b BA imposes special organisational duties on credit institutions involved in cross-border cashless payments. For instance, from 1 July 2003 a credit institution executing a bank transfer to a non-EU country must first record the name, account number and address of the transferor and transmit these data *in toto* to the beneficiary's credit institution or an intermediate credit institution.

Credit card business classified as a financial services transaction

To assist in the combating of money laundering, credit card business was likewise subjected to licensing requirements. Up to now enterprises not engaged in credit card business as guarantee business (section 1 (1) number 8 BA) were not classified as institutions but as financial enterprises within the meaning of section 1 (3) sentence 1 number 4 BA. In Germany, unlike most other EEA countries, such institutions did not need a licence. That meant they were subject to neither solvency supervision nor to supervision under the Money Laundering Act. The Financial Action Task Force on Money Laundering and the FFSA have found that credit card business can increasingly be abused for money laundering purposes through the use of credit card accounts, since certain types of credit cards provide for accounts and participation in payment systems similar to giro business. This means that thus far money could be deposited in credit card accounts and transferred across borders from one credit card account to another within the

same credit card association without the payment flows from the card business being supervised under the Money Laundering Act. Now credit card business has been classified as a financial service (section 1 (1a) number 8 BA) and hence is subject to prudential supervision. Other modern methods of settling payments, such as mobile banking or WAP technology, are likewise now classified as credit card business since these payment systems can also be misused for money laundering owing to their lack of transparency. However, only tripartite systems – ie where the card issuer, the card holder and the service provider (acceptor) are three different parties – are subject to supervision. Credit card business, however, does not require all-embracing solvency supervision; accordingly, the provisions on own funds and liquidity as well as on lending business are not applicable to dedicated credit card companies. In individual cases credit card companies may be completely exempted from supervision pursuant to the Banking Act, as long as the nature and type of their business do not need to be supervised.

Further amendments to the Banking Act in the near future

Implementation of additional EC Directives

Despite the extensive amendments to the Banking Act caused by the Fourth Financial Market Promotion Act, further changes will be necessary prior to the translation of Basel II into German law. Before then it will be necessary to implement Council Directive 2001/24/EC on the reorganisation and winding-up of credit institutions, which envisages a single Europe-wide reorganisation and winding-up procedure for credit institutions without the opportunity of a special procedure for branches, as well as the pending Council Directive on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate (COM/2001/0213 final – COD 2001/0095). Adapting prudential supervisory legislation to developments in the financial sector is an ongoing task which also places high demands on the supervised enterprises. Moreover, it will not be possible to slow down the pace of amending the Banking Act if Germany is to remain internationally competitive as a financial centre that meets international prudential supervisory standards.