Timothy D. Adams
President and CEO

December 1, 2020

Mrs. Mairead McGuinness
Commissioner
Financial Stability, Financial Services and the Capital Markets Union
European Commission
Rue de la Loi 200
1049 Brussels
Belgium

RE: IIF financial services regulatory priorities for consideration and engagement

Dear Commissioner McGuinness:

My colleagues and I at the Institute of International Finance ("IIF") congratulate you on your appointment on October 16 as European Commissioner for Financial Stability, Financial Services and the Capital Markets Union and wish you every success in your new role and mandate as member of the College of Commissioners.

The IIF would appreciate the opportunity to continue to engage constructively with you and your team at the European Commission ("Commission"), as we have done with your predecessors, including Executive Vice President Valdis Dombrovskis. We stand ready to support progress on shared priorities for a resilient and efficient financial system and contribute to the European debate with the perspective of the global financial services industry which supports open markets and the benefits of cross-border coordination and consistency, with the view of enabling financial integration and growth. The IIF shares the goals of a resilient, stable and strong EU financial sector that can provide efficient financing to the economy, support economic growth, and contribute to a low-carbon and digital transition. These goals have become even more critical as a result of the impact of COVID-19 on societies across the world, and the urgent need for coordinated steps to address the interlinked challenges of a green recovery. We commend the EU responses to the COVID-19 crisis and the Next Generation EU plan which can be seen as a turning point in European integration and an enabler of inclusive growth across the EU. We also support the more specific agenda related to financial services, including the relaunching of the Capital Markets Union, the Renewed Sustainable Finance Strategy, the Digital Finance Action Plan, the revision of the Anti-Money Laundering framework, among other areas of strategic interest for our European and global members. We are eager to support your work where we can, and as appropriate.

1. Supporting a green transition

The IIF commends the ambition of the new Commission's flagship European Green Deal and is supportive of the Commission's ambitious efforts to further articulate a strategic agenda for how the financial sector can support green recovery objectives. The IIF stands ready to contribute to European efforts to scale up financing for the transition through investments in green technologies, sustainable solutions and new businesses, to achieve the ambitious goals of the Paris agreement. We concur with the Commission that the Green Deal can be a strategy for significant EU growth, and we are committed, as an international organization, to spread broader awareness and foster international convergence in this area.

1333 H Street NW #800E • Washington, D.C. 20005 • 202.857.3600 • www.iif.com • @IIF

The IIF and its membership support the Commission's ambitious work on Sustainable Finance. In general, we would encourage focused attention to the role of the financial system and markets, within which banks play a key role, in financing the transition to a low-carbon, resilient economy, particularly given the importance of bank credit in the EU economy. Furthermore, we support the Commission's intention to consider the need for further corporate environmental, social and governance ("ESG") disclosures by corporates, through the revision of the Non-Financial Reporting Directive, as an essential input to the finance industry's ability to support those important objectives. To this end, the IIF has recently submitted responses to the Commission's consultations on the revision of the European Union Non-Financial Reporting Directive and the Renewed Sustainable Finance Strategy (see Annex section A) and stands ready to work collaboratively to support the development of forthcoming policy instruments.

The IIF is honored to be an official stakeholder of the Network for Greening the Financial System ("NGFS"), which includes several European central banks and supervisory authorities as well as the Commission. Our goal is to offer global industry views and experience to arrive at practical technical solutions that allow the industry to scale up investments in the most promising solutions at the international level. Given the global nature of climate change, the ensuing regulatory regime should be applicable globally and we note the leadership role the Commission has taken, including with respect to the creation and work of the International Platform on Sustainable Finance ("IPSF"). The IIF appreciates the urgency and the worldwide scale of the challenge and fully supports the Commission and European authorities to play a key role – not only via the NGFS and the IPSF, but also through global standard setters such as the Financial Stability Board ("FSB"), Basel Committee on Banking Supervision ("BCBS") and International Association of Insurance Supervisors ("IAIS") – in sharing knowledge and findings to avoid regulatory and supervisory fragmentation on sustainability-related matters and to help generate efficiencies given limited resources among regulators and the industry.
Over the course of this year, the IIF's work on sustainable finance has evolved in response to changing market and policy contexts—in particular the COVID-19 pandemic, which highlighted how sustainable finance is a vital channel to kickstart a green and socially-inclusive recovery. A detailed overview of our broader work on this critical agenda is available in Annex section A.

2. Achieving a risk-sensitive regulatory capital framework

The synchronized international implementation of the final Basel III framework, as developed by the BCBS, is an important objective. However, this coordinated implementation should be anchored in a global framework that remains appropriately structured and is calibrated for the risks being addressed. The IIF has always supported an efficiently designed risk-sensitive framework, including the use of appropriate internal models and notes that the final Basel package has ultimately become, in some elements, less risk sensitive, which may lead to a misalignment of requirements with risk profiles in specific jurisdictions.

The COVID-19 health crisis has also led to significant challenges in the global economy and for the financial system, with massive transformations in size and structure of balance sheets as banks have provided much needed support to the economy through lending and market making. It will be very important to consider the impact of the COVID-19 crisis and to evaluate the performance of the Basel framework during this period of stress. We welcome the Call for Advice that the Commission has sent to the EBA for a revised impact study, which will help inform the Commission and the EU co-legislators. We also welcome the statement by the BCBS on September 25th that it intends to conduct a range of empirical analyses to examine the COVID-19 crisis and to evaluate the post-global financial crisis reforms; whether there are any gaps in the regulatory framework and whether there may have been any unintended effects, and we intend to contribute actively to this important project.

1333 H Street NW #800E • Washington, D.C. 20005 • 202.857.3600 • www.iif.com • @IIF

As you may be aware, for many years now the IIF has led the most comprehensive industry study analyzing the potential impact of the final Basel III standards. The IIF will again be undertaking this work in the coming period and we intend to examine how the capital framework has behaved during the COVID-19 crisis (including the usability of the various capital and liquidity buffers) in order to support the work of the BCBS and to constructively inform the Basel review process. This will help to determine how the Basel framework performs under stress, to identify any unintended consequences and to reveal those areas of the framework that may be worthy of further targeted review.

Where possible we believe the BCBS should develop global responses to known issues in order to minimize the risk of regulatory fragmentation, and we encourage all major jurisdictions, including the Commission to support the BCBS in achieving this objective through an implementation of Basel III, both in substance and timing. That being said, the Basel III framework also includes several areas of discretion to accommodate local circumstances. We encourage the Commission to ensure that its decisions on those reflect the characteristics of the European financial sector with a view to avoiding undue impact of the Basel III framework, which studies by the EBA and others have estimated to be significantly burdensome in this regional jurisdiction as detailed in appendix section B.

We commend the swift and effective response to the COVID-19 crisis implemented by the Commission, notably the so-called CRR Quick Fix, which was proposed and voted on in record time, and provided European banks with the flexibility embedded in international standards. We welcome additional flexibility provided to the Competent Authorities in areas such as the VaR multiplier, in line with global standards. We note however that the legislative process led in many instances to compromises that were reducing the benefit of international guidance for European banks. We recommend the Commission to be vigilant to the risk of fragmentation linked to uneven implementation of COVID-19 responses. At this stage, it is already apparent that the full impact of the COVID-19 crisis is not yet quantifiable, nor will it be uniform: regions will be impacted in different ways and there will be differences in the rates and timing of recovery between regions. Therefore, it will also be important that, in seeking to ensure a consistent global crisis response, these differential impacts and timing issues are appropriately considered and taken into account, including in determining an appropriate roadmap for a 'transition to normal' (i.e. the reestablishment of prudential standards and measures to their pre-crisis level) including the exit from temporary measures and the replenishment of capital and liquidity buffers if they are utilized. The impact of the crisis will continue to unfold and impact the economy and we trust that the Commission, in close liaison with its international and European partners, will continue to monitor the situation closely and will react promptly with an extension of measures or additional targeted measures as they may become desirable to facilitate the recovery and minimize the social cost of this unprecedented crisis. The IIF looks forward to working with the BCBS, as well as regional regulatory authorities including the Commission, European Central Bank (ECB) and European Banking Authority (EBA), in ensuring that the international standards continue to be appropriately calibrated and globally supported.

3. Avoiding market fragmentation

Financial markets are experiencing increasing levels of fragmentation, and as such we support the important work being done in this area by the G-20, FSB and the International Organization of Securities Commissions ("IOSCO") as they seek to address divergences in regulatory frameworks that could impede the development and diffusion of beneficial innovations in financial services, and limit the effectiveness of efforts to promote financial stability.

In regard to European market fragmentation, it is critical that we welcome the Commission's efforts to accelerate the completion of the European Banking Union ("EBU") and to overcome the intra-EU home-host fragmentation or 'ring-fencing' of capital and liquidity of cross-border banking groups. This would enhance the European credit institutions' standing in the eyes of international capital markets, truly recognizing their pan-EU nature, and thus equally strengthening the external role of the euro. Permitting such efficiencies within the eurozone, if not within the EU, would also remove an impediment to cross-border consolidation achieving economies of scale that would enhance the profitability of banks.

In addition to completing the Banking Union, we support the Commission's Action Plan to accelerate the much-needed creation of a European Capital Markets Union ("CMU"), to stimulate diversified funding sources to the European economy as well as allow a broader distribution of risk across private sector actors. The EU should pursue globally coherent and consistent regulation underpinned by cross-border regulatory and supervisory co-operation, ensuring the free flow of capital within, into and out of Europe. In particular, we support the goal of strengthening public equity markets through reforms to the initial public offering process and by improving the securitization framework that would also contribute to the private risk-sharing objective.

In addition, different national standards, especially in terms of anti-money laundering and countering the financing of terrorism ("AML/CFT"), act as a barrier for cross-border customer on-boarding and help to explain why cross-border financial services cannot play a more significant role.

4. Addressing cyber risk and building up operational resilience

Effectively managing cyber risk also is a shared priority for both financial institutions and authorities given the increase in the number, scope and sophistication of attacks, and potential serious financial stability impacts. Firms are investing substantial resources into protecting themselves against cyber events and collaborating closely with other firms, third party vendors and the public sector to identify, mitigate and recover from cyber incidents. The EU National Cybersecurity Strategy ("NCSS") plays a key role in helping member states and the financial sector tackle and address these risks. As cyber risk continues to develop, it is important to formulate principles-based and risk-based approaches that make it easier for firms, their counterparts and the official sector to work together to quickly address cyber incidents and prevent them from further impacting the overall financial system. As such, the IIF welcomes the release of the Commission's Digital Operational Resilience Framework for financial services ("DORA").

Public-private partnerships around information-sharing and strategic coordination should be encouraged and prioritized. Similar to the AML/CFT data sharing challenge, it will be important to explore new models of information-sharing of cyber incidents among authorities and between firms.
Over the past two years, authorities have also increased their focus on operational resilience issues, in part due to enhanced cyber risk and threats around data corruption. Financial institutions, in turn, are heavily focused on both reducing the probability and impact of disruptions to business services, and on how best to deliver services continuously – or as quickly as possible – to customers when such disruptions occur. The most substantial work thus far has been undertaken by the BCBS and the UK, which have both released consultations, and we expect other regions to follow. Given the importance of this work, the IIF welcomes the EU's own proposal ("DORA") and the recognition it gives to supervisors working in a harmonized and convergent manner across Member States as well as across different parts of the financial sector. It would remain important for the Commission to play an active role in the formulation of such supervisory approaches to operational resilience maturity, including within the BCBS, that are in close coordination with global approaches so as to avoid fragmentation on what is a cross-border issue. In this respect, we welcome engagement with the Commission on its plan for a cross-sectoral financial services act on operational and cyber resilience.

1333 H Street NW #800E • Washington, D.C. 20005 • 202.857.3600 • www.iif.com • @IIF

5. Promoting a balanced and sound digital policy framework

Changes in the landscape for financial services are becoming more acute as artificial intelligence (AI)/machine learning, cloud computing, automation, digital platforms, super-computing, and 5G connected devices expand their role in the economy. This presents two major sets of challenges for the financial services industry, with accompanying policy considerations: first, asymmetrical frameworks across sectors that can impede partnerships and distort competition; second, the ability to experiment, innovate and keep pace with the adoption of these technologies; and third, a need for consistency and commonality across borders in an inter-connected digital world.

The IIF urges the Commission to work with the financial services industry to support the necessary investment in digital transformation of the sector. More specifically, we welcome that the Commission has set forth a regulatory framework that takes a horizontal approach to a data framework that can include comparable activities as well as institutions within its perimeter – i.e., that the same risks and activities are subject to the same rules. The IIF also supports the Commission in its effort to put in place a data or information sharing framework that is cross-border and cross-sectoral to release the full potential of the use of technology. We also stress the criticality of digital identity as an enabling technology in the digital economy, in particular for small businesses seeking to participate in an eCommerce world, with an important need for public-private cooperation and interoperability.

We also urge close consultation with the financial services sector on the potential development of central bank digital currencies ("CBDC"), in particular noting developments such as the ECB's recent discussion paper and consultation on a potential 'digital euro'. We encourage further examination and the full understanding of the key design considerations, and the potentially impacts for the retail deposit base that is so central for banks' funding, to both (i) provide credit into the economy, and (ii) satisfy regulatory requirements for liquidity.

6. Enhancing the framework for combatting financial crime

Combating financial crime remains a top priority for both the private and the official sector and one where our interests are aligned. While challenges remain, the commitment of the global financial industry to effectively fight financial crime remains strong. We are pleased to see the policy considerations put forward by the Commission already in the AML/CFT Action Plan which enhances the framework with further coherence and consistency in the implementation of the Union rulebook and by improving the effectiveness of the regime, such as through better financial crime information sharing among banks and between authorities and banks and through congruous customer due diligence and monitoring requirements. To that end we welcome the initiative to introduce a common, enforceable regulatory standard at an EU-wide level that also consistently addresses gaps in the EU AML/CFT architecture.

There is also a need to ensure the underlying global Financial Action Task Force ("FATF") standards and guidance are developed and implemented in a way that increases global effectiveness in the fight against financial crime. Here again, active European Union engagement on these issues within the FATF would be invaluable.

1333 H Street NW #800E • Washington, D.C. 20005 • 202.857.3600 • www.iif.com • @IIF

In conclusion, we would encourage the Commission to continue pursuing these important policies which we believe are instrumental in allowing the financial sector to contribute and support the goals of a robust, resilient, and green EU economy. The IIF and its members look forward to engaging with you and your fellow Commissioners in the Von der Leyen Commission. We stand ready–in Washington, DC and in our Brussels-based European Representative Office (led by my colleague Robert Priester)–to assist you across these important regulatory priority areas.

Very truly yours,

Timothy D. Adams
President and CEO
Institute of International Finance (IIF)

1333 H Street NW #800E • Washington, D.C. 20005 • 202.857.3600 • www.iif.com • @IIF

ANNEX to IIF letter of November 2020 to European Commissioner McGuinness on financial services regulatory priorities for consideration and engagement

A. Supporting a green transition

The IIF is keen to contribute to international discussions on sustainable finance and work collaboratively with the regulatory and supervisory community. The IIF Sustainable Finance Working Group ("SFWG"), comprising over 175 firms from the IIF's commercial and investment bank, asset manager, and insurance members, has actively engaged with a range of official sector entities including the G20 and B20, the United Nations ("UN"), the World Bank and the International Finance Corporation ("IFC") and other multilaterals, national authorities and the global regulatory and supervisory community. The IIF SFWG is honored to be an official stakeholder of the NGFS[1], and continues to work closely with the member authorities to build the tools for a common understanding.

The IIF is actively leading and supporting cutting-edge initiatives on environmental priorities. One of these initiatives is the *Taskforce on Scaling Voluntary Carbon Markets (TSVCM)*, which was formally launched on September 2.[2] The TSVCM was initiated by Mark Carney, UN Special Envoy for Climate Action and Finance Advisor to UK Prime Minister Boris Johnson for COP26, and is chaired by Bill Winters, Group Chief Executive, Standard Chartered, and sponsored by the IIF. The Taskforce has over 50 members from six continents with expertise across the carbon market value chain, including buyers and suppliers of carbon offsets, as well as market infrastructure providers and financial sector firms. The Taskforce is taking stock of existing voluntary carbon markets and efforts to grow these markets, identifying key challenges, impediments, and innovative solutions. A draft interim report will be released for public consultation on November 10. The final Blueprint will be launched in January 2021, with the aim of catalyzing action through a broad coalition of market actors committed to implement its recommendations.

Given the global nature of climate change and sustainable finance activities, we believe that regulatory and policy initiatives are more effective if they are harmonized and aligned internationally. As regulatory and policy initiatives around sustainable finance multiply, including on taxonomy, supervisory expectations and scenario analysis approaches, international collaboration and coordination is vital to avoid undesirable market fragmentation. We believe that such collaboration will help promote consistent mainstreaming of sustainable finance, and ultimately a safer and more stable financial industry that is equipped for the future needs of society and the global economy.

The IIF submitted a response to the Commission's public consultation on the revision of the EU Non-Financial Reporting Directive.[3] Based on IIF research on the fragmented ESG disclosure framework, we urged that steps should be taken to develop a harmonized cross-sectoral framework for ESG disclosure across jurisdictions. The IIF also submitted a response to the Commission's public consultation on the development of a Renewed Sustainable Finance Strategy.[4] The IIF welcomes the ambitious undertaking, which will set the groundwork for future measures to rapidly scale up flows of sustainable finance in support of a green recovery. The IIF believes that the Commission should work through formal global channels to promote harmonization of key evolving agendas in the sustainable finance

---

[1] Description and publications of IIF SFWG can be found here https://www.iif.com/Advocacy/Policy-Issues/Sustainable-Finance-Working-Group-SFWG

[2] https://www.iif.com/tsvcm/Main-Page/Publications/ID/4061/Private-Sector-Voluntary-Carbon-Markets-Taskforce-Established-to-Help-Meet-Climate-Goals.

[3] https://www.iif.com/Publications/ID/3947/IIF-Response-to-EU-Review-of-the-Non-Financial-Reporting-Directive

[4] https://www.iif.com/Publications/ID/4011/IIF-Response-to-EC-Consultation-on-a-Renewed-Sustainable-Finance-Strategy

space, including ESG disclosure standards, climate-related scenario analysis exercises, taxonomies, and definitions.

Addressing data gaps, as well as analyzing, measuring, and disclosing climate change risks, are indispensable first steps in tackling climate issues appropriately. The IIF has strongly supported the Task Force on Climate-related Financial Disclosures (TCFD) recommendations by encouraging adherence to this disclosure framework. While progress has been made, there is significant room for improvement, both in the take-up of the recommendations and in making the content more consistent and comparable. In collaboration with the UN Environment Programme Finance Initiative (UNEP-FI), the IIF has recently completed the first phase of a project to develop a "TCFD Playbook."[5] This Playbook provides insight into the 11 disclosures of the TCFD framework, in order to drive greater consistency and advance industry consensus on technical aspects of disclosures. We also plan to develop standardized templates for TCFD disclosures by financial institutions. Recognizing that these institutions will need flexibility on exactly how they seek to disclose climate-related information, these templates will provide a consistent format and enable harmonization of the delivery of quantitative data on climate risks and opportunities. We are also engaging to support progress on ESG disclosure in other areas, including efforts to initiate a Taskforce for Nature-related Financial Disclosures.

We would also like to draw your attention to the current proliferation of climate risk analysis exercises within the EU and beyond (e.g., the UK), which could lead to fragmentation, slower progress on technical capacity building within the public and private sectors and, ultimately, to potentially diverging frameworks. Given that climate issues call for increasing urgency, the IIF strongly urges further international collaboration between the industry and the regulatory community in developing relevant analytical frameworks and approaches. The IIF is currently doing work on how the prudential regime for climate risks should look like, where the limits of the current framework may be, and how it may need to evolve, with the goal of formulating recommendations geared toward achieving greater consistency in the emerging prudential supervisory framework. Given that both regulators and financial firms want to better understand risk profiles to ensure effective management of transition and physical risks – as well as ensure firm safety and soundness, and financial stability — we look forward to contributing to the discussion of these topics within the global standard setting bodies and with the EU authorities.

B. Achieving a risk-sensitive regulatory capital framework

The Commission will also oversee the implementation of the revised Basel III banking standards in Europe, for which the global implementation timetable has been delayed by one year due to the onset of the COVID-19 crisis. This is an extremely important topic for IIF members and the European banking sector in general. You will be aware of EBA's impact analysis, which showed the significant impact of the Basel III standards on banks in Europe. EBA's central impact assessment is a 20.2% increase in EU banks' minimum risk-based capital requirements.[6] In our next IIF industry study of the impact of the final Basel III standards, we intend to examine the impact of the COVID-19 crisis in order to support the work of the BCBS and to use our analysis and findings to inform constructively the Basel review process and, thereby, to inform regional regulatory authorities including the Commission.

We believe that the estimated impact of the final Basel standards is more significant than was initially anticipated by regulators when designing the global standards, and that some aspects of the framework may have unintended consequences on the EU banking sector's ability to offer critical services, such as lending to the real economy and helping end users to hedge financial risks. The COVID-

[5] https://www.iif.com/Publications/ID/4100/IIFUNEP-FI-TCFD-Report-Playbook

[6] See EBA estimates released on April 8, 2020. https://eba.europa.eu/eba-updates-impact-basel-iii-reforms-eu-banks%E2%80%99-capital-and-compliance-liquidity-measures.

1333 H Street NW #800E • Washington, D.C. 20005 • 202.857.3600 • www.iif.com • @IIF

19 crisis poses further challenges to the European economy and banking sector. Against the backdrop that the EU economy relies more heavily on a bank-based financing structure than on a market-based one it will be important in implementing the final Basel III package to ensure that where there are disproportionate impacts on the EU banking sector (for example in lending to unrated corporates or equity exposures), that the Commission supports the addressing of these matters and impacts including at the BCBS. The IIF and our members will continue to monitor and evaluate developments at the BCBS level and in key jurisdictions, including the EU and the US.

C. Position the European financial industry to compete in a global context

Financial firms around the world are undergoing radical transformation, driven by fundamental changes in technology and innovation. The European financial sector is not insulated from these trends. To remain a healthy and profitable sector over the long term requires banks to quickly transition to more digital strategies, business models and operations channels.

Boards are rightfully focused on the risks and opportunities of a digital world and ensuring that new technologies, including machine learning and AI, are effectively deployed across their businesses and operations. The European authorities and policymakers should see European financial firms in this context and help them in transforming the industry towards a new reality that can compete effectively with leading firms in other jurisdictions. As such, we welcome that the Commission has endorsed the EBA Regulatory Technical Standard on the partial non-deduction of software investment from CET1 that will incentivize banks to invest further and partially restore the level playing field with other key jurisdictions.

Given the global nature of financial services, and the connections between financial firms and economies all around the world, it is important that policies and regulations are coordinated globally. Europe plays a critical role in developing the standards at the FSB, the BCBS and other leading global standard-setters, and it is important that these standards are implemented faithfully and consistently in Europe, as across all jurisdictions.

There is no need to emphasize the benefits of an international and diversified financial sector for Europe, as it strengthens the overall resilience of the financial system and improves the funding capacity of the European economy during the different phases of economic cycles.

D. Completing the European Banking Union and the European Deposit Insurance Scheme

The European Banking Union is an ambitious project. By integrating the European banking market, the link between domestic economic developments and financial stability in each member jurisdiction would be eliminated. The first pillar, the Single Supervisory Mechanism ("SSM"), has already made big strides in streamlining supervisory practices and increasing comparability and transparency across the sector. The second pillar, the Single Resolution Mechanism, created a common resolution authority that is responsible for common rules and managing the Single Resolution Fund ("SRF").

While the first two pillars are in place and largely operational, it is now time to identify and agree on the overall architecture of the Banking Union that needs to be completed. By truly completing the Banking Union, including introducing a common insurance scheme, host jurisdictions within the euro area might feel less inclined to make use of prudential safeguards in their own jurisdictions.

The completion of the Banking Union and proper calibration of the SRF are central to the stability of the European financial sector, the funding of the European economy, and by extension the further consolidation of the banking sector. It is particularly encouraging that both the President of the Commission and the German Finance Minister have relaunched the debate to create a full Banking

Union, including - but not limited to - a common European Deposit Insurance Scheme ("EDIS"). While important challenges remain for the completion of the Banking Union, we encourage the EU authorities to continue employing their best efforts to find a compromise that would allow the completion of such a fundamental policy goal.

E. Avoiding market fragmentation

Financial markets are experiencing increasing levels of fragmentation, which can undermine the progress that has been made in re-building resilience of the global financial system since the financial crisis and can also result in negative consequences for economic growth and job creation. Furthermore, fragmentation resulting from excessive regulatory and supervisory divergence can trap capital, liquidity, and risk in local markets, create significant financial and operational inefficiencies resulting in additional unnecessary costs to end-users, and reduce the capacity of financial firms to serve both domestic and international customers. It is therefore critical that market fragmentation be addressed to avoid these consequences and the correlated impact on the global financial system and the world economy.[7] At the IIF we have identified examples of market fragmentation across four specific categories: Local Supervisory Measures and Ring-Fencing; Diverging Standards; Extraterritoriality; and, Obstacles to Cross-Border Cooperation and Information Sharing.

It is, therefore, very welcome that the G-20, FSB and IOSCO have launched new initiatives that seek to address divergences in regulatory frameworks that could impede the development and diffusion of beneficial innovations in financial services, and limit the effectiveness of efforts to promote financial stability. The IIF has organized forums around this topic, participated in FSB workshops, and produced staff papers and letters to contribute recommendations to the discussions on how to address market fragmentation.

As mentioned in the accompanying letter, it is critical to accelerate the completion of the Banking Union and to overcome the intra-EU home-host fragmentation or 'ring-fencing' of capital and liquidity of cross-border banking groups. Indeed, the recent supervision blog by Andrea Enria, Chair of the Supervisory Board of the ECB, and Edouard Fernandez-Bollo, Member of the Supervisory Board of the ECB, underlined the importance of improving the cross-border integration of banking groups, and recommended that the "heavy legacy of ring-fencing measures" be addressed to increase trust between national authorities.[8]

Resolution should be approached from a common position within the EU to help reduce market fragmentation in the areas of capital, Total Loss-Absorbing Capacity ("TLAC") and liquidity. When individual member states pre-position capital between them it further limits the ability of firms and home regulators to respond with group-wide resources during times of stress. The EU is so far the only jurisdiction that has chosen a "hard 90%" for calibrating internal TLAC, and 100% for banks from within the EU. This not only creates fragmentation within the EU but also makes it harder for banks in the EU to compete with other jurisdictions – including Hong Kong, Japan, Switzerland, the UK, and possibly the US – that have proposed calibrating TLAC at the lower end of the 75%-90% range. This calibration could potentially have significant consequences.

[7] IIF 2019. "Addressing Market Fragmentation: The Need for Enhanced Global Regulatory Cooperation" Jan. 2019.

[8] ECB 2020. "Fostering the cross-border integration of banking groups in the banking union" Oct. 9, 2020.

Perhaps by undertaking some measures such as completing EDIS, sufficiently capitalizing the SRF and harmonizing relevant parts of insolvency laws, home and host supervisors would gain sufficient comfort to reconsider the “hard 90%” approach to internal TLAC. This would also help motivate additional consolidation as banks could operate across borders in a more centralized and consistent approach.

This would enhance the European credit institutions’ standing in the eyes of international capital markets, thus equally strengthening the external role of the euro. Permitting such efficiencies within the eurozone, if not within the EU would also remove an impediment to cross-border consolidation achieving economies of scale that enhance the profitability of banks. A more credible integration of European banks in the eurozone would also increase the weight of the EU in global standards setting bodies as a truly single regulatory community.

This set of policy proposals represents a challenging task for authorities in Europe. However, the need for consolidation is increasingly urgent, which will only intensify further as new non-banking actors enter the market, primarily through new technologies. The ambitious agenda of the current EU Presidency (Germany) and the clear drive to complete the European Banking Union gives hope that such challenges can be addressed successfully.

Completion of the Banking Union would also contribute to the creation of the CMU, which will support diversified funding sources to the European economy as well as allow a broader distribution of risk across private sector actors. Enabling safe and transparent securitization of all asset classes of the balance sheets of European banks will help increase capacity for fresh lending and stimulate the secondary markets for such securities as a valuable contribution to help foster the CMU.

F. Addressing cyber risk and building up operational resilience

Cyber risk continues to be of critical importance for both financial institutions and authorities given the increase in the number, scope and sophistication of attacks, and potential financial stability impacts. As such, financial firms are investing substantial resources into protecting themselves against cyber events and collaborating closely with other firms, third party vendors and the public sector to identify, mitigate and recover from cyber incidents. There is also an increasing amount of regulation aimed at strengthening cyber-resilience across the financial services industry, including the recent release of DORA by the Commission. Although regulation can be an important tool in bolstering cyber resilience, it can also inadvertently increase cyber risk if regulatory approaches are conflicting, or resource draining, and more so if there is a lack of a unified approach to addressing cyber risk management for the overall financial services sector.

As such, the IIF supports global and cross-border approaches to cyber risk by the FSB, BCBS, IOSCO, IAIS and other global standard-setting bodies. The FSB’s cyber lexicon provides a common language that is helpful for industry and policy makers, and the industry-led Financial Services Sector Profile offers a useful method for helping internationally active firms map all their cyber requirements across a variety of global standards and regulations. The IIF supports public-private partnerships, where industry and authorities can cooperate around information sharing and strategic coordination. Cross-border efforts, such as the TIBER-EU Framework and Financial Services Information Sharing and Analysis Center (“FS-ISAC”), are especially valuable as the threats are often global, impacting institutions in many jurisdictions.

Authorities across the world have increased their focus on operational resilience issues, in part due to enhanced cyber risk and threats around data corruption. Financial institutions, in turn, are heavily focused on not only reducing the probability and impact of disruptions to business services, but on how best to deliver services continuously to customers when such disruptions occur. In October 2019,

1333 H Street NW #800E • Washington, D.C. 20005 • 202.857.3600 • www.iif.com • @IIF

the IIF and GFMA released together a set of "Discussion Draft Principles Supporting the Strengthening of Operational Resilience Maturity in Financial Services." These principles support the financial industry's efforts to continuously improve and strengthen the level of operational resilience for the firms, the customers, markets, the sector, and the broader economies they support nationally and across the globe.[9] The IIF has stressed these same priorities in consultation responses to the BCBS, UK and other stakeholders.

The IIF encourages the EU to work closely with the BCBS in formulating an approach that remains risk- and principles-based enabling firms to have the latitude to use their judgement and discretion to identify critical business functions, impact tolerances, and scenarios or types of disruptions that are the most relevant and proportionate to their business and risk profile, as well as the evolution of risk(s).

G. Promoting a balanced and sound digital policy framework

The IIF continues to focus heavily on the key data policy issues, including data privacy, cross-border interoperability, data exchange via frameworks such as Open Banking, sophisticated data analytics enabled by machine learning, and effect and secure data management via cloud. The COVID pandemic and the accelerated process of digitalization has added further urgency to these topics.

The importance of symmetrical obligations amongst all firms, from all sectors continues to be an essential priority, for ensuring adequate consumer protection and for addressing the new risks introduced by new entrants that focus on monetizing customer engagement platforms and data. The IIF will shortly also publish the results of our survey on Machine Learning Model Governance, exploring how models are tested and validated, the safeguards built into software, the types of data and methods used, and considerations for bias, ethics, and explainability. It will help in assembling a suite of good example practices (emphasizing that there is not a singular "best" practice) that can form the basis of a more agile and dynamic approach to supervision, as we have proposed to the EBA and national competent authorities.

We also continue our focus on data localization, cloud, and quantum computing. The IIF is working to quantify some of the adverse impacts of data localization measures in local economies, noting where the pandemic has demonstrated the crucial ability to move data and utilize multiple sites as an enabler for continuity of services. We similarly note the vital role of cloud in supporting continuity, but more so cloud's role in enabling the types of analytics needed in a rapidly-digitized competitive economy. We also note that the institutions that are most advanced in cloud are generally also the firms that are most prepared for the Quantum era, an important consideration both for the opportunities for next generation modelling, and concerns regarding preparedness for post-Quantum encryption.

The IIF-Deloitte Realizing the Digital Promise series has examined the key challenges, success factors and COVID impacts on digital transformation, where this has become more vital for ensuring a firm's ongoing viability in the new environment. In line with our key issues described above, the most common barriers in transformation include challenge in mobilizing partnerships between financial institutions and tech firms, inconsistencies in data regimes across borders and across sectors, and specific areas where regulation may be outdated or insufficiently agile.

The IIF continues to monitor developments with digital currencies, in particular the invigorated focus on CBDCs. We refreshed our analysis of the 'asymmetric disintermediation' risk under particular design scenarios in our *Money Redesigned* paper on the potential impacts on 'stable' deposit funding from both technology platforms for consumer finance and particular CBDC models, including that proposed

[9] IIF-GFMA 2019. "IIF and GFMA Release Joint Discussion Draft Principles Supporting the Strengthening of Operational Resilience Maturity in Financial Services" October 7, 2019.

1333 H Street NW #800E • Washington, D.C. 20005 • 202.857.3600 • www.iif.com • @IIF

in Sweden, and now also of the ECB.[10] We also welcome the Commission's proposal for a pilot regime to safely test crypto asset solutions, the design of which will be critical, so that it drives innovation, addresses regulatory barriers, provides regulatory certainty, and lays the foundations for the growth of a secondary market for security tokens.

H. Enhancing the framework for combatting financial crime

The real and present threat of criminal incursion into legitimate financial intermediation needs to be dealt with on a consistent, international basis. Though this global fight against financial crime is of paramount importance, the current AML/CFT framework is not as effective as it should or could be. The amount of money laundered globally each year is estimated at 2% to 5% of global GDP, or between EUR 715 billion and EUR 1.87 trillion.[10] Less than 1% of illicit financial flows estimated to occur in the EU alone are intercepted.[11] Cross-border criminal finance supports some of the worst problems confronting society today; including money laundering, terrorism, sexual exploitation, modern slavery, wildlife poaching and drug smuggling. The sheer size of the issue poses a risk to global financial stability. While we fully recognize that the private sector has a vital role to play in enhancing financial institutions' internal capacity to detect financial crime and adhere to the highest standards, the July 2019 Commission's Communication on these issues[12] points to significant gaps in effectiveness of the EU AML/CFT regime that would benefit from change.

The Commission's Action Plan on AML/CFT aims to address many of these gaps and we support the work of the Commission in this area. As we stressed in our response to the Action Plan Consultation, there is an urgent need to ensure that all relevant authorities effectively and consistently address the risks arising from money-laundering and terrorist financing and cooperate to share information that will help safeguard international finance against illicit use. A more coordinated common and enforceable framework in the EU for implementation and oversight of measures used in combating threats to the integrity of the financial system is imperative. The recent European Supervisory Authorities' joint guidelines[13] on information exchange between the competent national authorities is a step in the right direction.

Specifically, we believe the EU AML/CFT policy architecture would benefit from reform in the following key areas: 1. Greater consistency in AML/CFT requirements across EU Member States through common EU standards and worldwide through the FATF; 2. The adoption of improvements to the EU legal framework addressing domestic and cross-border information sharing, and the promotion of domestic and cross-border public-private partnerships, Suspicious Activity Reporting ("SAR") reform and beneficial ownership information reporting reform; and 3. Enhancements to the use and adoption of technology in fighting illicit finance.

---

[10] United Nations Office on Drugs and Crime ("UNDOC"): https://www.unodc.org/unodc/en/money-laundering/globalization.html.

[11] Europol, *Financial Intelligence Group Report, From Suspicion to Action – Converting financial intelligence into greater operational impact*, September 2017.

[12] European Commission, *Communication: Towards a better implementation of the EU's anti-money laundering and countering the financing of terrorism framework*, July 2019.

[13] Joint Committee of the ESAs, Joint guidelines on cooperation and information exchange for the purpose of Directive (EU) 2015/849 between competent authorities supervising credit and financial institutions, December 2019.

The recommendations outlined above are consistent with those formulated by the IIF in its recent report "The Global Framework for Combating Financial Crime"[14] which has put forward specific ideas in order to increase effectiveness in the global AML/CFT framework. In the report the following systemic improvements for financial crime risk management were outlined:

a. Advancing public-private partnerships;
b. Improving cross-border and domestic information sharing;
c. Improving the use and quality of data;
d. Reforming suspicious activity reports (SARs);
e. Mitigating the inconsistent or incoherent implementation of financial crime compliance standards and guidance, and providing regulatory clarity; and,
f. Increasing and improving the use of technology to combat illicit finance.

We believe all these recommendations have important specific EU dimensions and we look forward to working with the Commission and the other EU Institutions and Authorities on improving AML/CFT frameworks to ensure maximum effectiveness as legislative proposals are tabled in 2021.

-/-

[14] IIF, Publication with Deloitte entitled The Global Framework for Fighting Financial Crime: Enhancing Effectiveness Improving Outcomes, November 2019.

1333 H Street NW #800E • Washington, D.C. 20005 • 202.857.3600 • www.iif.com • @IIF