In collaboration with

bankenverband

Bundesverband Öffentlicher Banken Deutschlands

KPMG
cutting through complexity

FINANCIAL SERVICES

Impact of regulatory requirements

Study

December 2013

Content

1 Management Summary

The continuously increasing regulatory requirements have fundamental effects on the banking business. These also include the cost burdens from the implementation and ongoing fulfilment of the additional requirements and the associated commitment of resources. To create greater transparency here and to trigger discussions, KPMG has, in collaboration with the Federal Association of German Banks, and with the support of the Federal Association of Public Banks in Germany, conducted an "Impact of regulatory requirements" study in Germany.

The most important result of this study is that the regulation initiatives of the past years – incidentally contrary to a statement often made in public that "not much has happened" with regard to the banking regulation since the financial crisis – are developing a considerable impact.

Higher-level regulation goals were a stabilisation of the financial system and a substantial improvement of the equity and liquidity endowment of the banks so that the taxpayer does not have to jump in and rescue the banks if they experience difficulty in the future. The German credit institutions have made significant progress on this path.

Today, they have substantially more capital and liquidity reserves for the prevention of crises than before the financial market crisis.

This was accompanied by the striving of the regulators to focus the banks in the financial system more strongly again on their service provider role and parallel to this set tighter limits on their own trading transactions. This goal was also largely reached.

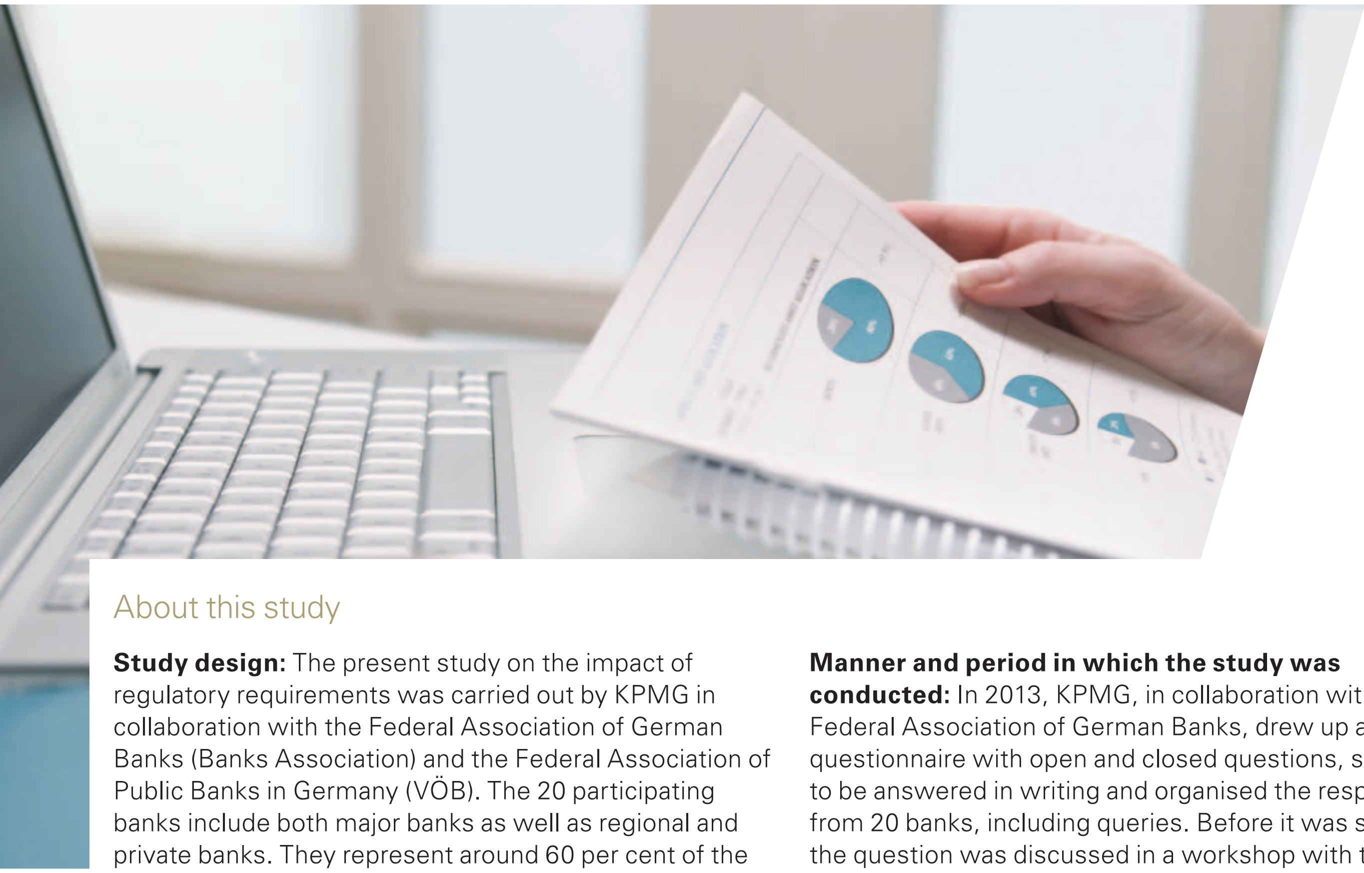
As the results of this study show, the banks are again concentrating more strongly on their customer business with corporate and private clients. They are also withdrawing entirely or at least in part from own trading or from particularly high-risk transactions that have become deliberately more expensive by the regulation, and are adjusting their business models, where it appears necessary.

According to the study results, achieving these important regulatory goals undoubtedly entails considerable costs. Even the operational implementation and the ongoing operation of the regulation measures have cost the institutions in Germany substantial sums: In the period from 2010 to 2015, direct costs have increased to an additional approximate amount of EUR 2 billion annually for the German loan industry. In addition, the credit institutions have to pay for further investments for the improved equity and liquidity endowment – a multiplication of the direct cost amount is additionally necessary for this. On the basis of the analysis results submitted, the overall costs of the regulation, which have to be sustained by the credit institutions, amount to a total of around EUR 9 billion every year.

It is also worth mentioning that, formerly lucrative business fields for the banks have become substantially more expensive. According to the study results, the banks have moved their business models towards corporate client and private client business in a remarkable breadth. In addition to the cluster risk through the synchronisation of regulatorily attractive transactions, this also harbours problems with regard to profitability. So that the banks, in the truest sense of the word, can get their money's worth here, they have to adjust their conditions accordingly. However, these effects are still barely tangible in the current macroeconomic environment of an ongoing low-interest policy of the European Central Bank and of the still relatively weak demand for credit.

Many study participants criticise the increasing complexity and cumulative consequences of the many different government approaches. Complexity arises not only from the sheer number of regulations but even more so from an often overlapping multi-layered structure of the regulatory initiatives, during the issue of which possible interdependencies are frequently not taken into account sufficiently. The considerable extension of the registration and reporting requirements was frequently named by the study participants as an example of complexity – and the greatest bureaucratic hurdle. The different handling of sovereign bonds in pillar 1 and pillar 2 according to the Basel regulations on the equity backing was also critically noted. This results in contradictory requirements between individual measures, which is reflected in contradictory management impulses for the credit institutions.

The banks try to limit the costs by using synergies from the simultaneous implementation of supervisory law requirements and economically necessary changes, whereby data management optimisation appears particularly urgent for many in the specific measures for the implementation of the regulations.



About this study

Study design: The present study on the impact of regulatory requirements was carried out by KPMG in collaboration with the Federal Association of German Banks (Banks Association) and the Federal Association of Public Banks in Germany (VÖB). The 20 participating banks include both major banks as well as regional and private banks. They represent around 60 per cent of the balance sheet total of all German financial institutions. The study "Impact of regulatory requirements" dealt with the latest requirements under supervisory law of German banks and the associated costs. For the period from 2010 until 2015 considered in the study, questions are asked regarding quantitative and qualitative effects of the regulation measures on the banking business with regard to the past as well as the future. In addition, the study participants were also asked for an expert or management assessment on specific topics. In the process, the participants were explicitly requested to also assess the impact of the regulation where difficulties arose in the precise distinction between response options. Furthermore, for each question, there was space available to enter free text for explanations, comments and also opinions and this space was amply used.

Manner and period in which the study was conducted: In 2013, KPMG, in collaboration with the Federal Association of German Banks, drew up a questionnaire with open and closed questions, sent it out to be answered in writing and organised the response from 20 banks, including queries. Before it was sent out, the question was discussed in a workshop with the study participants. Due to the number of participants, the expert and management assessments asked for and the specific planned approaches underlying the various answers, but also due to specifically requested future projections, the quantitative study results cannot claim to be statistically correct. Nevertheless, the claim of a "well-founded indication" is explicitly expected of the study participants also for the quantitative information.

2 Introduction
Costs of the regulation

In light of the experiences from the financial and sovereign debt crisis, the regulators have set a sustainable stabilisation of the financial system as their goal – through greater transparency, long-term orientation and a greater liability contribution of credit institutions in high-risk transactions. The continually increasing regulatory requirements derived from this have far-reaching implications for the credit institutions – for strategies and business models, structural and process organisation and very specifically for processes, methods, IT systems and the resource management (capital/liquidity/securities). Because all these aspects, their changes and possibilities interact with one another at many levels, it was the motivation and goal of this study to gain insight not only about individual but also about the aggregated effect of regulations.

Within the framework of the study, the banks firstly quantified their project costs and secondly their additional administration costs which were incurred on an ongoing basis (personnel and material costs) which result from individual regulations and in total in their sum. The questions were based on the period of the last three years and the coming three years.

The following tabular overview shows the accumulated results from the answers of the study participants.

The specified direct costs of the regulation correspond on average to around 25 per cent of the overall project budget 2010 to 2012 and approximately 35 per cent of the entire project budget of the banks for 2013 until 2015. Divided among the project budgets of individual budgets, high relative shares each with an average of more than 50 per cent are accounted for by "risk controlling/risk management" and "compliance"; the shares for "accounting/finance" or "internal auditing" are at substantially more than and around 40 per cent respectively, whereby the share of "internal auditing" will decline considerably over the next few years. Although with "IT/organisation" only around a quarter of the budgets are assigned to the regulation on average, the cost contributions are highest in absolute figures there: From 2010 to 2015, the

> "In addition, it appears important to us that the additional costs resulting from the regulation activities affect the banks in a generally challenging time in which the earnings situation is already difficult, among others, also due to the long-lasting low-interest environment. When viewed in isolation, cost blocks that appear moderate are indeed significant in the overall impact in the current environment. (i.e. therefore well before 2010)."
>
> **Quote from study participant – comment on the quantification of the costs of the regulation**

Direct costs of the regulation

	2010–2012	2013–2015
Required project budgets/ Investment costs from regulations	EUR 1.9 billion	EUR 2.5 billion
Additional ongoing administration costs from regulations	EUR 0.4 billion	EUR 0.4 billion
Direct costs of the regulation among the study participants in total	**EUR 2.3 billion**	**EUR 2.9 billion**

Source: KPMG, 2013

"General comments on quantitative information: The figures presented correspond to the current level of knowledge and have been determined to the best of our ability and knowledge. The quantitative information comes from different sources (reporting, planning, expert/management expert); compiled key ratios do not therefore represent any exact quantitative analysis but instead a well-founded indication."

Quote from study participant – comment on the quantification of the costs of the regulation

Operational costs of the regulation – implementation of supervisory requirements – percentages of the project budget of individual areas

	2010–2012	2013–2015
Risk controlling/risk management	57%	56%
Compliance	61%	54%
Internal auditing	42%	32%
Accounting/Finance	47%	52%
IT/Organisation	21%	27%

Source: KPMG, 2013

regulation costs for "IT/organisation" amount, solely based on information from the 13 credit institutions providing specific figures here (not aggregated), amount to EUR 1.8 billion, compared to EUR 1.3 billion for "accounting/finance" or EUR 1 billion for "risk controlling/risk management".

With the increase in personnel capacities due to regulations, which was also asked about, there is a substantial weighting in the field of "compliance" (2010–2012 average increase of more than 50 per cent). With "risk controlling", "internal auditing", "accounting/finance" and "IT/organisation", the personnel increases are around the ten per cent level. Focus areas result in the operational costs with regard to individual supervisory regulations in particular in connection with the implementation of Basel III through the "CRD IV/CRR" legislative package and in the "modernisation of the reporting" and – among the IFRS users concerned – the necessary changes as part of the new international accounting standards.

These directly determinable costs of the regulation from project budgets and additional administration costs were extrapolated based on the balance sheet total of the study participants to all German credit institutions. As the banks surveyed represent around 60 per cent of the balance sheet total of all German institutions, the following approximate primary total costs result with a corresponding scaling:

Direct costs of the regulation at German credit institutions in total

2010–2012	2013–2015
approximately EUR 3.8 billion	approximately EUR 4.8 billion

Source: Bundesbank banking statistics (balance sheet total "Monetary financial institutions") in relation to the balance sheet total indicated by the participants in each case (reference 2011), calculation of aggregation pursuant to the bank survey "impact of regulatory requirements" 2013.

When extrapolated, the direct costs of the regulation cumulated across all German credit institutions between 2010 to 2015 accordingly amount to approximately EUR 8.6 billion, which means that during this period around EUR 1.4 billion are incurred in this cost category on average every year.

The direct costs are supplemented by the bank levy pursuant to the ordinance regarding the collection of the contributions for the restructuring fund for credit institutions („Bankenabgabe“) which is to be paid every year to the Federal Agency for Financial Market Stabilisation (FMSA). According to a press release from the Federal Agency, an average of around EUR 600 million of this mandatory contribution were paid into the restructuring fund on average every year over the last three years (2011: EUR 590 million, 2012: EUR 693 million, 2013: EUR 520 million).

Overall, the costs of the regulation from these two directly assignable cost blocks amount to approximately EUR 2 billion every year over the entire German banking market.

A further question asked about the change in the equity due to regulatory requirements: “At how many percentage points do you estimate the change in the accounting return on equity before tax of your institute which has resulted solely from new regulations or will result in the future?”

Change in the return of equity before tax

2010–2012	2013–2015
minus 2.4 percentage points	minus 2.4 percentage points

Source: KPMG, 2013

Here, it should be noted that this estimate varies greatly depending on size and business model. The average figures calculated from the information from the banks for the effects of return on equity of minus 2.4 percentage points indicate a substantially higher cost block again. Incidentally, it is a coincidence that in the process the averages for the past and the future period of observation amount to equally 2.4 percentage points because the figures named by the credit institutions comprise different individual figures. If it is taken into consideration that in the years 2010 to 2012, the average return on equity of all German banks amounted to 7.1 per cent,[1] it is obvious that the effective overall costs of the regulation for the banks have to be substantially higher than the directly determinable costs from project budgets, additional administration costs and bank level suggest.

The assessment of the banks reveals that the costs of the regulation of the return on equity of all banks between 2010 and 2012 were reduced by a quarter on average. Based on the annual surpluses generated in these years before tax amounting to an average of EUR 26 billion per year for all credit institutions[2] this means that the banks surveyed assume that they will be able to generate an average of EUR 35 billion per year without the regulation costs. The total costs of the regulation thus amount to around EUR 9 billion per year.[3]

“Costs for RWA [Risk Weighted Assets]/capital release, bank levy, increased capital requirements for pillar 2, etc. are relevant. The influence of the financial transaction tax is decisive for the future.”

Quote from study participant – comment on the quantification of the costs of the regulation

1 Source: Bundesbank statistics “Earnings situation of the credit institutions”, monthly report September 2013. Figures rounded to full EUR billions.

2 Source: Bundesbank statistics “Earnings situation of the credit institutions”, monthly report September 2013. Figures rounded to full EUR billions.

3 Source: KPMG, 2013

"Restrictive regulation (with regard to Basel III, various restrictions in the business activity, additional taxes/levies, consumer protection) reduced the pre-tax RoE by around 4 to 8 percentage points. A change for the future is improbable (i.e. continuing regulatory pressure / corresponding uncertainties will probably restrict an active business management in favour of higher earnings also for the time after the current wave of regulation)."

Quote from study participant – comment on the quantification of the costs of the regulation

"The estimates with regard to cost of capital refer to the cost rates used in the internal management. The opportunity costs result primarily through the holding of higher liquidity reserves, in particular also through higher balances at the Bundesbank. These are countered by uncovered refinancing costs."

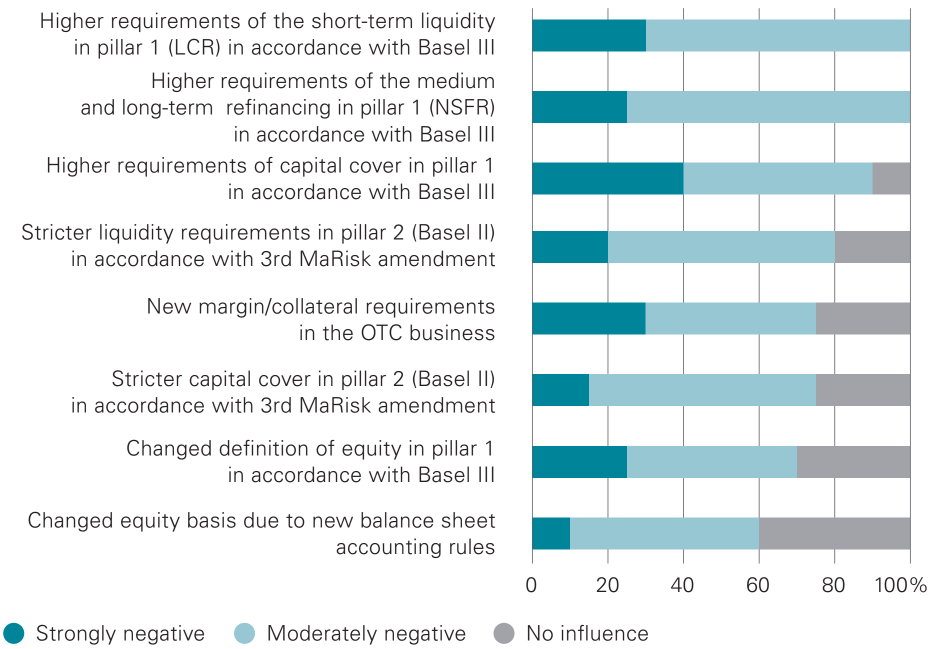
Quote from study participant – comment on the quantification of the costs of the regulation

Compared to the directly assignable costs from project budgets and additional administrative costs and the costs of the bank levy, the question arises regarding the origin of this cost component which is so significantly reflected in the reduction of the return on equity.

According to information from the survey participants, the capital and liquidity requirements from Basel III play the most important role in this cost block. This finding is supported by the answers to the question about the "Influence of the regulations in the field of capital and liquidity management on the business success of the institute". A relatively high negative influence is established there through the equity backing in relation from the existing to the generation of profits possible in the future. The influence of the two liquidity ratios according to Basel III is rated even more clearly negatively, and without exception by all survey participants. Incidentally, no participant in the study saw the answer category (which was also offered) of a "positively stimulating influence" of the regulations on the success of the business.

A clear variation dependant on size and business model is also shown with the response to this questions. As expected, higher requirements of the capital backing in pillar 1 (for instance IRC Incremental Risk Charge, CVA Credit Valuation Adjustment, Stressed VaR), of the short-term liquidity (LCR Liquidity Cover Ratio) and of the medium and long-term refinancing (NSFR Net Stable Funding Ratio) according to Basel III affect, just like the new margin and collateral requirements in the OTC (over-the-counter) business, only institutes with corresponding business. With smaller credit institutions, however, the estimate is much more moderate, or there is hardly any influence seen with the "conservative" business model.

No influence of the regulations in the field of capital and liquidity management on the business success of the institutions



Source: KPMG, 2013

"With regard to the liquidity, the latest adjustment of the Basel LCR reflect the concerns of many in the banking industry and also broader economic concerns. Many of these adjustments are, however, rescinded by a stricter MaRisk, which requires internal models that are considerably more conservative in entirely critical aspects than the LCR – particularly with regard to the assumptions relating to the liquidity process with institutional investors. In addition, the uncertainty with regard to the formulation of the NSFR and requirements of margins and securities in the OTC business contributes to withdrawing liquidity from the system, which causes financing costs to rise significantly."

Quote from study participant – comment regarding requirements of the liquidity

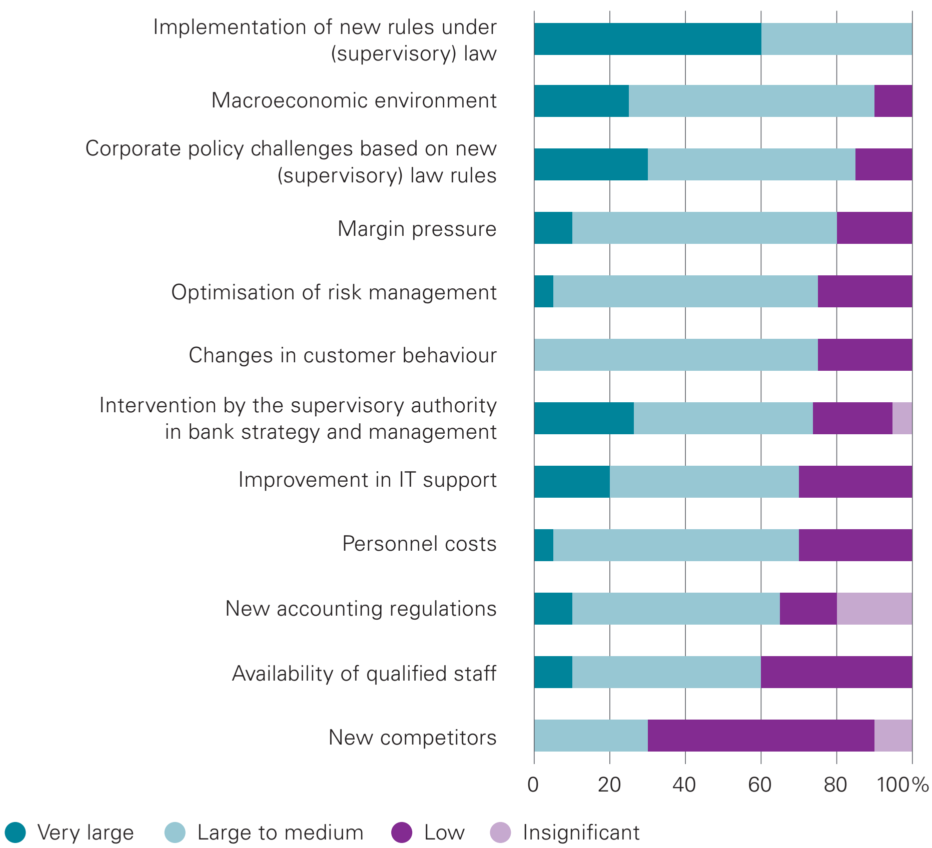
3 Banking Market
Current challenges and perspectives

"There is the challenge of reconciling law amendments with changes in customer behaviour and process optimisation. Short-term amendments in the regulation mostly do not permit a process optimisation in the brevity of the time available and result in cost-intensive follow-on projects."

Quote from study participant – comment on current challenges from the regulation

The effects of the regulation are seen by the banks as the central challenge for the mid-term company success. In particular, greater importance is placed here on the implementation of new rules under supervision law than new competitors, customer behaviour or even margin pressure. In addition, the "very great" importance of the "business policy challenges" resulting from the regulation and the "intervention by the supervisory authority in bank strategy and management" appear notable.

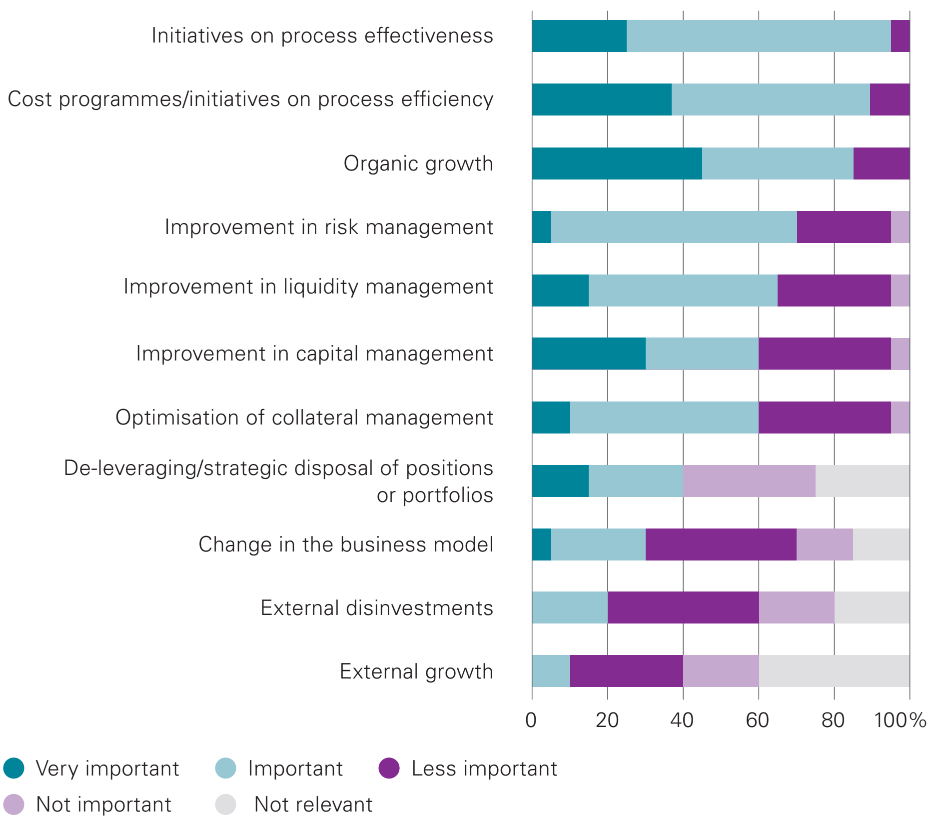
Challenges with regard to the medium-term (2013–2015) corporate success



Source: KPMG, 2013

In this regard, it should be first noted that projects to improve in particular the risk management but also in part the liquidity and capital management have already been completed or have been started. Consequently, some participants weighted their importance less as a "potential" initiative under this prerequisite. In addition, depending on the existing own business model, there are apparently different challenges for the respective companies.

Importance of potential initiatives for the medium-term (2013–2015) corporate success



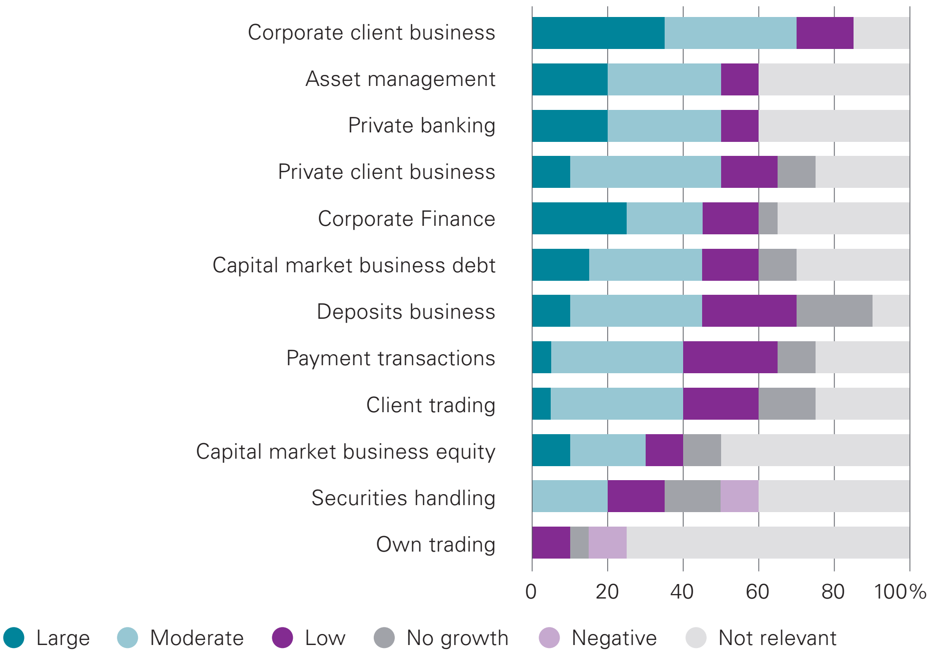
Source: KPMG, 2013

"An intense competition is to be noted in the classical credit business, in particular through competitors that bring customers directly to the capital market. In the commission sector, there is strong competition from foreign companies."

Quote study participant – comment on current challenges

In response to the question in which areas of the bank business the credit institutions see the largest potential for growth in the mid-term with regard to success of the company, the corporate client and the higher-level private client business are clearly favoured. In particular in the corporate customer business, this can lead to the risk of a concentration and associated falling margins. Notably, proprietary trading business is left far behind; in this respect, the goal of making this business unattractive through regulation measures has been achieved. This undoubtedly results in the challenge for the banks of countering the obvious risks of "herd behaviour", "clustering risk" and "diminishing margins" in this business field.

Areas of the banking business with the greatest mid-term growth potential (2013–2015)



Source: KPMG, 2013

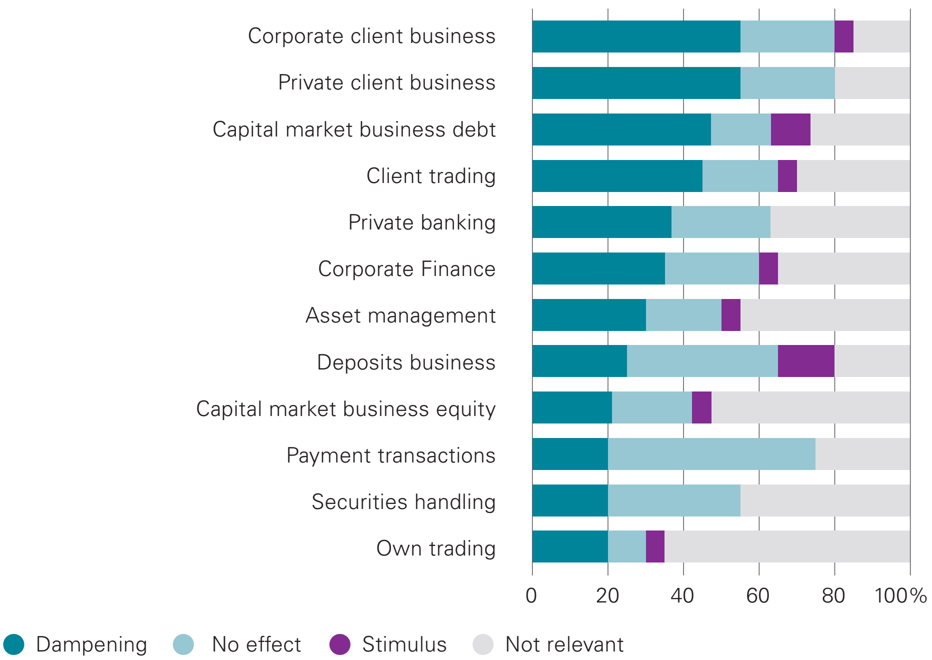
In comparing the question with the "areas of the banking business with growth potential" and the corresponding question about the "effect of new regulations", it becomes clear that particularly in the fields in which the banks see potential for the earnings of their institutes, strong damping effects from regulating measures are recognised at the same time. In the process, the contradictory differences between the perceptions of "damping" and "stimulating" effect in the same business field are explained by the business models of the persons surveyed. Some companies see the particular opportunity here that others will (must) withdraw from business fields due to regulatory requirements, and they will then use a competitive advantage in these business fields, whether based on equity strength, specialisation expertise or an even better reputation.[4]

"Fundamental damping effect via increase in minimum capital quotas, tightening of risk measurement and leverage ratio. Overall effect for respective business or product field depending on various other factors such as competitive environment, formulation of price conditions, etc."

"The problem lies not in the earnings but on the cost side. The regulatory requirements result in considerable costs that cannot in any extent be passed on to the customers. As a result, the result is substantially lower with the same scope of business and same earnings."

Quotes of study participants – comment on the effect of new regulations

Effect of new regulations on growth potential of the banking business



Source: KPMG, 2013

4 It should be noted that some business fields, for instance, own trading, are no longer operated by the institutions. This explains the high percentage of the responses with "not relevant".

4 Bank Business
Impact of the regulations

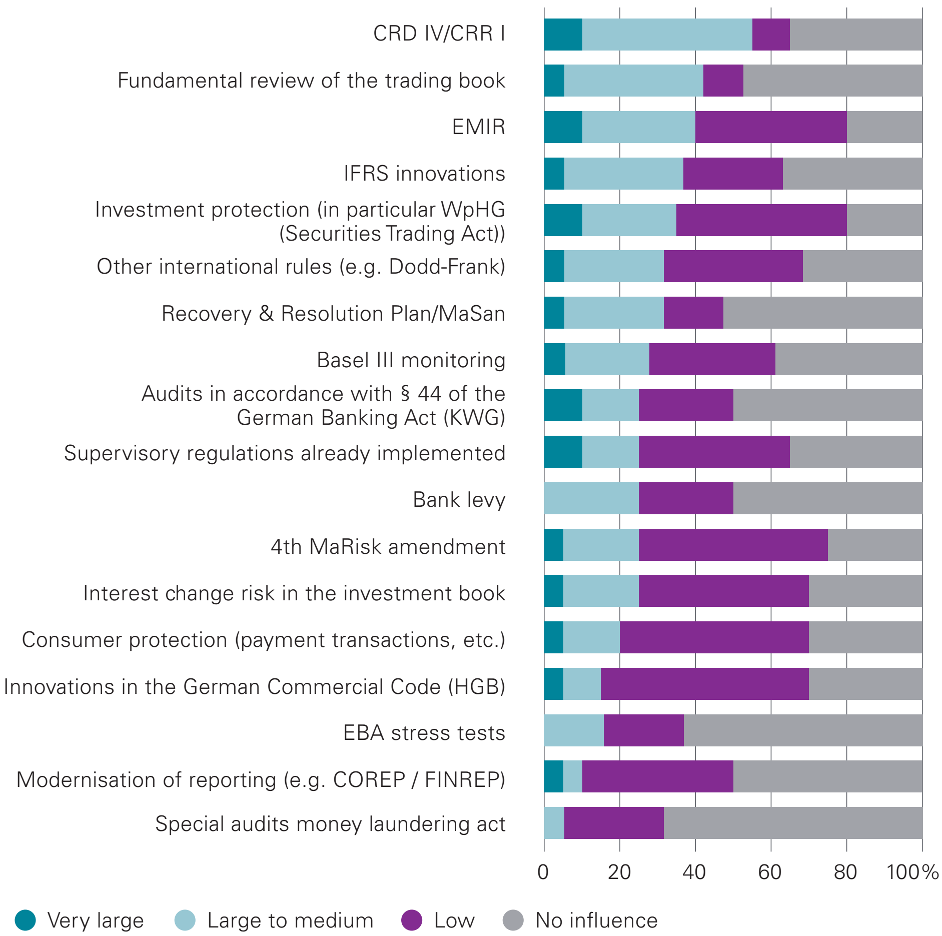
"Due to the successful business model of the company with traditional business, the need for adjustment is limited. From an organisational perspective, the situation is substantially different."

Quote from study participant – comment of the impact on the business model

Corresponding to a need, which tends to be rated as low, to change further the own business model overall[5], the specific influence of individual regulations on their business model tends to appear negligible to the credit institutions. This is at least the case when the relative underweighting is examined in comparison with the need for adjustment in the business organisation or in the bank management. A comparatively tangible influence or need for adjustment with regard to the business model is most expected from the implementation of Basel III in CRD IV/CRR. With individual banks, certain regulations – depending on the business model – trigger "greater" effects than can be read from the assessment on EMIR or also on investor protection.

If the influence or need for adjustment of the regulations on the respective

Influence and/or need for adjustment due to individual regulations on the business model



Source: KPMG, 2013

5 Regarding the potential "change in the business model" classified overall as "less important" in order to be able to be successful in the medium term, cf. above in the 3rd chapter "Banking market" also the chart regarding the question "Importance of potential initiatives for the medium-term (2013–2015) success of the company".

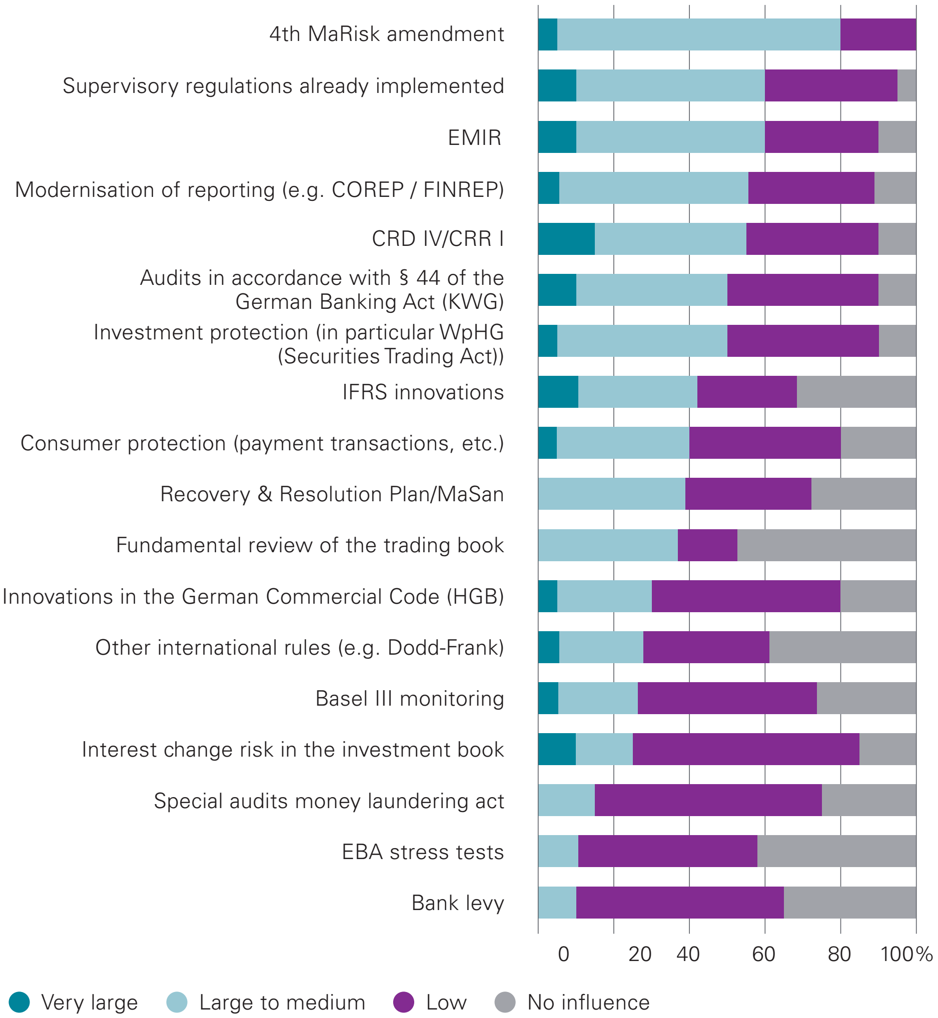
own business model is weighted so low on average, the question arises as to how the consequences of the regulation are to be valued here. Apparently most banks see their banking business as not being in doubt. But even if the business model remains the same in its fundamental alignment, other focus areas are now being set in many credit institutions.

There are thus significant adjustments within the business models in places, and entirely in the sense of the regulation goals: Here, the higher capital and liquidity endowment, but also the increased alignment to corporate and private client business and the withdrawal from own trading should also be mentioned.

"Considerable expansion of the processes in risk management as a result of the 3rd MaRisk amendment. Additional adjustments through the 4th MaRisk amendment: further expansion of the risk early detection, planning and stress testing processes."

Quote from study participant – comment on the question of the need for adjustment from individual regulations

Influence and/or need for adjustment due to individual regulations with regard to the business organisation (structural and process organisation)

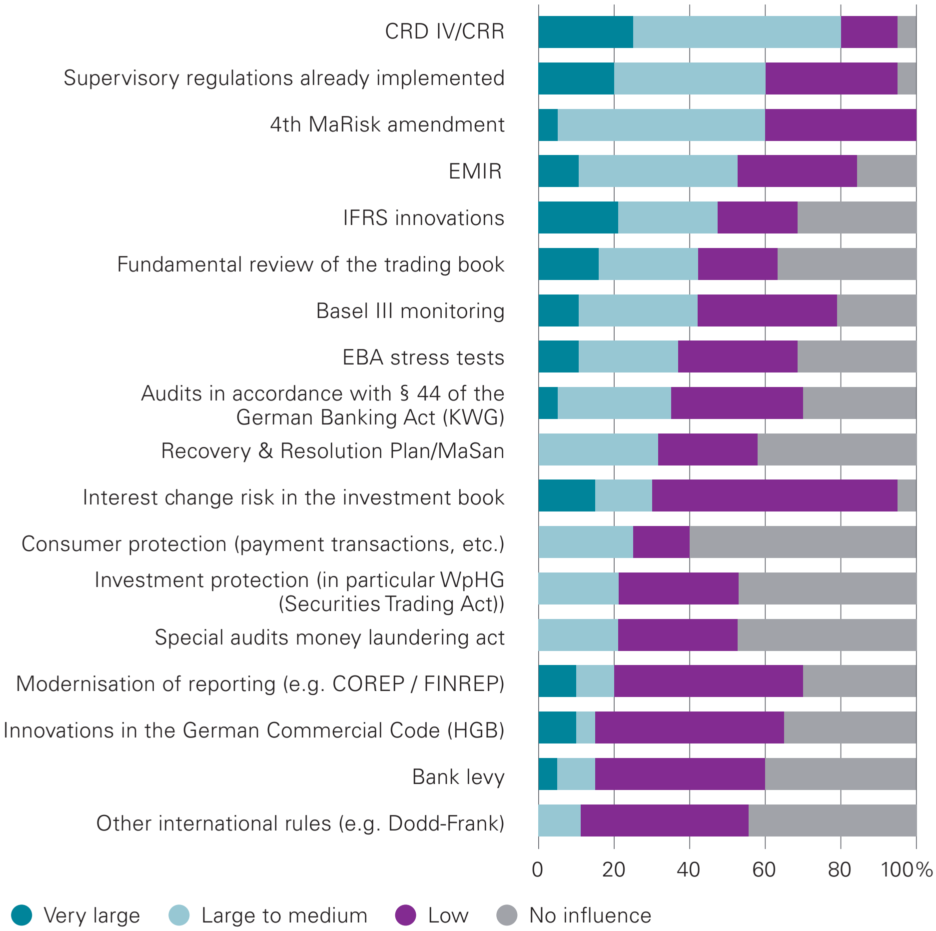


Source: KPMG, 2013

In comparison to the need for adjustment in the business model, the study participants recognise with regard to the business organisation, i.e. structural and process organisation, more effects from the regulations overall: As an overview with regard to the bars ("influence on business organisation") moved further right compared to the graphic ("influence on business model"), the assigned importance weighting appear slightly greater for the influence of individual regulations overall – even if still relatively moderate with regard to the assigned intensity of the influence.

Again, the effects from CRD IV/CRR are seen as relatively influential or have already entailed implementation measures. It is interesting that the focus is increasingly on EMIR and

Influence or need for adjustment due to the individual regulations with regard to the methodology of bank management



Source: KPMG, 2013

Section 44 (KWG) audits in individual cases – apparently, individual experience also places a role in addition to different business models.

Also with regard to the need for adjustment regarding to the methodology regarding bank management (for instance capital management, liquidity management, collateral management) which arises for the credit institutions from the individual regulations, the effects of the CRD IV/CRR are at the forefront. In addition, individual regulations are apparently more relevant again with regard to the specific business model than others.

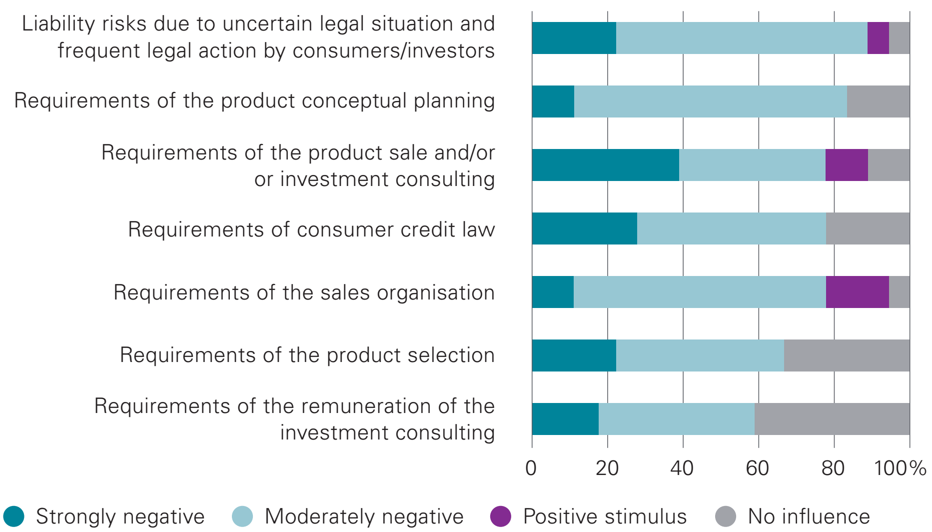
In response to the question as to how the institutions rate the specific influence of regulations or legislation in the environment of consumer and investor protection on their business protection, in particular the influence of "requirements of product sale or the investment consulting" are weighted "strongest" in comparison. In particular, the requirements of the documentation (in particular relating to: "consulting minutes") are seen as negative. The substantial consulting and documentation obligations not only put the brakes on business, according to the information from the banks. In consulting practice, the requirements, according to the information from the banks, is frequently in part even counterproductive, tends to prevent a transparent depiction for the customer and results in an overburdening or uncertainty. This is why wealth consultants with retail private customers now tend to avoid the securities business. However, on the other hand, there are also individual credit institutions that promise a positively stimulating influence on their business from

"The legislation of the Federal Court of Justice has an increasingly greater influence on the exercising of the business activity of the credit institutions."

"Overall there was little influence on the generation of profits to date. However, in particular through the requirements of the documentation, high costs in sales (time) and also organisation and IT) (after cost impact) are incurred."

Quote from a study participant on the influence of the regulations in the field of consumer protection

Influence of the regulations (or legislation) on business success in the field of consumer and investor protection



Source: KPMG, 2013

these requirements, whether from an increased position in the higher-level private client business, or from repositioning already made in the competition.

Inhibitive effects are also attached to the requirements of the consumer credit law (for instance information obligations, formal regulations, rights of revocation) and requirements of the product selection (for instance product suppliers, product range, product introduction process) and the resulting liability risks for the banks' own possibilities of generating profits in future. Despite an actually broad discussion in the media, for instance, with regard to the commission-based consulting versus fee-based consulting, for the rest, the "requirements of the remuneration of the investment consulting" appears at the lower edge of the relative weightings – with surprisingly even the highest share of those surveyed who see "no influence" here. "Negative" effects are also assigned to the requirements of the product conceptual planning (for instance sales potential, transparent design, pricing) or of the organisation of the sales (for instance, sales specifications, incentives, employee qualification). However, these do not really stand out in the valuation scale when both negative valuation grades ("strongly" and "moderately negative influence") are taken together.

It is undisputed that the tightened provisions of consumer protection entail considerable cost amounts for the banks. In response to the question of a prioritisation of measures in order to limit the costs from new rules on consumer protection, "increased training measures" and adjustments in processes and IT are given "very high" priority. Also under this question, the "revision of the incentive or remuneration models" also has a more average ranking. That the "integration of the legal or operational risks in the pricing" has priority at so few study participants leads to the conclusion that the costs of the consumer protection can scarcely be passed on to the customer.

In addition, it should be noted that requirements in the environment of consumer protection are frequently mentioned when the credit institutions are asked to name examples of regulations with which the cost appears particularly high compared to the regulation purpose: Consulting registration and complaint advisory register, but also provisions of the consumer credit line or account call-up procedures are apparently a thorn in the bank's side.

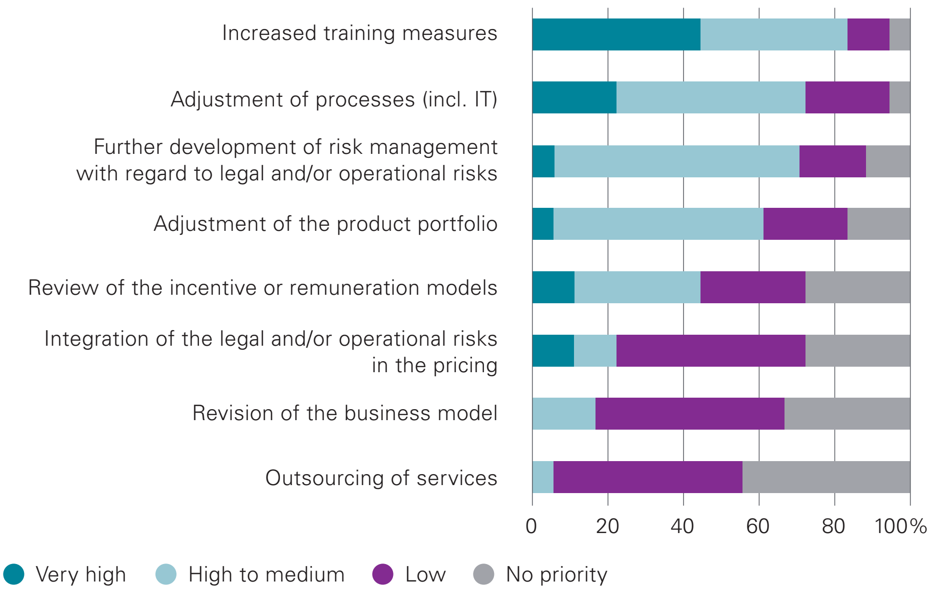
"Influence of MiFID II on processes, organisation and compliance costs. In particular, the potential heterogeneity of prohibitions and incentive structures in some EU countries makes it difficult to achieve an optimised process implementation throughout the EU."

Quote from a study participant on the influence of the regulations in the field of consumer protection

"Consumer protection: Pre-contractual information obligations pursuant to the consumer credit guideline are not justified from a material perspective and are frequently viewed in practice – particularly also by consumers – as much too comprehensive."

Quote from a study participant on the influence of the regulations in the field of consumer protection

Prioritisation of measures to limit the costs due to new rules on consumer protection



Source: KPMG, 2013

5 Cost Limitation

Purpose of regulation and cost of implementation

"Reports of all kinds, in particular that of the 'modernisation of the supervisory reporting': These reports are costly for the institute, however, in our opinion, are put away and forgotten at the regulators because the data reported cannot be analysed or only with difficulty in their reporting rhythms in intertemporal and cross-institutional form.

Documentation obligations: The positive effect of hugely increased documentation obligations on required financial market stability is not discernible for us. In addition, documentation itself is always only suitable for ex-post control activities – it is virtually impossible to discern a preventive character."

Quotes from study participants on the purpose of the regulation and cost of implementation

In light of the cost burden, the question arises as to whether the same regulation purpose cannot be reached more efficiently.

The new reporting requirements are mentioned strikingly frequently by the banks as examples of regulations with which the cost is particularly high compared to the purpose of the regulation.

In particular the level of detailing of the reporting requirement through reduction of the reporting threshold for Multi-million loans or through the introduction of reports on the standardised solvency reporting procedure COREP throughout Europe and/or to communicate financial information FINREP appears disproportionately high "compared to any gain in insight that may be generated from this". The lowering of the threshold for loans worth millions results firstly in a disproportionate increase in new borrowers to be reported and secondly to a permanently more comprehensive data inventory maintenance and monitoring. There is also no understanding that the German Banking Act (KWG) and CRR regulations on reporting tend to diverge in some places (definition of borrower units, consolidation groups under supervisory law versus under commercial law), instead of being standardised. In the area of accounting and finance, this requires not only a one-off introduction of the necessary IT structure and processes, but also an ongoing duplicate maintenance of the inventory.

The banks concerned rated the US tax auditing procedure FATCA as particularly costly. In addition, the provisions in the environment of EMR with regard to cost and regulation purpose, the monitoring of automated trading and also of financial transaction taxes which have already been introduced in individual European countries or are to be introduced were called "disproportionate" by different purposes. In addition to the comment that customers simply take alternative measures here with their business, the high recording, project and personnel cost for IT/organisation and back-office was emphasised.

Nonetheless one of those surveyed was also able to gain benefits for his company with the US counterpart to EMIR, the Dodd-Frank Act, for clearing and reporting. "Interfaces that largely exist and infrastructure whose obligatory usage offers great benefit, namely complete transparency in OTC products and as an implication uniform standards in settlement and securing of market-to-market fluctuations."

Despite residual potential for improvement, the "single rule book" was also seen as major progress. "As a bank we experience the benefits of the 'single rule book' very clearly in the collaboration with the international colleagues in the group: There are largely identical regulation texts that only permit limited options. With regard to the uniform interpretation of a uniform text, however, we are only at the beginning as each country first interprets its existing regulation in the new regulation where possible. However, this is nothing new for experienced IFRS users as there too national interpretations/implementation practices are lived very differently there."

Otherwise, however, there were very few positive comments on the question of naming examples of regulations with which the cost is low or proportionate compared to the purpose of the regulation. Here, in individual cases, the bank levy was recalled. "All required figures are already available anyway within the framework of the annual financial statements, i.e. no additional costs in the companies."

From the banks' perspective, a large number of comments related to inconsistencies (contradictions, duplicates, etc.) between individual supervisory law requirements. Among the examples named by the credit institutions for possible inconsistencies, the following focus areas can be defined:

- Reference was made by different people to the fact that within the CRD IV/CRR sovereign bonds of the euro zone are treated as privileged both in the determination of the risk assets and in the liquidity key ratios and also in the hedging of derivatives as virtually risk-free. Within the risk-bearing capacity concepts of pillar II, however, an immediate liquidation at market values is to be assumed. "In situations of crisis, this acts like a fire accelerant."
- The Leverage Ratio of Basel III aims to limit the absolute volume of the bank balance sheet. The introduction of the Leverage Ratio, however, thus contradicts the principle of management according to risk-sensitive rating systems, which results in distortions through the risk weighting of certain transactions. In particular, low-margin business with loan clients who are actually deemed to be low-risk, is no longer worthwhile from certain threshold values. "Thus cumulatively burdening effect for large-volume municipal financing business without taking into account the comparatively low-risk nature of the business."
- In light of the fact that Solvency II has indirect effects on the credit industry and in the asset business as well as in refinancing, contradictory impulses are set in ratio to the CRD IV/CRR. Whereas the banking regulation aims at long-term refinancing, the solvency regime of the insurers, which in the past acted as fundamental capital providers for the banks, prefers under certain requirements, bank bonds with short terms; long-term financing becomes substantially less attractive for the insurers. In addition, the better status of real estate financing compared to direct real estate investments within Solvency II offers incentives for insurances to be active more directly in real estate financing and thus act as competitors to banks. However, insurers are not subject to the same strict regulations in the credit decision process as banks. "The rule 'same business, same rules' must apply."

In response to the question what the supervisory authority should do in their opinion to limit the additional costs arising from the regulations, the study participants answered unanimously that they should extend the deadlines for implementation and improve coordination of the regulations.

"Contradiction between key ratios LCR and NFSR

Contradiction between financial transaction tax (no security and derivative transactions) and LCR and EMIR (additional security and derivative transactions)

Contradiction of supervisory law requirements and a risk-averse business model (e.g. hedging of underlying transactions through interest hedging transactions (Swaps)) and higher-level regulations, such as EMIR."

Quotes from study participants on contradictory requirements

"A simply reduced density and improved distribution time-limits for the extended or new regulatory requirements.

Awareness that not only costs are incurred in the institutions but also the administrative structure of the authorities is growing massively and thus the fixed cost blocks there.

The past shows that laws only know the path of growth and the increasing density of regulations and interlocking. It would be good if the regulator does not forget the regular purging, clearing up and deletion in its requirements.

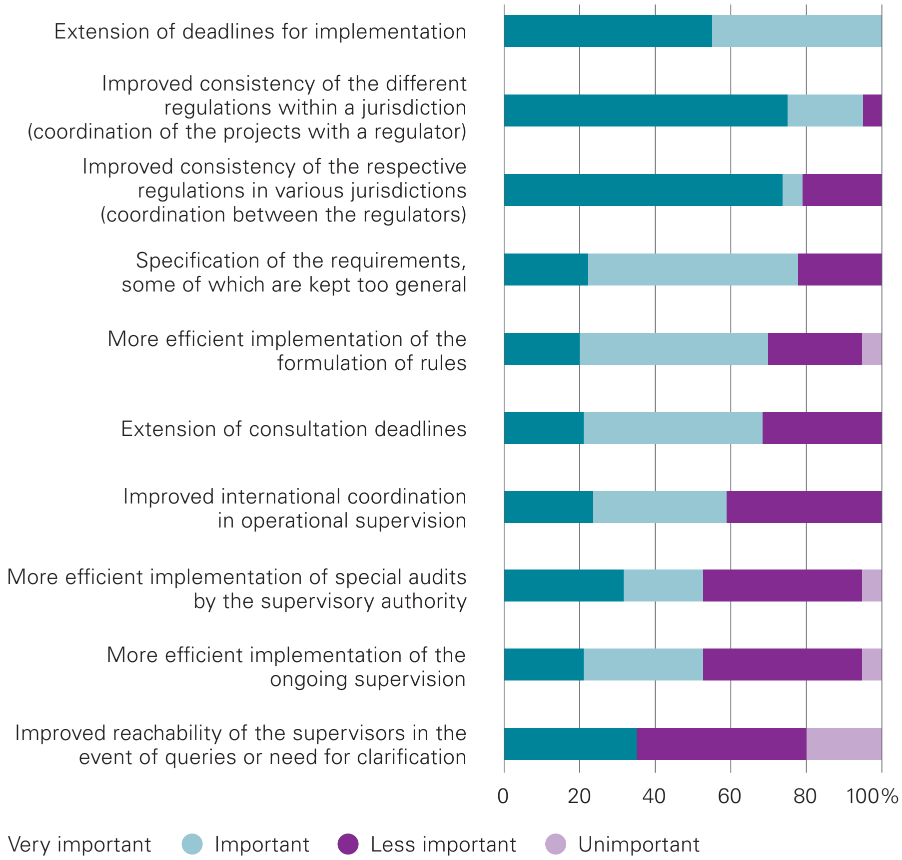
Develop requirements that (can) also have a genuine management impact in the institutions. Virtually no management impulses can be drawn from, for instance, documentation obligations, even at very great cost."

Quotes from study participants on possibilities for improvement in the regulation

As they see it, with regard to the "coordination", both the coordination of the different regulations "within a jurisdiction" and the coordination "between regulators of different jurisdictions" appear capable of improvement. As expected, the latter appears "less important" with nationally active banks.

The banks surveyed are in agreement that through a closer interlocking and a coordinated approach by the regulators – here reference was explicitly made by different persons to collaboration requiring improvement between European and national law – the "flood of regulation amendments" that is breaking over the credit institutes could be checked "at least in part".

Possibilities of the supervision to limit additional costs due to the regulation



Source: KPMG, 2013

Some study participants emphasised the additional cost that results from the fact that European regulation projects that have not yet been concluded have already been anticipated at national level. The willingness of the national legislator to implement many regulation projects not only faster ("front running") but also more comprehensively in places ("gold plating") than originally envisaged through international boundary regulations was also criticised in particular. At the internationally active banks, the resulting requirements are multiplying as a result of deviating national regulations and scope for interpretation in the implementation of international specifications.

For instance, in the view of the participants, it would have been target-oriented with regard to the law on the redevelopment and handling of credit institutions to wait for the insights of an impact study on the so-called Liikanen report and the formulations of the corresponding EU restructuring guideline. Here, a "national forge ahead" should already be avoided because additional costs are incurred by the banks with the preparation of such templates. If national laws are revised and adjusted again in the course of the European regulation within a very short space of time, planning uncertainty and unnecessary costs result.

A greater harmonisation of the globally different regulation activities of supervisory authorities and institutions was unanimously emphasised by the internationally active credit institutions. A consistent regulation system appears necessary in which the measures are tailored to one another at national, European and international level and standards are enforced at a uniform level. To safeguard the same conditions of competition, it would, for instance, be necessary that the US and Europe decide on regulation measures at the same time and largely identical with regard to content. This applies in particular for the implementation of Basel III and the capital market regulation (for instance derivatives).

However, smaller or only nationally active banks want a greater differentiation between the institutions in the scope of the supervisory application of regulations, and even in the formulation of regulatory requirements, the notion of proportionality should be given greater weighting. Taking into account the size of the institution and business model, accordingly, the size-related reliefs should be extended and the principle of proportionality be applied in particularly also towards the requirements in reporting, which are felt by many participants to be excessive.

In the naming of further measures that regulators and supervisory authority should take to limit the additional costs arising from the regulations, the banks regularly want greater consideration to be taken of the "time" factor. "The schedules in the entry into force of regulation specifications should facilitate realistic and timely implementation phases." With regard to existing practices, this initially meant an extension of implementation deadlines. Secondly, transitional periods actually granted by the regulation should be complied with by the supervisory authority in order to give the credit institutions the possibility of structural adjustment to new specifications. The EBA equity stress test in

"Timely impact analyses of regulatory measures to be implemented

Analysis of the interaction of regulatory measures

Less 'subsequent improvements' after a brief period of time

Wait for impact before new regulations are commenced (example: open-end real estate fund)

Create options for implementation that the institutions can implement depending on organisation (for instance consulting minutes or recording of telephone calls)

Compliance with other laws that hinder implementation (for instance data protection in the recording of telephone calls)

Conceptual planning of international regulations that constantly define the requirements under supervisory law over a lengthy period of time and do not present the institutes continuously with implementation and management challenges.

Coordination of the regulatory/statutory requirements with one another in the respect that greater convergence is facilitated between the internal controlling, the accounting and the reporting under supervisory law."

Quotes from study participants on possibilities for improvement in the regulation

"Currently, it is being shown that requirements of existing regulations (here Basel II) are being increased at will in ongoing audits. Requirements are simply tested in audits, without there being any communication in this regard in the run-up. In places, the new interpretation is also in a difficult-to-understand ratio to the underlying risk situation. The new interpretation is also partially not in an easy-to-understand ratio to the underlying risk situation. In part, an expedient risk valuation is prevented by the reinterpretation of individual paragraphs. Unplanned additional costs are created in order to cover these topics as expediently as possible nevertheless. In addition, the treatment of the topics is unsatisfactory with regard to risks."

Quote from study participant on purpose of regulation and cost of implementation

2011 was named as an entirely negative example here which to all intents and purposes brought components of the Basel III equity requirements forward by years.

In addition, sufficiently lengthy preparatory periods for the necessary technical implementation are seen as necessary, whereby these deadlines should also really not start to run until after a final definition of the requirements. Furthermore, earlier implementation ordinances and technical standards would be helpful to be able to prepare for specific requirements in IT and organisation.

Even if no single study participant questioned the regulation as such, several voiced their doubts that the technical possibilities of the banks are not always addressed in the formulation of requirements. From the banks' perspective, the purpose of the regulation can be reached more quickly and at a lower cost if the dialogue with the banks is intensified further in the run-up to the new regulation. The specific requirements of implementation and/or the question of which implementation will be seen as "appropriate" pursuant to the supervision should be clarified beforehand. There is a reminder with regard to considerations of proportionality by the participants which in addition to the purpose of the regulation also take into account the costs from the implementation and application of the regulation. This not only relates to the regulations themselves but in particular also to the specifications by the supervisory authorities. In addition, before the decision regarding new drastic measures, the implementation and then also the consideration of impact studies is fundamentally also requested.

6 Conclusion and Outlook

The results of the study show that the regulatory initiatives of the last few years have generated important progress in improving financial market stability. Banks have reduced their high-risk business activities and developed substantially higher capital and liquidity reserves. They have adjusted their business models and are increasingly concentrating on business with private and commercial customers again.

However, the implementation of the new regulations and their application entailed and still entail high costs. Only a small part of these results from the one-off investment costs for the implementation of new requirements and the ongoing additional administration costs based on new requirements. Rather, the higher capital and liquidity costs constitute the largest cost block. Due to the economic environment, banks are currently faced by considerable challenges anyway of continuing to operate in a long-term profitable manner. The costs from the regulation are increasing the pressure additionally.

Consequently, the credit institutions see it as necessary that future further developments, such as the financial transaction tax, the leverage ratio or the new Basel requirements of risk reporting and the risk data set pursuant to BCBS 239, are driven forward with a sense of proportion. From the banks' perspective, the supervision with future regulation projects should have a stronger focus on the implementation costs. Particularly important aspects for the banks are initially the consideration of the varying complexity of the different companies and secondly the international coordination of the regulations, the consistency of the different regulations amongst themselves and appropriate deadlines for implementation. Distortions of competition should also be prevented between financial market participants and financial centres; these could result, among others, in the bank business moving into non-regulated areas.

Glossary

Examples of regulations – Brief description of the laws, provisions, standards or initiatives mentioned by name in the study*

Selected regulations in brief form/abbreviation	Official name	Description of content
Bank levy	Ordinance regarding the collection of contributions to the restructuring fund for credit institutes	Amount of the bank levy pursuant to business volume, size and networking of the credit institution liable for contributions in the financial market
Basel III	Global regulatory framework for capital and liquidity	Framework specifications for a tightening of the globally valid rules for equity and liquidity, supervisory authorisations and risk management
CRD IV/CRR I	Capital Requirements Directive/ Regulation	Legislative package for the implementation of Basel III, EU reform of capital adequacy and banking supervision: regulation with direct commitment effect, directive for the implementation in national law
EBA/ESMA standards	Regulatory/Implementing Technical Standards (for instance CRD IV/CRR, EMIR)	Technical regulation and implementation standards with direct legal validity throughout Europe
EMIR	European Market Infrastructure Regulation/Regulation on OTC derivatives, central counterparties and trade repositories	Directive on OTC derivatives, central counterparties and transaction register for the increase of transparency and reduction of counterparty risks in derivatives trading
Fundamental Review Trading Book	Fundamental review of the trading book	Revision of the treatment under supervisory law of the market risk in the trading book
IFRS innovations	International Financial Reporting Standards (for instance IFRS 9: Financial Instruments, IFRS 10: Consolidated Financial Statements, IFRS 13: Fair Value Measurement and others)	Changes in central areas of the accounting, such as financial instruments, Group accounting or valuation methods
4. MaRisk amendment	Minimum requirements of risk management	Principle-based specifications for the formulation of the risk management with innovations for capital planning process, compliance function and invoicing systems for liquidity costs and risks
MiFID II	Markets in Financial Instruments Directive/Regulation	Directive/Regulation about markets for financial instruments (trading, derivatives, market infrastructures, investor protection)
Modernisation of reporting/FINREP and COREP	Modernisation of the bank supervisory reporting/implementing technical standards on supervisory reporting requirements for institutions: financial and common reporting	Detailing of the national reporting for financial data and introduction of a standardised equity and solvency reporting throughout Europe
Audits in accordance with § 44 of the German Banking Act (KWG)	Banking Act, § 44 information and audits by institutions	Special audits of the supervision, issuing of information about all business matters and documents
Recovery & Resolution/ MaSan	Framework for the recovery and resolution of credit institutions and investment firms/Minimum requirements of the formulation of restructuring plans	
Interest change risks in the investment book	Interest change risks in the investment book	Determination of the impact of unexpected interest changes (interest shock scenario calculation and reporting)

* Status September 2013

Responsible regulation authority/ setter of standards	Status	(anticipated) entry into force
National – Legislator/FMSA Federal Agency for Financial Market Stabilisation	in force	2012
International – BCBS Basel Committee on Banking Supervision	in implementation	in Germany/Europe 2014
EU – Commission/Council and Parliament	in force	2014
EU – Commission/EBA European Banking Authority/ESMA European Securities and Markets Authority	in consultation/in implementation	2014 f.
EU – Commission/ESMA European Securities and Markets Authority	in force/in implementation	2013 f.
International – BCBS Basel Committee on Banking Supervision	consultation finished	
International – IASB International Accounting Standards Board	in consultation/in implementation	(2013 ff.)
National – BaFin Federal Financial Supervisory Authority	in force	2013 f.
EU – Trilogue	in final discussions	2015
National and EU – BaFin and EBA	in consultation/in implementation	2014 ff.
National – Legislator/BaFin – Bundesbank	in force	continuous
EU and national – Commission and BaFin	in consultation	2014 ff.
National – BaFin	in force	2012

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