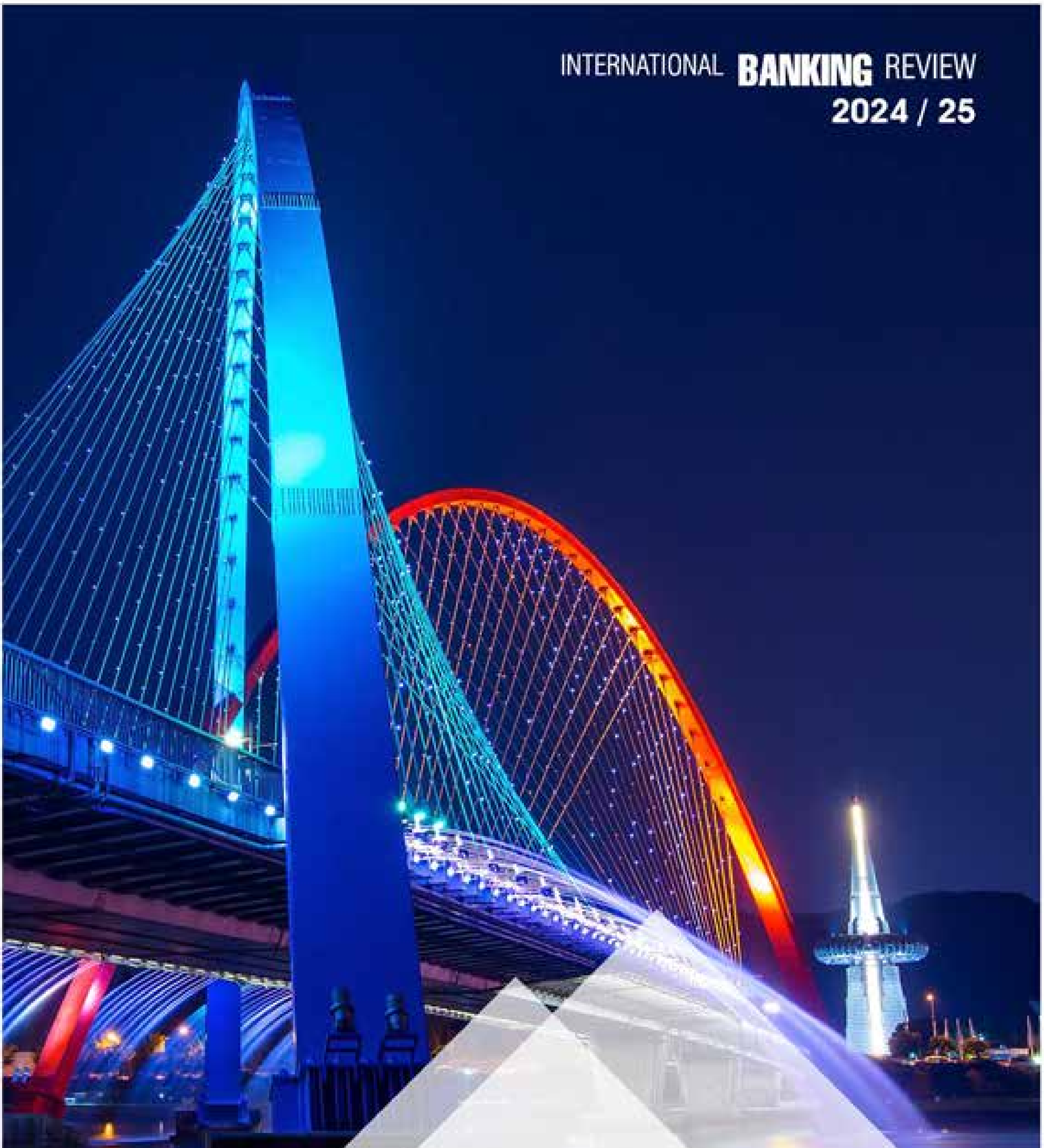
INTERNATIONAL **BANKING** REVIEW
2024 / 25



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The International Banking Review 2024/25

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THE WORLD BANK

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BIO

Yira Mascaró is a World Bank Practice Manager for the Finance, Competitiveness and Innovation Global Practice in Latin America and the Caribbean (LAC) region. From 2016- end 2020, she was the manager of the global team leading on financial stability and integrity, which engages with standard setters and the IMF. She works with policymakers and partners (e.g., IMF, IADB) to help countries build stable, efficient, and inclusive financial systems and a stronger private sector that can leverage economic growth and job creation. She is a macrofinancial economist with experience across LAC, Africa, and Europe and Central Asia. Yira received her Ph.D. and Masters' degrees from the Ohio State University, focusing on economics, development economics and the role of the financial sector, and got her Licenciate degree in economics from the PUCMM in the Dominican Republic, her home country, focusing on international trade.

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APPROACHING THE MIDDLE OF THE 2020s WITH A GLASS HALF FULL?

The decade of the 2020s commenced with the unprecedented challenge of COVID-19 to the global economy. This was followed by difficult geopolitical stances, including increased international strife and logistical challenges causing supply chain disruptions affecting energy prices, trade, and market stability. There was also an economic slowdown among major global players, materialising financial risks, and mounting climate change risks along with emerging environmental, social, and Governance (ESG) issues.

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Additionally, the increased role of private equity and venture capital funds during the prolonged period of low interest rates earlier in the decade masked heightened risk taking.

The fiscal and monetary resilience that most countries had prior to this decade has eroded to help address the new emerging challenges. Post pandemic, inflation returned with a vengeance, and central banks worldwide started focusing on managing it through substantial interest rate hikes. These higher-for-longer interest rates have made riskier practices more visible in financial institutions, leading to bank failures during 2023. Simultaneously, insolvency risks of non-financial firms increased as the fiscal support during the pandemic has started to expire just as the economic environment became less favourable.

Additionally, the increased role of private equity and venture capital funds during the prolonged period of low interest rates earlier in the decade masked heightened risk taking. With the higher interest rates, some risks have materialised, resulting in low returns and flatter investments in some sectors. Meanwhile, countries are facing increasing financing needs to leverage private capital to achieve lower carbon emissions and to advance growth and job agendas.

While these trends can be discouraging and scary, there is emerging progress that gives hope. Some of these include decreasing global inflation, increased proliferation of alternative financing instruments and broadening of investors pools, increased measurement, disclosure, and management of climate change risks in financial institutions, digital technology adoption, greening of firms, and increased access to digital financial services, among others. All these can make one see a glass half-full, but there is no space for complacency.

Improved financial institutions’ resolution and liquidity frameworks post the Great Financial Crisis have averted bigger crises since then. However, there is a need for further improvement, particularly in assessing cases wrongly presumed to be non-systemic, addressing excessive moral hazard and bank resolution costs, cross-border challenges, and liquidity pressures that can lead to widespread insolvency. Regulatory and supervisory frameworks need to remain updated and fully implemented to avert crises, including in the non-bank space where timely information on risks is harder to obtain. This is particularly relevant in the current context of growing ties between traditional and non-bank groups which could pose systemic risks.

Indeed, risk-based supervision activities should constantly calibrate risk criteria to avoid missing new risks but also to avoid shutting down opportunities. For instance, while cybertechnology brings sneaky and elusive risks, it also has the potential to increase the role of financial systems to serve the real economy and help create economic growth and jobs. Post COVID, some industries, such as commercial real estate have been particularly strained with NPLs emerging in affected markets, while innovation is bringing about new promising opportunities in different fields, such as long-lasting batteries, rare metals, semiconductors, and Artificial Intelligence.

In green and sustainable finance, the pace of labelled bonds and private climate finance has increased substantially –albeit from a low base, energised by the development of frameworks, taxonomies, disclosure standards, and climate risk assessments that help guide capital towards sustainable projects. Importantly, debt sustainability should remain at the centre of these engagements. The need for stronger institutional and regulatory frameworks also applies to carbon credit markets as announced at the COP28 in Dubai, marking an opportunity to reduce carbon emissions at scale in a commercially viable manner, provided countries manage to increase the climate and financial integrity of markets – that is, suitable financial and trading infrastructure, clear legal nature, accounting and reporting of carbon credits, registries, and price transparency, plus climate change rigor to prevent greenwashing. Regulatory bodies are starting to implement disclosure requirements related to ESG factors, leading to stronger consideration of how financial institutions are incorporating these factors into investment decision-making processes. In the coming years, it will be crucial to evaluate the impact, cost, and benefits of these initiatives to coordinate global efforts in a proper and fair manner.

In sum, these are worrying times, but as we approach the middle of the 2020s there is hope that the second half of the decade could be better by learning from earlier challenges, increasing traditional resilience through prudent fiscal and monetary stances, adopting –and implementing— clever regulation, supervision, and disclosure frameworks, as well as enabling innovation to achieve a greener and brighter future. I choose to see this greener glass as half- full, while hoping it doesn't turn into half-empty through complacency, or simply because there are much harder shocks to handle.

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Clever regulation, supervision, and disclosure frameworks, as well as enabling innovation to achieve a greener and brighter future.

PwC

BIO

Dr. Elina Christofides is an Advisory Partner, in charge of banking, at PwC Cyprus, who has been advising banking institutions, supervisory authorities and other clients in the financial services industry with a focus on governance, risk and regulatory compliance. She has over 20 years of experience in the sector both in an advisory capacity and from her prior roles at major global banking institutions in London. Elina studied Civil and Structural Engineering at the University of Cambridge, Trinity College, receiving a Master's Degree (MEng). She then continued her studies at Imperial College London, where she obtained a doctorate (PhD) in Quantitative Finance.

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Christos Pieridis is a Director in the Advisory department of PwC Cyprus focusing on risk and regulation. With over 13 years of practical experience in an advisory capacity on a number of assignments in the banking sector, Christos guides organisations through the complex nuances of banking risks and regulations. He serves as a trusted advisor to banking institutions by offering advice and support in the interpretation of regulations, risk management and mitigation and the quantification of risks with the use of advanced analytics.

Christos studied Accounting and Finance and acquired his Master's degree in Finance, at Lancaster University. He is also a qualified Chartered Accountant (ACA) and a member of the Institute of Chartered Accountants of England and Wales (ICAEW) and the Institute of Certified Public Accountant of Cyprus.

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Transforming Banking: Navigating the Challenges & Embracing Change

Digitisation, operational resilience and sustainability will be the drivers of the continuous transformational journey of the banking sector in Cyprus in the decade ahead.

INTRODUCTION

Cyprus has a strong and flexible, serviced-based economy, with a quite diversified tertiary sector that comprises approximately 85% of GVA. The banking industry is a key component of the financial services industry, supporting the economy's performance. Indeed, the robustness of the banking industry acts as a key driver toward the country's growth, resilience and prosperity.

"Amidst the continuous waves of shocks and high uncertainty, the Cypriot economy has demonstrated significant resilience.

In the not-so-distant past, the sector was grappling with the aftershocks of a severe crisis, while navigating the complex waters of new regulations, profitability concerns and heavy operational costs. Yet, the sector has recovered and with a transformed business model, it is pursuing new sources of value while preparing to face the new challenges unfolding.

With the echoes of the disrupting forces of the past fading, the recent global shocks have been unfolding successively and their impact has been persistent in the economic sectors affected, highly impacting the global and the European economy. These shocks create an environment characterised by uncertainty and volatility, with risks materialising with a slowdown of economic activity mainly driven by the immense inflationary pressures and the rising interest rates.

Amidst the continuous waves of shocks and high uncertainty, the Cypriot economy has demonstrated significant resilience to these shocks including the COVID-19 pandemic crisis, the recent energy pressures and the geopolitical conflicts unfolding. According to the European Commission (EC), Cyprus' growth is expected to slow down in 2023 and 2024 to 2.4% and 2.8% respectively, after a robust growth of 5.1% in 2022.

The rising interest rates witnessed since July 2022, in an effort to ease inflationary pressures, have benefited the Cyprus banking sector as they have become a significant source of profit due to the excess liquidity the sector enjoys. Indicatively, based on the European Banking Authority (EBA) Risk Dashboard for Q3 2023, the sector enjoyed significant excess liquidity with the average liquidity coverage ratio standing at approximately 347%, compared to a European Union (EU) average of 161%. As a result, most banks are recording strong profits.

However, the higher interest rates, coupled with the elevated prices, are expected to negatively affect household disposable income, corporate investment and residential construction for domestic demand, as well as demand for new lending. Lower demand for loans and stricter lending criteria, are expected to further reduce economic activity going forward, albeit growth is expected to remain stronger compared to EU peers.

In addition to the recent shocks, significant developments in the banking landscape ranging from the rising supervisory expectations for sustainable financing linked with Environmental Social and Governance (ESG) criteria, the ongoing digital transformation and key regulatory developments, are expected to further shape the sector in the short to medium term.

KEY DEVELOPMENTS SHAPING THE FUTURE OF THE CYPRUS BANKING SECTOR

ESG and Sustainable Banking

ESG has been evolving as a key theme for nearly two decades, at least since the topic was highlighted in a 2006 United Nations report on principles for responsible investment. Attention has intensified, as evidence of climate change has increased. The growing attention and urgency have not only raised concerns about the 'E' in ESG, but have also added to interest in whether companies and in particular banking institutions are being responsible stakeholders and applying practices that conform with both the letter and the spirit of the principles promoting environmental goals.

The need to focus on ESG is only expected to increase as more states and organisations commit to net-zero targets and regulators are stepping up pressure for businesses to be more sustainable. Likewise, investors say they prefer to put money into businesses with a strong ESG profile (even if investors aren't yet willing to sacrifice much return to do so). In the recent PwC Global Investor Survey, global investors placed climate risk amongst the top five threats that their business will be exposed to in the coming periods. In parallel, customers, employees, and potential employees are evaluating companies on ESG criteria, urged on by activists and other social forces.

During the last few years, regulations and guidelines published in the area of ESG have impacted the banking industry as well. The EC mandated a high-level expert group to develop recommendations for the design of a sustainable financial system that served as the basis for an action plan. In 2018 the EU published its action plan on financing sustainable growth. This action plan recognises that the shift of capital flows towards more sustainable activities needs to have a holistic understanding of the sustainability of activities and investments.

With environmental, social and governance standards becoming increasingly critical to banks' reputation and licence to operate, the multidimensional ESG ecosystem needs to be translated into banking institutions' strategic approaches. The areas that are expected to be impacted are numerous ranging from new loan originations and ongoing monitoring, reporting requirements and disclosures to investors, to risk management and operational aspects.

So what does ESG really mean for Cypriot banks? Financially the sector will need to reshape its investment strategies, directing funds towards more environmentally and socially responsible initiatives and projects. To achieve this, banks will need to be in a position to evaluate risks, including climate and environmental ones, and take measures to adequately mitigate material risks that arise in their books. This will significantly impact operations as well, as new processes will need to be adopted and the workforce will need to be educated and re-skilled to understand and quantify these risks and communicate their implications to their clients. Institutions will also need to look inwards, in the way they adopt sustainable practices, reduce their carbon footprint and promote ethical business conduct.

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The need to focus on ESG is only expected to increase as more states and organisations commit to net-zero targets.

The Cyprus banking sector is making significant investments in the area of ESG, in an effort to tackle the strategic, financial and operational aspects of this complex topic. All of the major banks of the island are investing in their data and reporting capabilities, in the training of employees and customers, in risk management practices and product design, and of course in shifting the strategic vision of the institutions towards sustainable outcomes and practices.

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> Cyprus banking institutions are investing heavily in a number of areas to reap the benefits of such transformations and to safeguard their market positions.

Digital Transformation

The COVID-19 pandemic significantly accelerated the need for digital banking services on a global scale. In parallel, the introduction of new market participants, such as FinTech and BigTech companies, in the otherwise traditional and difficult to enter banking market, has further exacerbated the need for banking institutions to accelerate the pace of their digital transformation.

The benefits of this ongoing transformation are multilayered. Increased operational efficiencies directly translate to reductions of costs in a sector that is still healing from the impact of the latest financial crisis; diversification of revenue with new innovative services and new channels for sales is positively influencing growth potential; while transformation of legacy systems and processes is enabling banks to better identify opportunities and challenges and better capitalise and mitigate these respectively.

The journey for banking institutions has not been without its challenges. According to a report published by Workday and PwC, two common blockers for digital transformation are poor implementation of new technologies and the lack of a coordinated strategy. Another critical part of such journeys is strong cybersecurity practices in which banks need to continuously invest and proactively deploy to mitigate the elevated regulatory, operational and reputational risks at hand.

Cyprus banking institutions are investing heavily in a number of areas to reap the benefits of such transformations and to safeguard their market positions. Key investments are being made in the area of data and analytics with an objective to drive innovation and decision making. Data points from different sources within institutions are pulled together to better understand financial performance of products and services, employee activity, costs of operations and of course customer behaviour. The insights from this unified view of information allow banking institutions to make informed decisions in relation to strategy, risk management, product development as well as marketing. Moreover, banks are investing in the development of the digital economy by creating new platforms linking customers and businesses.

The speed at which decisions are made is also crucial for institutions, both in terms of strategic planning and in terms of client experience and satisfaction. In the "new normal" consumers are no longer willing to wait, as other providers offer real-time or near real-time information and outcomes. This is where the cloud comes into play, since it has enabled institutions to deploy services and applications faster, while scalability can be achieved with ease.

An important aspect of digital transformation relates to a key pillar of productivity in banking institutions, their workforce. Cypriot banks are currently focused on the upskilling of their workforce with new technical skills as well as new soft skills including advanced collaboration, change programmes that relate to new tools and core systems, and the mastering of digital labour in the form of Artificial Intelligence (AI) tools.

Digital transformation is expected to remain in the spotlight both at an international and at a local level in the years to come, as mobile banking becomes the preferred channel for clients and as national borders become less relevant in servicing clients within the EU.

The Regulatory Avalanche

Developments in the regulatory space have been continuous since the global financial crisis, with the overall objectives as per the ECB focusing on the safety and soundness of the banking system and on increasing financial integration and stability. In alignment with these objectives, the banking sector in Cyprus has come a long way since the financial crisis of the last decade. According to data from the EBA, banks have solid capitalisation buffers with Tier 1 Capital standing at 21%, with the sector returning a sizable profit both in 2022 and in the first three quarters of 2023.

The current supervisory priorities, as identified by the ECB for the years 2024 to 2026, cover the resilience of banking institutions to macro-financial and geopolitical shocks, the effective remediation of shortcomings in governance and the management of climate-related and environmental risks, and lastly further progress in digital transformation and enhancement of operational resilience frameworks.

Banking institutions in Cyprus are currently facing a number of obligations in relation to upcoming regulatory deadlines, which impact operations, risk management and their strategy. The areas that institutions are currently focusing on in the face of regulatory expectations and requirements are diverse and range from ESG, with the implementations of the Corporate Sustainability Reporting Directive (CSRD) and the ECB guide on climate-related and environmental risks, enhancements in their digital transformation strategy and operational resilience, investments in data governance for more effective data aggregation and reporting, and of course the finalisation of the Basel III implementation in the EU.

In the area of ESG, Cyprus banks are investing heavily with multi-year compliance projects that cover the requirements in this space. Reporting requirements are becoming increasingly detailed with the introduction of CSRD and the IFRS Sustainability Disclosure Standards. Risk management is also impacted with the introduction of the ECB guide on climate-related and environmental risks, that covers expectations ranging from business models and strategy, to risk appetite, governance and risk management.

On operational resilience, the Digital Operational Resilience Act (DORA) was recently introduced, which is an EU legislation that sets specific rules for banks on Information and Communication Technology (ICT) risk management capabilities, testing, third party risk monitoring and incident reporting. The requirements will apply from the start of 2025, while multiple regulatory and implementing technical standards are expected to be issued by supervisory authorities within 2024.

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Basel III also entails significant changes, as compliance is expected to be more complicated than initially anticipated. The latest proposal introduces a number of refinements and modifications that will require banks to adjust their controls, calculations, processes and data, which could strain resources across all three lines of defence. Additionally, and more importantly, banks will likely need to update their capital allocation strategies as a result of the changes in the regulatory capital calculations, whilst evaluating the potential benefits of adopting internal models for certain portfolios as part of their capital strategy.

At the centre of all of the aforementioned areas are the data aggregation and reporting capabilities of banks, which need to be further enhanced to accommodate the new and ever-evolving regulatory and internal requirements in a flexible and agile manner. Simultaneously, data governance considerations need to be taken into account since banks need to rigorously adhere to strict privacy requirements, ensuring data is secure, confidential and used responsibly.

CONCLUSION

In the wake of a tumultuous period marked by the financial crisis, stringent regulations, profitability woes, the COVID-19 pandemic and the geopolitical conflicts unfolding, the banking sector in Cyprus has emerged from the storm stronger and more resilient. Overcoming the successive challenges was not easy nor without a cost, but the industry has rebounded. This hard-earned stability and the current profitability can become a bedrock upon which the economy of Cyprus can rely and thrive.

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> The current period is considered a period of stability for the Cyprus banking sector, as also evidenced by reports from the International Monetary Fund (IMF) and the EC, as well as by a series of credit rating upgrades.

The sector has been navigating the complex landscape of regulations and is continuously adapting to new rules and guidelines with agility and speed. In parallel, embracing digitisation and technological innovation has been one of the cornerstones of this recovery. With an eye on the evolving customer behaviours and the changing business environment, banks in Cyprus are strategically transforming their operations. This transformation has not only streamlined processes but also enhanced customer experiences, ensuring the sector can remain relevant and responsive to the ever-changing needs of its customer base.

The current period is considered a period of stability for the Cyprus banking sector, as also evidenced by reports from the International Monetary Fund (IMF) and the European Commission (EC), as well as by a series of credit rating upgrades. The industry is not just focused on short-term gains but it has committed to longer-term, responsible investments. Demonstrating the longer-term nature of the strategy of banks, we see investments in green and socially responsible products that align the growth of the sector with the principles of environmental and social responsibility.

In the words of an ancient proverb, “The best way to predict the future is to create it”. From the current starting point and building on the dedication, resilience and innovative spirit of their people, the sector can actively shape the future of Cyprus.

Let's shape the future of banking together

PwC Cyprus has a dedicated team of banking experts that comprises 10 Partners and Directors and more than 100 client facing professionals committed in delivering quality services to our clients. The PwC Cyprus professionals operate within a tightly-knitted international network of industry experts ready to deliver local knowledge with global expertise to help turn challenges into opportunities in all key areas of your business.

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DENTONS

DENTONS

1. Impact of rising interest rates on German banks

In an outlook on the major risks for the banking sector published in January 2023, the German Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, "BaFin") mentioned, inter alia, risks resulting from the decline of real estate prices (see paragraph 2 below), risks of defaults on loans to German companies due to the overall deterioration of the German economy and risks from cyberattacks. However, the rise in interest rates was identified as one of the greatest and most fundamental risks. The abrupt rise in interest rates began to constitute a challenge for the profitability of many banks which has led to losses in their securities and fixed rate loan portfolios. The BaFin forecasted that a further sudden and sharp rise in interest rates would place a heavy burden on some institutions.

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One of the focuses of BaFin's enforcement practice is on prohibiting unregulated entities from conducting banking business or from offering financial services to German clients.

2. Substantial decline in real estate prices

For many years prices of both residential and commercial real estate in Germany increased steadilyr, despite the warning from supervisors against an "overheating" of the market. This development was supported by a booming real estate finance market that provided for relatively cheap financing, due to low interest rates. The volume of real estate loans in the books of German banks constantly increased. 2023 marked the end of this long-term boom. Driven by an increase in interest rates and by fears of a recession of the German economy, real estate prices declined sharply, and so did the volume of real estate finance. While some commentators welcomed this as an end of the "overheating" of the market, others saw parallels to the beginning of the 2008 financial crisis. Not surprisingly, the BaFin became concerned about the risks that this development posed for banks. In 2022, the BaFin had already introduced an countercyclical capital buffer of 0.75% and a systemic risk buffer of 2% for residential real estate risks. This requirement had to be implemented by 1 February 2023.

In addition, real estate related credit and market risks have become one of the top priorities in the supervisory practice of BaFin and Bundesbank. On 29 June 2023, the BaFin published a revised version of its guidance on minimum requirements for risk management (Mindestanforderungen an das Risikomanagement, "MaRisk"). This revised version contains a new section on the management of real estate related risks. Inter alia, it contains detailed rules on the approval process for real estate financing, the role of external experts in the valuation of real estate, risks that have to be taken into account and ongoing valuation.

3. Regulatory enforcement

Like in the years before, the trend towards a stricter regulatory enforcement practice by the BaFin has continued in 2023 and is likely to continue in 2024. Almost on a daily basis, the BaFin announces new enforcement actions. One of the focuses of BaFin's enforcement practice is on prohibiting unregulated entities from conducting banking business or from offering financial services to German clients. This includes unregulated entities from jurisdictions outside the EU that offer financial services (often related to crypto assets) clients in Germany via the internet.

However, the BaFin also took actions against regulated entities, mainly because of alleged deficiencies in their business organisation (such as their anti-money laundering infrastructure). The amount of fines imposed continues to be much higher than in comparable cases in the past.

4. ESG and Sustainable finance

Sustainable finance continues to be one of the regulatory priorities of the BaFin. On 26 July 2023, the BaFin published a "Sustainable Finance Strategy" which sets out BaFin's supervisory priorities relating to sustainable finance. These priorities are summarised in 5 points:

(1) Risk-oriented and practicable regulation: The BaFin re-emphasised its opposition against introducing amendments to capital requirements that would support "green" assets and penalise "brown" assets for the mere reason of being "green" or "brown", because such amendments would not be consistent with the risk related to the relevant assets.

(2) More reliable data on financial climate risks: The BaFin highlighted the importance of reliable data for managing ESG-related risks. As disclosure of such risks at company level is essential for collecting the relevant data, the BaFin announced that it would closely supervise such disclosure and increase its capacity for enforcement of the disclosure requirements.

(3) Appropriate management of climate-related financial risks: Due to the uncertainties involved in ESG-related risks, the BaFin expects supervised entities to consistently review how they assess and manage such risks.

(4) Preventing greenwashing: The BaFin announced that it would use all available supervisory powers to combat both, the use of wrong, incomplete or misleading information about financial products, as well as inadequate disclosure by companies of their ESG-related risks.

(5) Generating and sharing knowledge in an open dialogue: BaFin is committed to participating in further expert discussions in order to exchange information and share experience.

Following the publication of its Sustainable Finance Strategy, bank, funds, investment firms and other market participants have increased their efforts to be transparent with respect to the reasons why they market a financial product as "sustainable" or "green". However, the BaFin acknowledged that market participants face a lack of clear and binding criteria, as well as empirical data, for assessing whether a financial product fulfills what it promises. Distributors of financial products have also continued to explicitly ask clients about their sustainability preferences in order to be able to recommend them a financial product that meets these preferences.

From a banking regulatory perspective, ESG-related risks for financial institutions (such as losses suffered as a consequence of natural disasters) have been a significant concern for regulators. This resulted in BaFin's calls for scenario analyses and stress tests that banks have to conduct to assess their ESG-related risks. The BaFin has announced that in 2024, it will perform special audits on some banks in order to assess whether their management of ESG-related risks is adequate. In addition, the aforementioned guidance on minimum requirements for risk management (MaRisk) was amended by two separate sections on ESG-related risks.

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On 26 July 2023, the BaFin published a "Sustainable Finance Strategy" which sets out BaFin's supervisory priorities relating to sustainable finance.

To the extent possible and reasonable, the BaFin requires banks to perform quantitative assessments of ESG-related risks.

5. Banking resolution

As a consequence of the financial crisis, regulators all over the world have introduced new tools on how a bank that is in financial distress can either be rescued or resolved without spending taxpayers' money. On an European level, Directive (EU) No. 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms and Regulation (EU) No 806/2014 on the Single Resolution Mechanism set out a framework for the recovery and resolution of credit institutions and investment firms. This directive was implemented in German law by the Restructuring and Resolution Act (Sanierungs- und Abwicklungsgesetz, "**SAG**"). While the SAG was already enacted in 2014, the BaFin continues to offer guidance. On 23 October 2023, the BaFin has published detailed draft guidance on organisational requirements that banks have to meet in order to ensure that they can be resolved, if necessary.

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In addition to these legislative developments, the BaFin for the first time recognised resolution measures taken by a non-EU resolution authority. On 10 March 2023, the Department of Financial Protection and Innovation of the State of California closed Silicon Valley Bank ("**SVB**") appointed the Federal Deposit Insurance Corporation ("**FDIC**") as receiver of SVB. A receiver has powers similar to those of a resolution authority under EU banking resolution law. Inter alia, it can transfer assets to a bridge bank and arrange for the sale of such assets. The FDIC transferred all of the deposits and substantially all assets to the newly established Silicon Valley Bridge Bank N.A. Under US resolution law, this transfer also applied to assets of Silicon Valley Bank Germany Branch. The FDIC subsequently sold some of the assets and liabilities of SVB Germany branch to an investor, while the remaining assets were wound-up. Under section 169 SAG the BaFin can recognise resolution measures taken by a non-European resolution authority. On 1 August 2023, the BaFin used such power for the first time and recognised the resolution measures taken by the FDIC, to the extent they related to claims and obligations governed by German law or assets of Silicon Valley Bank Germany Branch located in Germany. The effect of such recognition was that resolution measures taken by the FDIC, became effective under German law, so that, for example liabilities of Silicon Valley Bank Germany Branch were first transferred to the German branch of Silicon Valley Bridge Bank and later to the investor who purchased certain parts of Silicon Valley Bank Germany Branch's business.

6. Distributed ledger technology and crypto assets

On the European level, the official publication of the Markets in Crypto Assets Regulation ("**MiCAR**") on 9 June 2023 set the framework for the regulation of distributed ledger technology ("**DLT**") and crypto assets ins Europe. Albeit MiCAR has entered into force on 29 June 2023, most of its provisions will begin to apply only at a later stage. The requirements relating to the issuers of certain tokens will apply from 29 June 2024, and the remaining provisions, including licenses requirements for entities providing services related to crypto assets, will begin to apply on 30 December 2024.

Germany has already preempted some of the new requirements, for example by introducing a license requirement for crypto custody services and by qualifying crypto assets as financial instruments (1 January 2020). Thus, entities providing services related to crypto assets already today need to be licensed as investment firms or banks.

For providers of DLT market infrastructure, such as crypto exchanges, Regulation (EU) 2022/858 of 30 May 2022 on a pilot regime for market infrastructures based on distributed ledger technology ("**DLT Pilot Regime**") has introduced the possibility of obtaining a temporary license for the offering of DLT market infrastructure. Holders of such license do not have to comply with certain requirements that would otherwise apply. The DLT Pilot Regime therefore constitutes a so-called "regulatory sandbox" that reduces the regulatory burden in order to foster innovation in the DLT market. Licenses under the DLT Pilot Regime have been available since 23 March 2024. The European Securities and Markets Authority ("**ESMA**") has issued guidelines on the application process. The BaFin announced on 19 April 2023 that it will fully apply such guidelines in its supervisory practice.

7. Regulation of credit servicing

Directive (EU) 2021/2167 of 24 November 2021 on credit servicers and credit purchasers ("**NPL Directive**") introduced regulatory requirements in connection with the provision of certain services for purchasers of non-performing loans that were issued by EU credit institutions ("**Credit Services**"). Such Credit Services include

(a) collecting or recovering from the borrower, in accordance with national law, any payments due related to a creditor's rights under a credit agreement or to the credit agreement itself;

(b) renegotiating with the borrower, in accordance with national law, any terms and conditions related to a creditor's rights under a credit agreement, or of the credit agreement itself, in line with the instructions given by the credit purchaser;

(c) administering any complaints relating to a creditor's rights under a credit agreement or to the credit agreement itself; and

(d) informing the borrower of any changes in interest rates or charges or of any payments due related to a creditor's rights under a credit agreement or to the credit agreement itself.

The NPL Directive stipulate that EU member states have to require credit servicers to obtain an authorisation. Such authorisation can be "passported" into other member states, which means that credit servicers authorised in one member state can provide their services also in other member states, either on a cross-border basis or by establishing a branch. Credit service providers also have to comply with certain conduct of business rules aimed at protecting the debtors. In addition, the sellers and purchasers of NPLS are subject to certain reporting requirements.

The EU member states had to implement and apply these requirements by 30 December 2023. The German statute that implements the NPL Directive was published on 2 December 2023 (the "**German NPL Act**") and entered into force by 30 December 2023. Credit servicers that had already offered credit services before such date were eligible to a grandfathering rule. If they notified the BaFin no later than 16 February 2024 of their intention to apply for a license under the German NPL Act, they could file an application no later than 5 April 2024 and continue to provide credit services without waiting for the granting of the license.

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The NPL Directive stipulate t hat EU member states have to require credit servicers to obtain an authorisation.

HONG KONG

The dichotomy of Hong Kong banking trends: A gloomy outlook or opportunity for growth?

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BIO

Trinh Hoang practises in the area of banking law, with a particular focus on special situations financing and restructuring of debt facilities, as well as structured finance, acquisition finance and general corporate loans in Hong Kong and across other countries in Asia.

Trinh's clients include private credit funds, investment banks and corporate borrowers.

Trinh works closely with her clients to understand the commercial drivers affecting their business, helping to bring their goals to fruition.

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During his studies, Alvin was awarded a string of scholarships and prizes for academic excellence and achievements in mooting.

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The dichotomy of Hong Kong banking trends: A gloomy outlook or opportunity for growth?

After a disappointing 2023 for the Hong Kong banking sector, 2024 may at first glance seem to offer little room for redemption. Repercussions of the Chinese real estate crisis continue to be felt throughout Hong Kong, while interest rates are likely to remain high amidst existing and potential geopolitical tensions, causing a domino effect across all sectors. This paints a stark contrast against the idealistic ESG initiatives and fintech innovations dominating the other half of banking headlines.

> “The sector itself has bottomed and it now has to recover from that new lower position.”
>
> – Noel Quinn, CEO of HSBC

Despite this, Hong Kong can and should be optimistic about a 2024 recovery. With businesses adapting well to post-pandemic life, and the major crises behind us, Hong Kong enters 2024 with fresh new plans to advance the development of the city. Major projects in the Northern Metropolis of Hong Kong and the Greater Bay Area will prove crucial in driving economic growth.

Overcoming the Chinese real estate crisis

Hong Kong’s banking sector has been deeply embroiled in the Chinese real estate crisis since the collapse of the Chinese real estate market in late 2021. This is not surprising given that Hong Kong has long been the main “offshore” platform for Chinese real estate developers to raise foreign capital, primarily through IPOs and bond issuances on the Hong Kong Stock Exchange.

Repercussions of these developers’ collapses can be felt throughout the financial markets. On a macro level, Hong Kong banks and financial institutions are increasingly reluctant to have further exposure to the real estate sector as a whole, and the Chinese real estate sector in particular. Consequently, we are seeing more investment focus both from within and outside of Hong Kong directed towards other industry sectors and across the Asia Pacific region including Australia and India.

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Real estate finance in Hong Kong, once a reliable source of new business for banks and financial institutions, now primarily provides opportunities in the restructuring or work out space.

The beginning of 2024 however witnessed a momentous decision from the Hong Kong courts to wind up Evergrande, the world’s most indebted real estate company, whose debt default was the original spark that set off the real estate crisis. The potential collapse of other heavily indebted Chinese real estate developers appears all the more likely with this decision, although some are more hopeful that the winding up of Evergrande provides an even greater incentive for stakeholders to engage in restructuring negotiations given the dire alternative.

Nonetheless, the experts’ view is that Hong Kong banks are generally well-capitalised and highly liquid, and should be able to absorb the impact of this crisis. The optimist’s view is that the situation can only improve from 2024 onward. Indeed, China has rolled out, and is planning to further roll out a series of policies to encourage investments into the real estate sector. Whilst these policies are mainly designed to benefit individual consumers in China, the knock-on effect will be equally beneficial for real estate developers both in China and further afield.

Growth amidst volatility and high interest rates?

2024 will likely be a year of volatility for the Hong Kong market. Whilst a persistently high interest rate and the corresponding domino effects are likely to result in the continued market stagnation seen in 2023, experts are cautiously optimistic of a bounce back this year.

The case for recovery has not been helped by Moody's downgrading of Hong Kong's credit outlook from its "stable" rating to a "negative" rating, following a similar downgrade to China's rating. Moody's justified the downgrade by citing the "tight political, institutional, economic and financial linkages between Hong Kong and the Mainland". Continuing geopolitical tensions, Sino-US competition, and US imposed sanctions on Hong Kong individuals are likely contributing factors that led to the downgrade. The Hong Kong government itself gave a reserved GDP growth forecast, estimating a 3.2% increase, lower than the earlier forecast of 4-5%.

The volatility in the market is closely linked with the high interest rates that dominated headlines during 2023, with the US Federal Reserve raising interest rates 11 times, causing the pegged Hong Kong Dollar to experience similar rises. Whilst general market consensus is that interest rates have peaked, they are likely to stay at a similar level for the majority of 2024. The repercussions have been felt throughout Hong Kong, evident through slashes in property values and low levels of M&A activity, with individuals and corporations unwilling to take on debt.

Recent reforms and initiatives are likely to encourage a reversal against the trend in 2024. In 2023, the Hong Kong Stock Exchange added Chapter 18C to its Listing rules, which will promote the listing of specialist technology companies in Hong Kong. Similar changes made to the secondary GEM board are likewise expected to attract high performing start-ups and SMEs across the Greater Bay Area. These reforms reflect investor's changing sentiments and a shifting focus towards tech companies. Hong Kong has also strengthened its ties with the Middle East, with the first ever Saudi Arabia exchange-traded fund listed on the Hong Kong Stock Exchange (HKEX), further reinforcing Hong Kong's position as an international financial centre.

Regulatory authorities prioritise Green and sustainable finance

Hong Kong's central banking institution and regulator, the Hong Kong Monetary Authority (HKMA) launched a number of ESG initiatives in 2023. In July 2023, the HKMA launched an "Enhanced Competency Framework on Green and Sustainable Finance", with the objective of establishing a set of common and transparent ESG competency standards in the banking sector. This is a voluntary licensing regime that aims to serve as a benchmark of industry-level ESG standards. Core to this framework is the provision of training programs for relevant persons, namely those involved in the analysis, development, implementation or execution of ESG related matters within an authorised institution (AI). The training sessions aim to ensure standardisation of ESG competency across these AIs. Concurrently, the HKMA has begun planning for a net-zero transition by identifying high-level principles/ guidelines, complying with the Hong Kong government's objective of attaining carbon neutrality by 2050. Among other plans, this includes setting up a robust governance framework, devising appropriate initiatives and actions to achieve these objectives, and to maintain transparency with the public on goals and progress.

> "The Voluntary Code of Conduct will help strengthen the transparency, quality and reliability of ESG information used by licensed corporations in their investment decisions."
>
> – Julia Leung, CEO of the SFC

Similarly, the Hong Kong regulatory body for securities and futures markets, the Securities and Futures Commission (SFC) has introduced the development of a Voluntary Code of Conduct (VCoC), which will align with international best practices on ESG matters. The development of the VCoC began after an announcement by the Green and Sustainable Finance Cross-Agency Steering Group chaired by the HKMA and the SFC, which announced a series of mandatory enhanced climate-related disclosures to be complied with by players across the financial industry, namely banks, asset managers, insurance companies and pension trustees by 2025.

The HKEX has also launched initiatives to promote green financing following the signing of a Memorandum of Understanding with the China Beijing Green Exchange, with agreements on exploring green financing options, and implementation methods. One of the main initiatives undertaken by the HKEX is to implement climate-related disclosure requirements compliant with ISSB standards in its listing rules, which will take effect on 1 January 2025, covering categories of governance, strategy, risk management, and ESG metrics and targets.

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> The HKMA is prioritising fintech, hedging on its ability to drastically transform the financial landscape.

Earlier in 2023, the Loan Markets Association, the Loan Syndication & Trading Association and the Asia Pacific Loan Market Association published updated versions of the Green Loan Principles and Guidance, the Social Loan Principles and Guidance on the Sustainability Linked Loan Principles and Guidelines. These updated principles encourage lenders and borrowers to agree upon certain ESG linked KPIs, such as caps on greenhouse gas emissions or limits on water or energy consumption. Satisfaction of these KPIs will reward the borrower with more beneficial economic terms, such as reducing the interest margin under the relevant loan agreement.

Keeping up with technological advancements and an evolving market

i. Fintech takes priority

The HKMA is prioritising fintech, hedging on its ability to drastically transform the financial landscape. We expect the following three business areas of fintech to be prioritised and developed. The first is wealthtech/investech. These are tech products/initiatives aimed to facilitate the distribution, manufacturing, and trading of wealth management activities, by utilising technology to carry out tasks such as real-time portfolio tracking, performance analysis, risk assessments and rebalancing capabilities. The second category is insurtech, which uses technology innovations to find cost-saving methods, and to improve allocation of resources in the insurance industry. The third and final area is Greentech, which is technology that identifies sustainable investment opportunities by collecting, analysing, and interpreting ESG related metrics. To support the growth and integration of these initiatives, the HKMA plans to utilise artificial intelligence and distributed ledger technology.

Additionally, the HKMA has also required all Authorised Institutions to implement e-banking measures by 31 March 2024, and is encouraging them to educate the public on issues surrounding e-banking fraud, implement more developed security measures to detect fraudsters, and to give customers the autonomy to safeguard their own bank accounts.

i. Recognising the need for regulation

With the plethora of improvements pushed out by the government, corresponding regulations and legislations are essential. In 2023 alone, Hong Kong proposed two new legislations to address developments in the banking sector.

First, the HKMA has proposed to reduce the current three-tiered banking system to two-tiers. The current banking system consists of licensed banks, restricted license banks, and deposit-taking companies. Traditionally, this three-tiered system was designed to strike a balance between flexibility of entry into the banking sector, whilst ensuring sufficient protection for small individual depositors. Due to the dwindling market share of deposit-taking companies, the companies with the lowest entrance-barrier, the HKMA is proposing to phase that category out by merging them with restricted license banks, resulting in a two-tiered banking structure in Hong Kong.

Second, the Financial Services and the Treasury Bureau, together with the HKMA jointly issued a public consultation paper titled "Legislative Proposal to Implement the Regulatory Regime for Stablecoin Issuers in Hong Kong" on 27 December 2023. With the rise of crypto assets, stablecoins have been presented as a method to combat the volatility in the valuation of cryptocurrency. Stablecoins achieve this by pegging their value to specific non-virtual assets, namely fiat-currencies. The proposal aims to target these stablecoins pegged to fiat-currencies, given their high volume usage, by introducing a licensing regime to regulate the industry. This reflects the earlier efforts of the Hong Kong government to regulate the industry, with the SFC amending the Anti-Money Laundering and Counter-Terrorist Financing Ordinance to cover virtual asset exchanges, and the introduction of the Guidelines for Virtual Asset Trading Platform Operators, providing details on how to implement a Virtual Asset Trading Platform regulatory framework.

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DLA Piper's banking lawyers have extensive experience in all types of financing and restructuring matters. Our clients include private credit funds, investment banks, and corporate borrowers among others. We work closely with our leading real estate lawyers and other sector specialists to execute new money financings, as well as transactions in the restructuring space.

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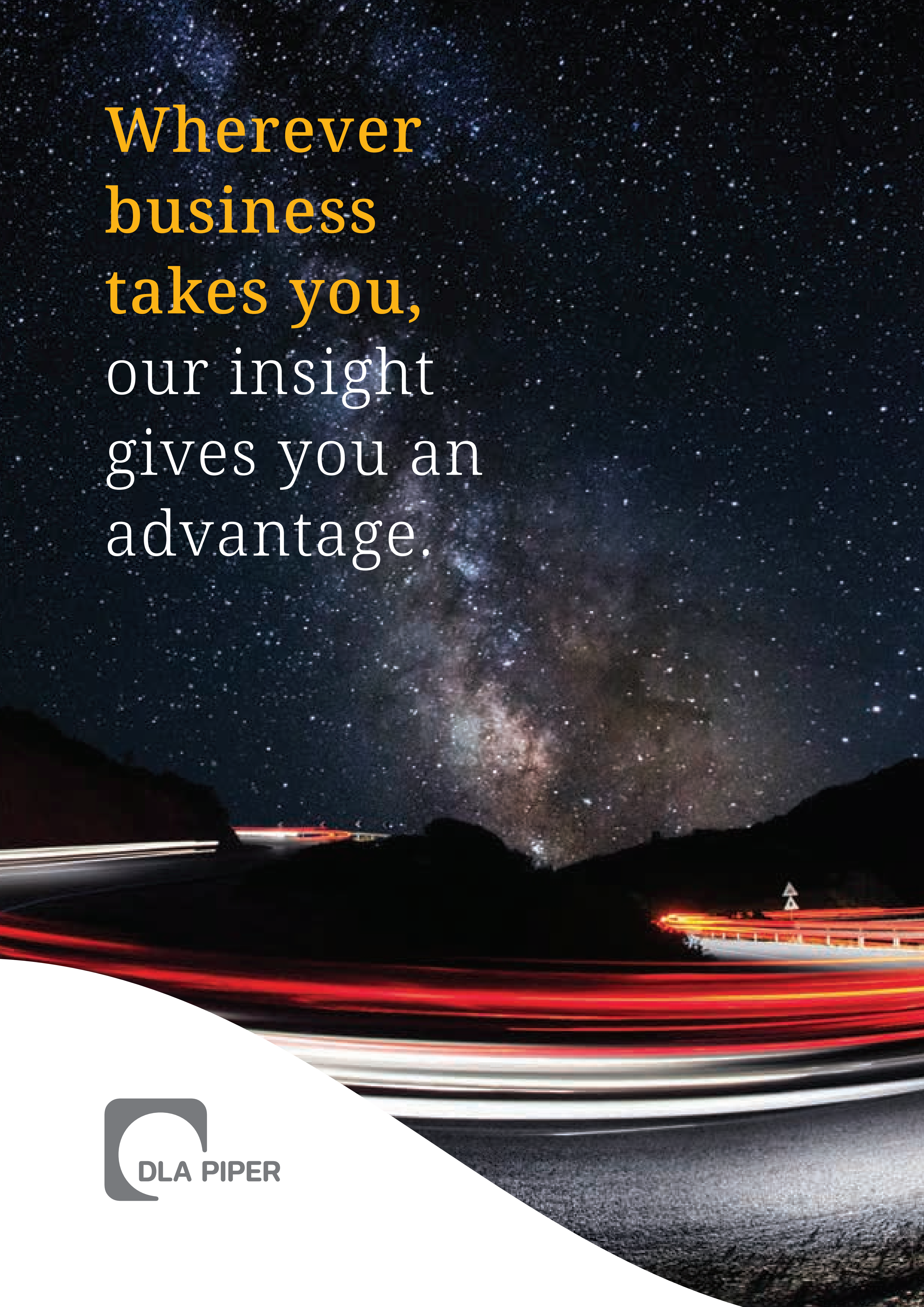
As pioneers in technology law, our partners are leading the technology legal sector. Our lawyers are at the top of their game, advising clients in all areas, ranging from digital assets blockchains, stablecoins and cryptocurrency to AI, machine learning and robotics technology.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Pierfrancesco Anglani is an assurance Partner in the banking and capital markets practice at PwC Milan. Pierfrancesco is chartered accountant, member of the Financial Services Technical Commission of Assirevi (the Italian audit firms association) and member of various national and international banking working groups.

Pierfrancesco has been with the firm since 1994 and has an extensive experience in providing audit services to primary national and international banks and financial institutions.

Pierfrancesco Anglani is also involved in a number of non-audit assurance engagements including due diligences, credit risk management, control assurance engagements and regulatory services.

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Gabriele is partner in PwC Italy Financial Services. He is the reference point for regulatory strategy topics and is expert in structuring, transactions, strategic evolutions and sustainable finance.

Prior to becoming part of PwC, Gabriele worked for the Bank of Italy Supervisory Division, where he was involved in on-site and off-site supervisory activities. He has been a university professor in economics and has a previous experience in a major consulting company.

In PwC Gabriele is mainly focused on regulatory and strategic evolutions and on the structural changes of the banking sector. Moreover, he has followed many transactions as advisor with particular focus on structuring and regulatory strategy.

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Pier Paolo Masenza is PwC Italy Financial Services Strategy & Value Creation leader and EMEA Value Creation Leader. He has more than 30 years experience and has been a partner with PwC since 2003.

He has an extensive knowledge in M&A, due diligence, and restructuring Services where he has served a wide range of Italian and International Corporates, Banks and Investors, both on the buy and sell side, and as financial and industrial advisor.

Pier Paolo has a consolidated experience in Banks, NPL, Corporate Investment Banking, Asset Management and Real Estate. Recently he played an active role in the NPL debate and the implementation of the ECB guidelines in the NPL framework.

Author of numerous studies and publications in the banking and financial field (Sole 24 Ore and Milano Finanza) and chief editor of PwC periodic publication on NPL, as well as active participations, as a speaker, in technical conferences organized by leading associations and study centers (ABI, AREL, etc.).

He holds a bachelor degree summa cum laude in a Business Administration from the University "La Sapienza" in and is a fellow of the Italian Chartered Association of Certified Accountants and a registered auditor in Italy.

The Evolution of the Italian Banking Sector Landscape

Over the past ten years, the nature and structure of the Italian banking sector have undergone significant changes and developments. These transformations have been driven by a combination of regulatory reforms, economic challenges (including the COVID 19 pandemic) and advancements in technology.

Starting from 2014, supervision of Italian banks shifted from the Bank of Italy to the European Central Bank (ECB), with drastic changes in the supervisory approach. Firstly, the ECB pushed for a significant reduction in non-performing loans: from 2008 to 2015, banks' non-performing loans grew from €85 billion to €341 billion (of which €200 billion were bad loans). Following a deep deleveraging process, aided by state instruments such as GACS (the Italian acronym of Guarantee on Securitisation of Bad Loans) and systemic operations, gross bad loans now amount to approximately €21 billion, while the total of non-performing loans stands at €56 billion. Consequently, the Gross NPE Ratio of significant banks plummeted from 17.0% in 2014 to 2.4% in June 2023 [dedicated focus below].

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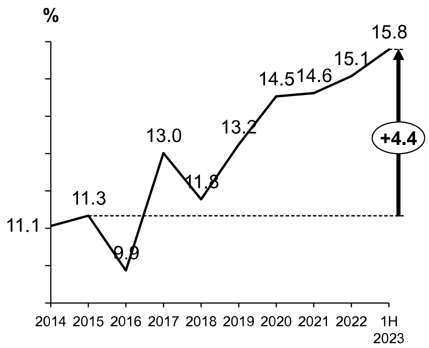
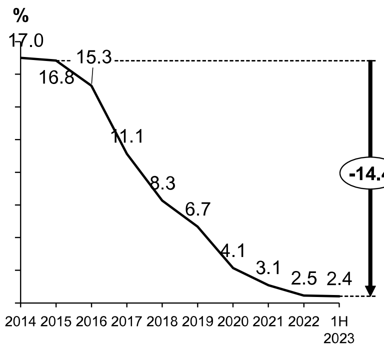
> From 2014 to June 2023, significant banks improved their CET1 ratio from 11.1% to 15.8%

Simultaneously, Italian banks underwent a substantial capital strengthening. From 2014 to June 2023, significant banks improved their CET1 ratio from 11.1% to 15.8%. In 2023, capitalisation is poised to see further enhancement with the introduction of the Italian Windfall Tax for Banks (Law Decree n°104). In accordance with the law mechanism, the majority of banks have chosen to sidestep the government's newly imposed windfall tax on additional profits by electing to allocate 2.5 times the amount of the tax due to a non-distributable reserve. Furthermore, capital profitability has risen to levels not seen since before the global financial crisis, driven by interest income and a decrease in credit provisions (Return of Equity of significant banks up to 13.9% in 1H 2023).

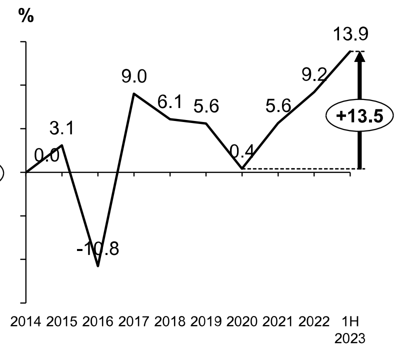
CET1 Ratio (fully phased)
Significant banks; %



NPE Ratio
Significant banks; %



Return on Equity
Significant banks; %



Over the last ten years mergers and aggregations, in some cases necessary to avoid failures, led to a significant simplification or rationalisation of the sector.

This process was also determined by some reforms and legislative proceedings which intervened in reforming the market structure. The Legislative Decree No. 3 of 2015 mandated the transformation into joint-stock companies for cooperative banks with assets exceeding 8 billion euros. The Legislative Decree of February 14, 2016, No. 18 reformed cooperative credit banks, (totalling 226 banks by the end of 2022), obliging them to choose membership in one of the nationally relevant banking groups (ICCREA and Cassa Centrale Banca) or in the Raiffeisen Südtirol IPS.

This consolidation has also resulted in the creation of larger and more robust banking institutions capable of withstanding economic shocks and better serving their customers.

In the course of this consolidation process, the size gap between the two largest Italian banking groups (Intesa Sanpaolo and UniCredit) and the rest of the market increased. Over the temporal span extending from 2014 to 1H 2023, the total asset ratio between the second and third market operators rose from 3.5x to 4.2x.

Furthermore, there has been a shift in the distribution model, with the number of bank branches dropping below 21,000 (a decrease of 32% compared to 2014).

In the last decade, approximately 10,000 branches have been closed, with approximately more than 50% of these closures occurring in the last 5 years. Similarly, the number of bank employees has decreased to 264,000, marking a 13% reduction from 2014.

Aligned with the evolution of the distribution network, Italian banks' offerings have progressively embraced digitalisation. In recent years, technological innovation has played a pivotal role in reshaping the global banking system, a transformation that was underway even before the onset of the Covid-19 pandemic. The pandemic underscored the importance of digital transformation, ensuring seamless access to financial services for bank customers.

As per ABI's 2022 report, the overall use of Internet banking in Italy, whether for informational or transactional purposes, continues to strengthen. Nearly two out of three customers, totalling 20 million bank users, are now actively engaging with digital banking services. Despite this positive trend, international statistics reveal that Italy still lags behind other European countries in terms of both customer adoption of digital financial services and the level of FinTech investments.

Furthermore, the size of banks plays a crucial role in driving these innovations forward. Given the substantial initial investments and the requirement for highly skilled employees, digitalisation and the diffusion of emerging technologies tend to be more pronounced among significant banks compared to their less substantial counterparts.

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Recent Trends and Performance of the Italian Banking Sector

In 2022, the Italian banking sector recorded extremely positive performance in terms of profitability, which continued to improve in 2023. The interest rate scenario underwent a profound transformation, with the ECB initiating a restrictive monetary policy from July 2022 to curb inflationary pressures.
This had positive impacts on the financial results of the Italian banking groups. The widening gap between the average yield on loans and the average cost of funding had particularly positive effects on the banks' net interest margin. Italian significant banks recorded an average ROE of 13.9% in the first half of 2023, marking an increase of approximately 478 basis points year-on-year.

The surge in profitability primarily resulted from a boost in net interest income. The net interest margin, which increased from 1.2% to 2.0% year-on-year, remains the primary contributor to net interest income, offsetting a slight reduction in financial asset stock year-on-year (-9%).

The increase in market yields favoured banks with traditional operations, whose profitability had been under pressure in previous years due to low-interest margins. On the other hand, the current interest rate scenario slowed down fee-related components of Asset & Wealth Management and Insurance activities, which had previously supported good financial results and now face competition from plain vanilla asset classes.

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> The average cost-to-income ratio dropped from 61.2% to 52.1%, reaching an all-time low, as banks successfully managed to control the inflation of their expenses.

Despite the challenging macroeconomic environment, the asset quality of banks remains robust. The gross non-performing loan ratio remained at its lowest level (2.4%), while the allocation of Stage 2 loans stood around 11% (-2% year-on-year). The cost of risk was 36 basis points, closely aligned with the levels reported in the last two years.

The average cost-to-income ratio dropped from 61.2% to 52.1%, reaching an all-time low, as banks successfully managed to control the inflation of their expenses. The evolution of the cost base continues to be one of the Italian banks' greatest achievements, especially in the context of continued nearly-double-digit inflationary pressure, implying that, in real terms, operating expenses are decreasing very significantly.

In this context, the average price-to-book ratio of Italian banks increased, influenced by improved profitability. However, it remains below unity, in line with observations for euro area intermediaries.

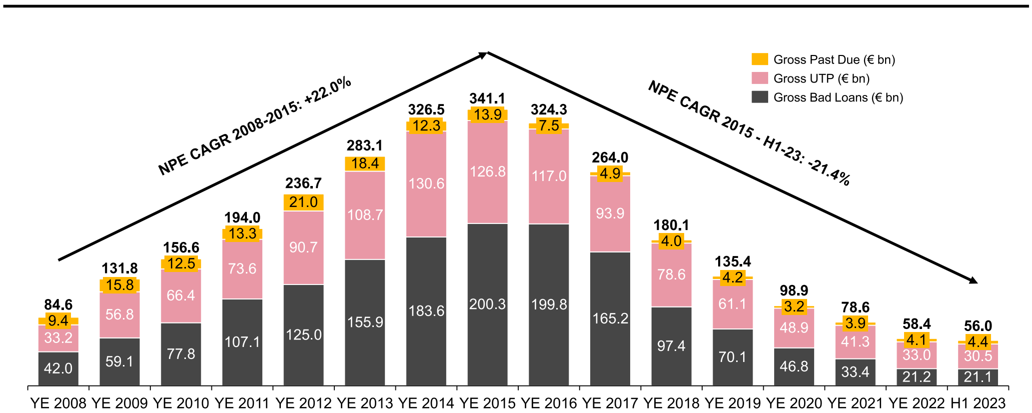
Market consensus expects Italian bank P&Ls to maintain robust performance next year. This is attributed to resilient net interest income, driven by higher average interest rates compared to 2023 while deposit betas are expected to remain controlled. Additionally, there is an anticipated recovery in asset management fees despite a potential decline in interest rates. Provisions are expected to remain under control, and there is a focus on cost control. However, some potential threats to the sector persist: the repricing of liabilities, ongoing inflationary pressures on operational expenses, the impact of labour contract renewals and subdued growth in loans.

Asset quality: still (?) a critical point

Asset quality continues to be a hot topic in the financial sector, both globally and locally.

In recent years, Italy has made significant progress in managing distressed credit after the peak of NPEs reached in 2015. In 2015 the gross NPE in the balance sheet of Italian banks amounted to €341.1 bn, decreasing to €56 billion as of June 2023 leading to an average NPL ratio well below 3%.

Gross NPE trend



Data show that banks have been working hard in identifying several measures that have proven to be effective solutions, also in response to market and regulatory pressures. Indeed, investors and external stakeholder started paying increasing attention to the NPE and, at the same time, the ECB and Bank of Italy published dedicated guidelines and gave specific targets in terms of NPL ratios.

Therefore, banks implemented both internal and external strategies. Firstly, financial institutions strengthened their internal skills and created dedicated organisation units to adopt proactive strategies for the recovery of impaired loans. Secondly, the external environment played a key role. The ecosystem around banks evolved, with the birth and the development of dedicated players, focused on the management of non-performing exposures, to which banks and investors outsourced servicing activities. Several investors started to consider with interest the Italian market making possible derisking for banking players.

Despite these positive results, the future still presents challenges:

- Interest rate trend and lack of economic growth must be closely watched, since it can affect the ability of borrowers to honour their financial commitments, affecting the overall credit quality.
- There are over €300 billion of total NPEs that are still present in the market, including those sold to specialised investors, as a significant portion of the loans transferred by banks in the deleveraging process is outstanding and requires appropriate management.
- There are over €200 billion of Stage 2 loans that require close monitoring. Italy ranks third in Europe for Stage 2 loan stock (led by France and Germany with €435 and €212 billion respectively as of H1-2023), but it has the highest proportion with respect to the total loans (over 11% compared to a European banks' average around 9%). These positions, although not yet classified as non-performing, could represent a potential future risk, especially in a changing economic environment.
- Between 2020 and June 2023, over €340 billion in loans with state guarantees have been disbursed, generating a loan stock of approximately €230 billion as of June 2023. Pre-amortisation periods ended and repayment of principal started. As a consequence, there has been a slight increase in the corresponding loan default rate, consistently remaining higher than the default rate for borrowers that did not utilise government-guaranteed loans (2.1% compared to 1.1% in June 2023).

Hopefully, the implementation of stricter controls during the origination phase and of more careful monitoring processes, will help reducing new flows of impaired loans.

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In conclusion, credit quality in Italy benefited in recent years from targeted measures and increased control in the origination and management. However, constant monitoring and adaptation to economic dynamics remain imperative. Financial authorities and institutions must continue to work ensure the long-term stability of the Italian financial system.

The Rise of New Competitors

In the aftermath of significant market and regulatory upheavals over the past decade, tangible structural changes are reshaping the banking and financial landscape. Forces such as technology, evolving customer behaviours and regulatory shifts are propelling a paradigm shift.

Amidst this transformative background, a cohort of new players is leading the change in innovation and providing customers with expanded choices. These include specialised banks and emerging entities with digital business models. Furthermore, players from different industries are entering the fray, forming unexpected alliances and partnerships that are redefining the industry landscape, with the significant disruptive potential of Big Tech on the horizon.

Among these transformative forces, 'Challenger banks' stand out as a group of innovative players pursuing distinct strategies compared to traditional high-street banks. Their strategies focus on product/customer specialisation and/or technological innovation. Typically targeting niche segments with attractive risk return profile, Challenger Banks leverage non-traditional distribution channels and rely heavily on digital technology and flexible operating models.

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> In 2022, the Bank of Italy also conducted a survey to assess the alignment with expectations.

Italy, with over 15 Challenger banks, ranks as the second-largest country in Europe after the UK in terms of their proliferation. Italian Challenger banks predominantly aim to address specific customer groups or products that receive less attention from traditional banks. In contrast to the overall banking system, these banks have experienced consistent portfolio growth in recent years. Their primary focus lies in SME lending and specific products such as government-guaranteed loans and factoring. Another area of emphasis has been NPL purchasing, also given the relevance of NPL market in Italy.

However, Challenger banks do not enjoy the same funding conditions as the traditional banking system, characterised by a high level of resilience in retail funding costs that are not always linked to market dynamics.
Today the management of capital and funding becomes a highly sensitive issue for the entire segment, impacting not only challenger banks but also growing institutions in a macroeconomic and monetary policy environment vastly different from just a few months ago.

In this context, Traditional banking institutions are not shying away from this digital upheaval. They are strategically embracing digitalisation by establishing their own digital banking brands. This strategic move empowers them to compete effectively with digital-only players and simultaneously bolsters the resilience of the banking ecosystem, reducing customer acquisition costs in the process. The recent example of Intesa Sanpaolo's strategic shift to digital banking with Isybank exemplifies strategic response to digital disruption.

Emerging trends: ESG

Italian banks are increasingly recognising the need to integrate sustainability into their operating and decision-making processes, thanks to both an evolving regulatory framework and increasing attention to these topics by stakeholder.

In 2020, the ECB published specific guidance on how to integrate climate and environmental risks into the strategy, business model and risk management processes of significant banks, and conducted numerous exercises and supervisory activities on the topic. A similar initiative was taken by the Bank of Italy in April 2022 with reference to less significant Italian banks and financial intermediaries.

Supervisory expectations are focused on environmental considerations, and they encourage banks to integrate climate and environmental risk factors into all banking and financial activities.

In 2022, the Bank of Italy also conducted a survey to assess the alignment with expectations. The assessment, extended to both transition and physical risk, revealed, net of some positive exceptions, a low degree of alignment with the expectations, but, at the same time, a widespread and growing awareness of the importance of the theme for the prospective sustainability of the business model.

Specifically, the management of climate and environmental risks is now under the responsibility of many boards of directors, supported by dedicated Committees or internal functions. Moreover, many banks have performed analyses aimed at mapping the regulatory and/or competitive context in order to review their strategies. However, the greatest difficulty concerns the availability of data. Consequently, quantitative approaches in the measurement of climate risks are still rare and not systematic, risk management processes are poorly structured, objectives expressed in terms of quantitative risk indicators and performance are not widely spread.

In order to deal with the poor situation highlighted by the survey, Bank of Italy required to define 3-years action plan to design initiatives in line with supervisory expectations and Italian players are therefore currently working on them, with a constant interaction with the Supervisor.

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Recent Amendments to Banking-Related Regulations in Japan

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On March 5, 2021, a bill (the "Bill") was submitted to the Diet based on the recommendations of the Financial System Council (the "Council") of the Financial Services Agency of Japan (the "FSA"). The Bill encompasses, among others, amendments to the Banking Act and the Financial Instruments and Exchange Act (the "FIEA"), to strengthen and enhance the stability of Japan's financial system in response to the socio-economic impact of Covid-19 and other developments. The Bill was approved by the Diet on May 19, 2021 and came into force on November 22, 2021.

"The Banking Act is premised upon the separation of "banking" and "commerce".

Based on the recommendations of the Council, the FSA has also amended the Cabinet Office Ordinance on Financial Instruments Business (the "COOFIB") and the supervisory guidelines in relation to firewall regulations in June 2022.

This article provides an outline of (i) the amendments to the Banking Act, (ii) the amendments to the COOFIB and the relevant supervisory guidelines published by the FSA and (iii) the resulting developments following the aforementioned amendments.

1. AMENDMENTS TO THE BANKING ACT

The Banking Act is premised upon the separation of "banking" and "commerce". Under the Banking Act, banks are only permitted to engage in core banking activities (i.e., deposit taking, lending and funds remittance), limited businesses ancillary to banking activities, and certain securities-related businesses specified in the Banking Act. Banks are also generally prohibited from holding subsidiaries or holding more than 5% of the voting rights in domestic companies that engage in businesses other than those permitted under the Banking Act ("Restricted Entities"), except in certain limited circumstances. These limitations have been imposed on banks with the objective of, among others (1) preventing damage to the financial soundness of banks as a result of their engaging in non-banking related activities and (2) preventing banks from being conflicted between acting in the interest of customers of their core banking businesses (and depositors in particular) and the interests of customers in their other businesses.

However, given the low interest rate environment in Japan and the development of new methods of funds remittance by fintech companies, the prevalent business models of Japanese banks are expected to undergo inevitable change. Moreover, given the headwinds presented by the aging demographics in Japan, banks are expected to be at the vanguard of efforts to rehabilitate the economy and spearhead sustainable growth. In line with this, the Council's "Banking System Working Group" undertook a review of the banking system and published a report on December 22, 2020, summarising its recommendations of measures for improving the banking system (the "Banking System Report"). The improvement measures are aimed at, among others, relaxing the scope of businesses in which banks and their subsidiaries may engage, based on recent socio-economic developments. The Bill includes amendments to the Banking Act based on the Banking System Report.

Pursuant to the amendments to the Banking Act under the Bill (the "Banking Act Amendments"), banks are permitted to engage in certain businesses relating to the digitalisation and rehabilitation of regional economies in Japan by utilising their banking-related management resources. Under the Banking Act Amendments, such businesses, which are considered ancillary to banking activities, include provision of the following services: (i) services that support the livelihood of customers; (ii) IT systems and applications originally developed by banks for internal use; (iii) data analysis, marketing and advertising services; (iv) temporary staffing services; and (v) consulting and business-matching services.

Under the Banking Act Amendments, banks are also able to more flexibly invest in domestic companies. For example, a bank may hold a subsidiary that engages in a business related to the rehabilitation of regional economies in Japan. The scope of domestic companies in which a bank may invest has been expanded into the area of venture investments and business rehabilitation projects. Such investments may be conducted through the subsidiaries of banks that are established for purposes of investing in other companies. Further, the requirements for investments in such companies have been relaxed and the permissible term for which a bank may invest in such companies has been extended to enable banks to make broader and longer-term commitments to venture investments, business rehabilitation and business succession projects.

Under the erstwhile banking regulations, banks and banking groups were permitted, with the FSA's approval ("Investment Approval"), to hold more than 5% of voting rights in Restricted Entities if (i) the business of the Restricted Entity would or would potentially enhance the operational sophistication of the banks or (ii) the business of the investee company would enhance or would potentially enhance the convenience of customers of the relevant bank ("Complementing Companies"). This has enabled Japanese banks to obtain Investment Approvals for investments in fintech companies, such as those that have developed electronic Know Your Customer (e-KYC) or fraud detection technologies, as well as regional trading companies. The Banking Act Amendments augments this by including provisions that expand the scope of situations in which banks and banking groups may apply for Investment Approvals (including allowing investments in companies that would contribute or would potentially contribute to social sustainability) and relaxing the criteria for Investment Approval in certain circumstances. Further, banking groups certified as having sufficient financial strength and satisfactory standards of corporate governance may invest in Complementing Companies without Investment Approval. Accordingly, the Banking Act Amendments enable banks and banking groups to expand the scope of their businesses based largely on their resourcefulness and ingenuity. Following the Banking Act Amendments, Japanese banks have obtained Investment Approvals to establish various subsidiaries that engage in businesses related to renewable energy (e.g., generation and supply of renewable energy) and software engineering, among others.

The Banking Act Amendments are also designed to strengthen the international competitiveness of Japanese banks. Under previous banking regulations, banks and bank holding companies that hold foreign banks as subsidiaries are generally required to dispose of their subsidiaries within five years of acquisition if the businesses of such subsidiaries fall outside the scope of the permissible businesses under the Banking Act. A bank or bank holding company that fails to do so would be required to restructure the business of its foreign bank subsidiary(ies) for compliance with the Banking Act or to liquidate the foreign bank subsidiary(ies). Under the Banking Act Amendments, however, the timeframe for such mandatory sell-off has been extended to ten years, with the possibility of a further extension if regulatory approval is obtained. Such extension may be obtained if it can be shown that the extension is necessary for the competitiveness of the foreign bank subsidiaries. The Banking Act Amendments also allow banks and bank holding companies to invest directly in foreign money lenders and leasing companies that concurrently engage in non-"finance-related" businesses, as long as the main businesses of such money lenders and leasing companies are money lending, leasing or other finance-related businesses.

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2. AMENDMENTS TO FIREWALL REGULATIONS

The FIEA and the COOFIB both contain "Ginsho firewall regulations." (A Ginsho firewall refers to a firewall between banks and securities firms.) As a general rule, pursuant to such regulation, no non-public information regarding a client may be shared between a bank and a securities company within the same financial group without that client's prior written consent.

Following discussions at the Council's "Working Group on Capital Market Regulations", the Council published its first capital market report ("First Capital Market Report") on December 23, 2020, followed by a second capital market report ("Second Capital Market Report") on June 18, 2021.

> "According to the First Capital Market Report, however, non-public information relating to foreign corporate clients should be excluded from the scope of the Ginsho firewall regulation.

The First Capital Market Report addresses, among other issues, amendments to the firewall regulations between banks and securities firms in respect of foreign corporate clients.

The Second Capital Market Report addresses, among other issues, amendments to the firewall regulations between banks and securities firms in respect of domestic clients.

(i) Foreign Corporate Client Information Firewall

As mentioned above, as a general rule, pursuant to the firewall regulations, no non-public information regarding a client may be shared between a bank and a securities company within the same financial group without that client's prior written consent. Such general rule was applicable to foreign corporate clients unless certain exemptions apply (such as where an opt-out option is given to a client (enabling a client to opt out of the sharing of its information between a bank and a securities company within the same financial group) and the client chooses not to opt out, or where consent by email is provided by a client).

According to the First Capital Market Report, however, non-public information relating to foreign corporate clients should be excluded from the scope of the Ginsho firewall regulation. Accordingly, amendments to the COOFIB to exclude information relating to foreign corporate clients from the definition of non-public information were proposed, and subsequently published for public consultation on March 26, 2021. This was followed by eventual amendments to the COOFIB based on the recommendations in the First Capital Market Report, which came into force on June 30, 2021.

(ii) Domestic Client Information Firewall

As noted above, pursuant to discussions at the Council's "Working Group on Capital Market Regulations" following publication of the First Capital Market Report, a Second Capital Market Report was published on June 18, 2021. The Second Capital Market Report contains the Council's further recommendations on amendments to the COOFIB, including recommendations for amendments to be made to the Ginsho firewall regulation in respect of domestic clients. As noted above, the general rule under current regulations is that a domestic client's prior written consent is needed before non-public information regarding client can be shared between a bank and a securities company within the same financial group. However, the consent to sharing of non-public information relating to domestic corporate clients (i.e., excluding domestic clients who are individuals) is subject to an opt-out rule.

According to the Second Capital Market Report and the amendments to the COOFIB, such firewall regulations for domestic clients will be relaxed to a certain extent. More specifically, for clients that belong to a corporate group that includes listed companies ("Listed Company-Related Clients"), prior written consent would not be necessary for the sharing of non-public information regarding that client between a banking entity and a securities company within the same corporate group, unless the client specifically opts out of such information sharing.

Further, the procedures for opt-in will be simplified for both the domestic corporate clients as well as the domestic individual clients under the amendments to the COOFIB, based on the Second Capital Market Report.

For example, under the amended COOFIB, which is based on the Second Capital Market Report, electronic media (such as email) are now acceptable media through which clients may indicate their agreement to opt into information-sharing. Certain other measures were also implemented in the amendments to the COOFIB. Among these is the relaxation of the limitations on access to non-public information by those who double-hat as officers and/or employees of both a bank and the securities company within the same banking group. Under such measures, information-sharing between banks and securities companies within a banking group will be relaxed.

In exchange for such relaxation of the regulations on information-sharing, regulations on strengthening the effectiveness of prevention of harmful effects of information-sharing between banks and securities companies will be enhanced. According to the Second Capital Market Report, the amendments to the COOFIB, as well as the relevant supervisory guidelines, the regulations to be enhanced will include those relating to (i) management of customer information by banks (e.g., prohibition against the sale and purchase of securities by banks and their employees based on undisclosed material information in respect of listed companies and implementation of internal management systems based on the "need-to-know principle"), (ii) management of conflict of interests among the banking groups (which will enhance the way conflicts of interests are managed by a banking group) and (iii) prevention of abuse of dominant bargaining position by banks (e.g., enhancing regulatory supervision of such abusive actions in coordination with the Japan Fair Trade Commission).

Amendments to the COOFIB as well as the supervisory guidelines reflecting the recommendations in the Second Capital Market Report, were published for public consultation on December 24, 2021. The eventual amendments to the COOFIB, after the public consultation period, came into force on June 22, 2022. At the same time, the FSA also established a desk dedicated to the collection of information on abuse of dominant bargaining position relating to firewall regulations.

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(iii) Further developments

The relaxation of regulations pursuant to the Banking Amendments has been welcomed by the banks and banking groups in Japan, and further relaxation of regulations on the business scope of banks and bank group companies have been proposed and appear to be forthcoming in the foreseeable future. Indeed, some amendments have already come into effect and some proposals, based on industry demands, have been made available for public comments. More specifically, on June 1, 2023, the FSA has made amendments to its supervisory guidelines to clarify that banks and banking groups may, before obtaining an Investment Approval, conduct experimental tests in respect of the businesses they plan to conduct after obtaining an Investment Approval. Further, on June 30, 2023, the FSA published proposals for amendments to Cabinet Ordinances relating to the Banking Act and relevant supervisory guidelines. Among the suggested amendments was a proposal allowing banks to engage in the intermediation of issuance of credit cards by credit card companies.

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> The relaxation of regulations pursuant to the Banking Amendments has been welcomed by the banks and banking groups in Japan.

Moreover, it was noted in the "Grand Design and Action Plan for a New Form of Capitalism 2023 (Revised Version)", which was published on June 16, 2023 and adopted by the Cabinet, that the Japanese government will promote the relaxation of requirements for investment regulations, in order to expand the scope of startups that banking groups can invest in, so as to provide more support for startups. Considering these recent trends, the scope of businesses that banks and their subsidiaries may conduct are expected to be further relaxed if the regulatory authorities consider such relaxation necessary and if such relaxation is unlikely to adversely affect the effectiveness of regulations on the scope of businesses that banks and their subsidiaries may conduct. With that said, the separation of "banking" and "commerce" will still be maintained under the Banking Act.

With regard to the firewall regulations, the regulatory authorities are currently discussing whether regulations on sharing of non-public information of clients should be further amended to provide greater convenience for bank customers, but in a way that balances the need for customer-protection. In line with this, the Working Group on Capital Market Regulations has published an interim report in June 2022 and a second interim report in December 22. It is stated in both reports that the Working Group will continue to consider the possibility of relaxing the firewall regulations, while examining the effectiveness of measures that have been implemented to prevent the harmful effects of information-sharing between banks and securities companies. In this connection, it was stated in a paper published by the FSA on August 29, 2023, titled "The JFSA Strategic Priorities July 2023 - June 2024", that FSA will deliberate on possible amendments to the firewall regulations, taking into consideration the level of protection provided by financial institutions to their customers, as well as the need to facilitate the ability of financial institutions to provide their customers with adequate financial services. Further developments are expected, and industry watchers are closely monitoring the situation for clues on the position that the regulatory authorities will ultimately take.

JAPAN

Regional financial institutions play a vital role on the path to true regional development

Recent developments affecting the business of regional financial institutions

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Recent developments affecting the business of regional financial institutions

Japan was no exception to the temporary slowdowns in global economic activity induced by the spread of the covid-19 pandemic in early 2020. The Japanese government responded to these developments by providing — through Japan Finance Corporation and Shoko Chukin Bank — a policy-based directed credit program available to small and medium enterprises (SMEs) impacted by COVID-19 (known as "zero-zero loans"), wherein interest was forgiven and repayments deferred for a period of 3 years from the date of the loan. There was a large influx of applications when the program began in March 2020[1], and in May 2020 private financial institutions also began to finance loans under equivalent terms by leveraging the aid provided to policy-based directed credit programs provided by Japan's prefectures made possible through the credit guarantee system.[2]

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The process of establishing a regional trading company was streamlined with the revision of the relevant Supervisory Guidelines (the Comprehensive Guidelines for Supervision of Regional Financial Institutions) in 2019

Given the record-breaking amounts lent during the height of the COVID-19 pandemic and the increasing demand for financing as the COVID-19 pandemic begins to subside, the total outstanding balance of loans made to small and medium enterprises by a total of 99 regional banks stood at JPY302,000 billion, a 5% increase year-on-year. This marks a 150% increase of the JPY201,000 billion in outstanding loans by regional banks as of 31 March 2011, a JPY100,000 billion increase over just twelve years. This rate of increase is substantially greater than the nearly 20% increase in loan balances seen in urban banks over the same time period.[3]

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The evolving role of regional financial institutions

Major societal changes, such as the imposition of restrictions on the freedom of movement due to the COVID-19 pandemic, continue to generate new expectations for the roles to be played by regional financial institutions.

One such development is that regional banks have begun to establish regional trading companies through which they provide support to private companies operating within their given region. Much is expected of the regional trading companies established in this manner, including the identification of exceptional products and services within the region, utilisation of new sales channels and branding campaigns to increase profits to unprecedented levels, and distribution of the knowledge and profits generated through such activities to the region; as well as the discovery of latent talent and resources alongside the building of a larger community of non-resident individuals with ties to the region (a concept known in Japan as the "related population").

The process of establishing a regional trading company was streamlined with the revision of the relevant Supervisory Guidelines (the Comprehensive Guidelines for Supervision of Regional Financial Institutions) in 2019, which provided clarity regarding the examination of advanced banking service companies and the rules pertaining to investments in regional trading companies.[4] Exposure to the dampened profits of regional companies during the COVID-19 pandemic forced regional banks engaged in regional company financing to enhance the management support functions they provided to such lendees (e.g., product development and sales channel development), and the additional risks to the recovery of outstanding liabilities posed by inaction is likely to have further accelerated the adoption of regional trading companies as a means of providing such support.

1. As of 31 March 2023, the cumulative total of loans issued by the Japan Finance Corporation amounted to JPY16,868.4 billion (1,148,337 loans) with a total outstanding balance of JPY12,441.1 billion (954,236 loans). The cumulative total of loans issued by the Shoko Chukin Bank amounted to JPY2,568.0 billion (38,864 loans) with a total outstanding balance of JPY1,867.3 billion (35,031 loans).
   Board of Audit of Japan, FY 2022 Audit Report https://www.jbaudit.go.jp/report/new/all/pdf/fy04_09_04.pdf
   (Accessed 14 December 2023)
2. The credit guarantee balance relating to loans issued through zero-zero loans made by private financial institutions peaked at more than JPY20,000 billion in May 2021 before slowly decreasing to approximately JPY14,500 billion as of August 2023.
   Informational materials, "11th Subcommittee for Finance, Council for Small and Medium Enterprise Policy", Small and Medium Enterprise Agency
   https://www.chusho.meti.go.jp/koukai/shingikai/kinyu/011/02.pdf
   (Accessed 14 December 2023)
3. The Nikkei, "地銀の貸出金300兆円突破、ゼロゼロ融資の返済本格化へ [Regional banks exceed JPY300 trillion in loans with repayment of zero-zero loans looming]", Accessed 15 June 2023
4. Financial Services Agency, "金融機関の業務範囲等に関する新たな規制緩和 [Additional deregulation pertaining to the scope of services permitted of financial institutions]", Accessed 6 January 2020, https://www.fsa.go.jp/frtc/kikou/2019/20200106_P38-42.pdf

Further reform of the Banking Act in May 2021 provided for a "Revision of restrictions to the scope of services" and a "Revision of restrictions on investments." These revisions contained measures providing for the relaxation of the restrictions on the scope of services respectively permitted to banks and the subsidiaries or sister companies of such banks enacted with the intention of addressing the impact of the COVID-19 pandemic to enable the formation of a sustainable society through means such as digitalisation and regional revitalisation; as well as measures pertaining to restrictions on investments, providing for the ability to conduct investments amounting to 100% of voting rights in a non-listed regional development business to facilitate a wide range of support activities conducted through bank financing including the multi-dimensional revitalisation of regions.[5]

Following the relaxation of such restrictions, regional financial institutions began to accelerate the pace at which they establish regional trading companies as well as the operation of registered staffing services and a diverse range of consulting services.

Regional advancements leverage digital transformation (DX)

The COVID-19 pandemic forced even companies apprehensive about digitalisation to adapt and led to the rapid acceleration of ongoing digitalisation activities, particularly those involving contactless or unattended services. The tourism industry was particularly hard-hit by the COVID-19 pandemic and is now faced with the challenge of determining how best to digitalise existing data and utilise that data to further collect and leverage the potential of regional-level data. Many regions are currently engaged in the process of implementing digitalisation and other DX initiatives, with one notable example seen in Hyogo Prefecture's Kinosaki Onsen Town, which has begun utilising regional-level data generated and collated from various property management systems — used to manage bookings and other aspects of its local ryokan inns and hotels — to track vacancies throughout the area and enable short-term demand forecasting. Demand forecasting enables additional forecasting for employee shift planning and procurement planning, as well as the optimisation of profits through revenue management, and is expected to increase profits throughout the region and to provide opportunities for corporate-level enhancement of both profits and productivity.[6]

However, many such initiatives to have local businesses provide data to the region and track demand throughout the area are stuck in a cycle where an idea is raised, fails to see fruition, and yet another idea takes the place of the first. One major obstacle to such initiatives can be found in the data acquisition process, e.g., the inability to reach a regional consensus or the reluctance of individual companies to share their data. Although it is a given that any such data will be anonymised prior to its use, resistance to releasing company data is well-entrenched as the parties involved often have their interests directed towards besting their regional competitors. Distributing point of sales (POS) data (including data on purchases) to the region allows for a clear picture of the amount of purchases made throughout the entire region as well as the assessment of the size of the regional market. Pairing this information with occupancy rate data enables the estimation of visitor demand, which could generate increased expectations for new business opportunities in the area and provide opportunities for new entrants to the regional market. It remains a fact, however, that regardless of how well the parties involved understand the benefits, regions nevertheless struggle to make real progress on any such initiative.

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5. Financial Services Agency, "新型コロナウイルス感染症等の影響による社会経済情勢の変化に対応して 金融の機能の強化及び安定の確保を図るための 銀行法等の一部を改正する法律案説明資料 [Explanatory materials: On addressing the impacts of the COVID-19 pandemic and other changes in the socioeconomic sphere — Draft legislation aiming to revise a portion of the Banking Act to enhance financial functions and stability], Accessed March 2021, https://www.fsa.go.jp/common/diet/204/01/setsumei.pdf (Accessed 14 December 2023)
6. EMIRA, "兵庫· 城崎温泉は "共存共栄の精神" で観光DXを推進し、経営を改善！ [Hyogo's Kinosaki Onsen bets on mutual aid and prosperity for tourism DX and better management]", December 2023, https://emira-t.jp/special/23464/, Accessed 14 December 2023)

Regional financial institutions and the quest for regional development

Regional financial institutions place high value on the support of regional SMEs as a means for both institutional and regional growth. Continuous support for company growth is predicated on the ability to have a timely assessment of the status of a company's business, but financial institutions have only limited opportunities to make such assessments via, e.g., annual financial statement data, the trial balances companies are required to provide on a periodic basis, or (if the bank is the main bank utilised by the company) account withdrawal and deposit data. Access to more dynamic data at timely intervals would have a significant impact on the positions taken in regard to the support of SMEs.

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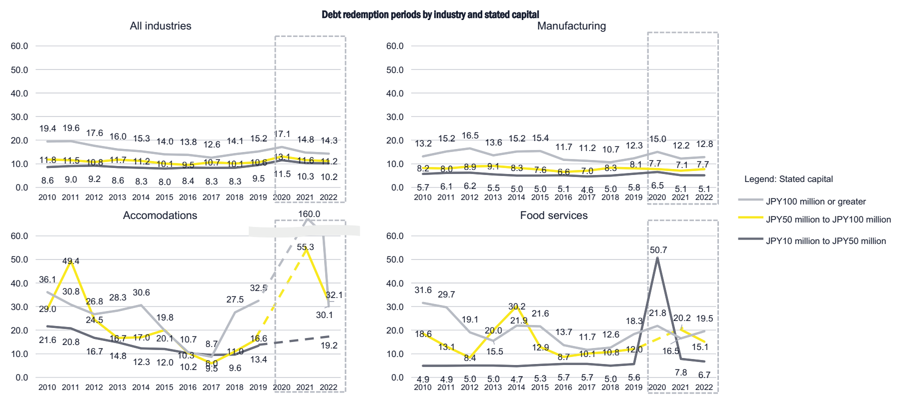
Dynamic data acquisition is already a reality in the FinTech space, wherein EC businesses utilise the transaction data and other information sourced from EC sites in transaction lending. However, as such data is limited to that pertaining to online transactions, it is insufficient for use in the provision of support to regional SMEs.

As discussed above, one of the primary obstacles to regional-level data tracking is that companies refuse to provide the data necessary to do so. SMEs face the constant challenge of securing access to working capital and capex in preparation for business expansions. A financial institution successful in encouraging companies to share transaction data daily and leveraging that data to conduct financing would be in a position to provide both capital and business management advice in the interest of regional growth.

A few use cases are discussed in detail below. Zero-zero loans, originally a measure meant to support SMEs during the COVID-19 pandemic, may now be acting as a significant barrier to the growth of the rapidly recovering tourism market. Business operations in the tourism industry suffered extensively from the pandemic and debt redemption periods for such businesses currently exceed pre-COVID-19 levels. The ability to accurately predict regional-level bookings, room occupancy, average daily rates and other factors several months in advance could increase the willingness of lenders to provide additional working capital. In-depth communication with lodging facility operators about such data and demand predictions on the scale of several years could also increase the willingness of lenders to provide access to funds for capital investments without overreliance on real estate collateral.

The benefits extend beyond increased willingness to lend capital, and into the recoverability of debts; the early detection of financial distress in lendees, for instance, could enable financial institutions to more easily provide management advice or opportunities for debt rescheduling.

Figure 1: Debt redemption periods by industry and stated capital



*As the accommodations and food service industries posted sizeable ordinary income losses in 2020 and 2021, the author has refrained from displaying numerical results and inserted dashed lines during periods where the redemption periods were incalculable (negative).

1 *Prepared by EY based on Ministry of Finance data, "法人企業統計調査 [Financial Statements Statistics of Corporations by Industry]", https://www.mof.go.jp/pri/reference/ssc/index.htm, accessed 1 December 2023

Access to region-level data provides benefits

Access to data about the business conditions of a given region facilitates the ability to provide financial support to the SMEs that act as the pillars of the regional economy, and thus contributes to the growth of the regional economy itself. The ability to track the economic conditions of a given region, including via predictive data, also helps attract investment from non-local parties, and even holds the potential to facilitate the formation of an ecosystem amenable to the market entry of startups.

Collaboration between regional financial institutions and their local counterparts to collect, collate and leverage such region-level data for the development of the region and in support of local companies will provide the means necessary to build a circular economic model into the regional economy.

In the light of a decreasing and aging population, there are only two possible pathways for maintaining a regional economy: meeting non-local demand through the sale of products in non-local localities (export and inter-regional trade) or enticing non-local demand into the region and inducing local consumption (tourism). During the height of the COVID-19 pandemic, there was accelerated adoption of regional trading companies, which place a focus on export and inter-regional trade, in the interest of supporting SMEs in the development of products and sales channels. Given the nature of financial institutions, however, it is advisable that such institutions also place an emphasis on the latter point, i.e., the question of how to entice non-local demand into the region and induce local consumption. This is the very definition of tourism, which requires participation not only from lodging business operators, restaurants and retailers, but industries of all shapes and sizes, as it involves the provision of products and services to non-residents. Tourism has the potential to act as the foundations of innovation, which involves analysing data to identify needs and using that information to develop new products and services.

The case could even be made that what is truly required to accomplish these aims is support for regenerative economic growth via a framework adopted and led through the partnership of regional financial institutions and other regional actors, one which generates the sustainable regional-level growth captured only when regional actors operate in unison to exploit the potential of regional resources.

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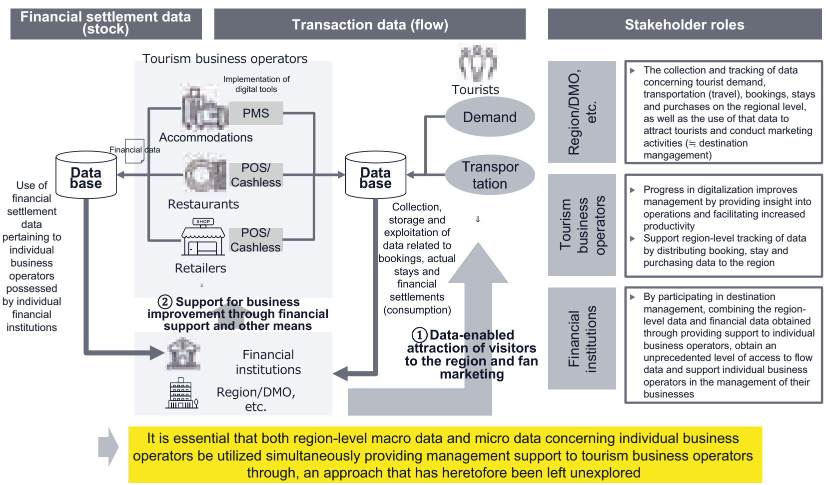
Figure 2: Data-enabled model for regenerative economic growth



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PHILIPPINES

Recent Trends in Philippine Banking Laws and Regulations: Towards Financial Inclusion and Consumer Protection

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Recent Trends in Philippine Banking Laws and Regulations: Towards Financial Inclusion and Consumer Protection

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INTRODUCTION

The Philippines is among the fastest-growing economies in Southeast Asia.[1] However, large traditional banks have focused on wholesale and commercial products, leaving a vast potential retail customer base underserved.[2] The banking penetration rate remains among the lowest in the region at just 56% in 2021.[3]

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> Before the PPSA, the creation of a valid security interest over personal property under Philippine law was governed by the Civil Code and the Chattel Mortgage Law.

Recent legislation and regulations have generally focused on addressing this gap. In 2018, Congress passed the Personal Property Security Act (Republic Act No. 11057) (“**PPSA**”), allowing retail customers and micro, small, and medium enterprises least-cost access to credit. In May 2022, to protect financial consumer rights and grant financial regulators powers to protect such rights, the Financial Products and Services Consumer Protection Act (“**FPSCPA**”) was signed into law. Additionally, in September 2022, in line with its policy of enabling responsible innovation to promote the development of an inclusive digital financial ecosystem, the Bangko Sentral ng Pilipinas (“**BSP**”), the Philippine central bank, issued BSP Circular No. 1153 and approved a Regulatory Sandbox Framework.

THE NEW PPSA AND ITS REGULATIONS

One of the significant developments in Philippine legislation is the passing of the PPSA, amending or repealing certain laws,[4] including the Civil Code provisions on the creation of pledges and the Chattel Mortgage Law regarding the creation of chattel mortgages and registration procedures for security interests over personal property.

The PPSA was enacted to strengthen the legal framework for secured transactions in the Philippines. It provides for the creation, perfection, determination of priority, establishment of a centralised notice registry, and enforcement of security interests in personal property (tangible and intangible), except aircraft[5] and ships.[6]

The PPSA took effect on 9 February 2019. However, its full implementation is conditioned upon the issuance of the relevant implementing rules and regulations and the establishment and operation of a new centralised registry (wherein notices of security interests may be registered). The implementing rules and regulations of the PPSA (“**PPSA Rules**”) were published and took effect on 3 December 2019, and directed the Land Registration Authority (“**LRA**”) to establish the registry within six months from that date.[7] The LRA announced the soft launch of the Personal Property Security Registry (“**PPSR**”) on 25 March 2021 for the registration of user accounts. Until the PPSR achieves full implementation, there will be no centralised and publicly searchable registry for security interests or encumbrances in the Philippines. As of November 2023, the PPSR has not achieved full implementation or operations.

Before the PPSA, the creation of a valid security interest over personal property under Philippine law was governed by the Civil Code and the Chattel Mortgage Law. Under the PPSA Rules, however, all security interests created from 9 February 2019 until the PPSA’s full implementation when the registry is established and operational (the “**Transitional Period**”) will be governed by the PPSA, except that registration should be completed in accordance with the Chattel Mortgage Law. Once the registry is established, the creation of a valid security interest over personal property under Philippine law will be entirely governed by the PPSA and the PPSA Rules, except interests in aircraft and in ships.

1. Philippines Market Overview at https://www.trade.gov/country-commercial-guides/philippines-market-overview (last accessed on 1 December 2023).
2. On the verge of a digital banking revolution in the Philippines at https://www.mckinsey.com/industries/financial-services/our-insights/on-the-verge-of-a-digital-banking-revolution-in-the-philippines (last accessed on 1 December 2023).
3. BSP 2021 Financial Inclusion Survey at https://www.bsp.gov.ph/Inclusive%20Finance/Financial%20Inclusion%20Reports%20and%20Publications/2021/2021FISToplineReport.pdf (last accessed on 1 December 2023).
4. PPSA, Section 66; PSA Rules, Section 9.01.
5. Security interests in aircrafts are subject to the Civil Aviation Authority Act of 2008 (Republic Act No. 9497).
6. Security interests in ships are subject to the Ship Mortgage Decree of 1978 (Presidential Decree No. 1521).
7. PPSA Rules, Section 5.01.

Creation of Security Interest

The PPSA introduced new rules governing the creation and registration of security interests over personal property in the Philippines. Under the PPSA Rules, parties are free to enter into any form of security arrangements over movable property as long as the security arrangement is not inconsistent with the PPSA or the PPSA Rules. Further, subject to existing law, parties may also apply the PPSA Rules to other functional equivalents of security interests, including fiduciary transfers of title; financial lease; assignment or transfer receivables; and sale with retention of title.[8]

Under the PPSA, a security interest over personal property may be created by a 'security agreement', an operating lease for not less than one year, or the sale of an account receivable (unless otherwise stipulated by the parties in the document of sale).[9] Except as otherwise provided in the PPSA, the PPSA Rules, or the agreement of the parties, a security interest will continue in the collateral notwithstanding its disposition.[10] A security interest is extinguished when all secured obligations have been discharged and there are no outstanding commitments to extend the credit secured by the security interest.[11]

A security agreement must be in writing and signed by the parties, identify the collateral and the secured obligation, and provide for the language to be used in the agreements and notices.[12] A model security agreement is annexed to the PPSA Rules.[13] There is no requirement under the PPSA that the security agreement be in a public instrument, but it is advisable given the practical effects of placing documents in a public instrument.[14] In creating a security interest, it is sufficient that the collateral be reasonably identified.[15] The security agreement may provide for the creation of a security interest in future property or after-acquired assets, but the security interest in that property will be created only when the grantor acquires rights in it or the power to encumber it.[16] The security agreement may also provide that a security interest in a tangible asset that is transformed into a product extends to that product (but it shall be limited to the value of the encumbered asset before it became part of the product).[17] It may likewise provide that a security Interest in a tangible asset extends to its replacement (but it shall be limited to the value of the encumbered asset before it was replaced).[18]

Perfection of Security Interest

The PPSA provides that a security interest over personal property may be perfected to bind third parties through the following means: registration of a notice with the registry, actual or constructive possession of the tangible collateral by the secured creditor, or control of the investment property or deposit account.

The PPSA also sets out new rules for determining priority of security interests over the same collateral. Generally, priority is still determined by the time of perfection. However, there are specific rules that apply depending on the nature and kind of property involved.

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Priority of security interests

The priority of security interests in the same collateral is generally determined by time of perfection.[19] However, with respect to security interests over personal property, there are rules for determining priority for specific types of properties, such as a deposit account or investment property where the secured creditor is the deposit-taking institution, security certificates, electronic securities not held with an intermediary, electronic securities held with an intermediary, and negotiable documents.

8. Philippines Market Overview at https://www.trade.gov/country-commercial-guides/philippines-market-overview (last accessed on 1 December 2023).
9. PPSA, Section 5(a); PPSA Rules, Section 3.01.
10. PPSA Rules, Section 3.02.
11. PPSA Rules, Section 3.12.
12. PPSA, Section 6; PPSA Rules, Section 3.03.13. Security interests in ships are subject to the Ship Mortgage Decree of 1978 (Presidential Decree No. 1521).
13. PPSA Rules, Annex A.
14. PPSA, Section 7; PPSA Rules, Section 3.04. Public documents or instruments are admissible in court as evidence without the need for further proof of its authenticity and due execution (Rules of Court, Rule 132, Section 20).
15. PPSA Rules, Section 3.04. A description such as 'all personal property', 'all equipment', 'all inventory' or 'all personal property within a generic category' of the grantor shall be sufficient.
16. PPSA, Section 5(b); PPSA Rules, Section 3.05(a).
17. PPSA Rules, Section 3.05(b).
18. PPSA Rules, Section 3.05(c).
19. PPSA Rules, Section 6.01.

Enforcement of Security Interest

With respect to enforcement, a secured creditor may enforce its security interest by: selling or disposing of the collateral, publicly or privately, or proposing to the debtor and grantor to take all or part of the collateral in total or partial satisfaction of the secured obligation, subject to certain notice and consent requirements.[20] The debtor is also required to satisfy any deficiency. Under previous laws governing pledges, a secured creditor cannot recover any deficiency after a foreclosure sale.

THE FINANCIAL PRODUCTS AND SERVICES CONSUMER PROTECTION ACT

> "[The FPSCPA] aims to protect the rights of financial consumers.

The FPSCPA was signed on 6 May 2022. It aims to protect the rights of financial consumers.[21] It gives financial regulators, such as the BSP, powers for rulemaking, market conduct surveillance and examination, market monitoring, enforcement, consumer redress or complaints handling mechanism, adjudication, and other powers as provided by its enabling law.[22] It also requires financial service providers[23] to provide appropriate product design and delivery; ensure transparency, disclosure, and reasonable pricing; ensure fair and respectful treatment of clients; respect client privacy and protect client data; establish a financial consumer protection assistance mechanism; and adopt and implement information security standards.[24]

The law renders void any provision of a contract for financial product or service[25] if the provision deprives a client of a legal right to sue the financial service provider, receive information, have their complaints addressed and resolved, or have their non-public client data protected.[26]

The FPSCPA provides for criminal[27] and administrative sanctions[28] for violations and declares as unlawful the commission of investment fraud.[29]

On 17 November 2022, the BSP issued BSP Circular No. 1160 to implement the FPSCPA. On 24 March 2023, the BSP issued Circular No. 1169, providing for the Rules of Procedure for the Consumer Assistance Mechanism, Mediation, and Adjudication of Cases in the BSP, to carry out the objectives of the FPSCPA and provide for just and speedy determination of complaints.

REGULATORY SANDBOX FRAMEWORK

On 5 September 2022, the BSP issued BSP Circular No. 1153 and approved a Regulatory Sandbox Framework (the "**Framework**"). The Framework aims to promote a more active, evidence-based, and results-driven assessment of new and emerging financial solutions.[30]

The Framework

The Regulatory Sandbox is a controlled, time-bound, live testing environment, featuring regulatory waivers at the regulator's discretion, to promote the development of transformative technologies under the "test-and-learn" approach. Eligible participants must operate within testing parameters (including metrics to assess the viability of the solution being offered) agreed upon with the BSP.

The Framework applies to all BSP-Supervised Financial Institutions ("**BSFIs**"), third-party service providers of BSFIs, other BSP-registered institutions, and other entities that intend to offer or use any emerging or new technology to deliver financial products and services within the BSP's regulatory authority.[31]

20. PPSA, Section 58.
21. Financial consumer is defined as a "person or entity, or their duly appointed representative, who is a purchaser, lessee, recipient, or prospective purchaser, lessee or recipient of financial products or service" (FPSCPA, Section 3(a)).
22. Id., Section 6.
23. Financial service provider is one which "provides financial products or services that are under the jurisdiction of financial regulators" (FPSCPA, Section 3(e)).
24. Id., Section 8.
25. Financial product or service is defined as those "developed or marketed by a financial service provider which may include, but are not limited to, savings, deposits, credit, insurance, pre-need and health maintenance organization (HMO) products, securities, investments, payments, remittances and other similar products and services" (FPSCPA, Section 3(c)).
26. Id., Section 12.
27. FPSCPA, Section 15.
28. FPSCPA, Section 16.
29. FPSCPA, Section 11. Investment fraud is defined as any form of deceptive solicitation of investments from the public under Section 3(f).
30. BSP Circular No. 1153, Section 1, amending Section 115 of the MORB and Sections 112-Q/115-S/115-P/113-T/103-N/141-CC of the MORNBFI.
31. Id. (Coverage).
32. Id. (Operational Guidelines).

Four Stages[32]

The Framework contemplates a four-stage process: the Application, Evaluation, Testing, and Exit Stages. During the Application Stage, applicants are mandated to submit certain minimum documentary requirements, including an eligibility self-assessment checklist. During the Evaluation Stage, the BSP evaluates the completeness of the documentary requirements based on certain eligibility standards. The Testing Stage is divided into two phases – testing design phase and testing implementation. These determine the proposed solution's viability. Finally, during the Exit Stage, the participant will prepare a final report, providing a comprehensive evaluation of the entire sandbox activity.

Participants whose sandbox activities are assessed as successful and whose products or services are deemed fit for public consumption after having completed the Testing and Exit Stages may submit to the BSP an application for authority to operate and offer the proposed product or service to the public.[33]

Consumer Protection

Under the Framework, participants must adopt measures to protect consumer rights and interests. They must inform customers that the product or service offered is under the Framework and the possible risks associated with such product or service.[34] The participants should also inform customers of the related complaints handling and dispute resolution procedures, ensuring that adequate, prompt, and effective mechanisms or procedures for handling and resolving disputes covering regulatory sandbox issues are in place.[35]

All regulatory sandbox experimentation must follow the rules and regulations on data sharing, data privacy, and data protection in all phases. The right to control the use of customer data are limited to the boundaries of the consent provided by the customer in availing the product or service.

CONCLUSION

The shift to the PPSA is expected to contribute to financial inclusion by allowing more people and businesses to use their assets to access formal lending channels. This is particularly important in the Philippines, where a significant portion of the population has been traditionally underserved by the banking sector.

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The BSP has noted that technology is one of the major drivers of financial inclusion and that financial service providers has been utilising technology by investing in platforms or systems that can create products and services particularly in payments and credit or loans that are suitable to the Filipinos, especially those who are underserved or unserved.

Thus, with the issuance of the Regulatory Sandbox Framework, it is expected that more and new entrants will move swiftly and offer products tailored to the needs of underbanked businesses and consumers. The issuance of the FPSCPA will ensure that financial consumers will remain protected notwithstanding the surge of new financial products and services, including those driven by technology.

33. PPSA, Section 58.
34. Financial consumer is defined as a "person or entity, or their duly appointed representative, who is a purchaser, lessee, recipient, or prospective purchaser, lessee or recipient of financial products or service" (FPSCPA, Section 3(a)).
35. Id., Section 6.

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Founded in 1945, SyCip Salazar Hernandez & Gatmaitan (SyCipLaw) is one of the largest law firms in the Philippines. It has offices in Makati City, the country's business and financial center, as well as Cebu City, Davao City, and the Subic Bay Freeport Zone.

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Inflation, the economy & interest rates

Following record rates of inflation in 2022 – with the Eurozone and the UK (and temporarily also the US) hitting double-digit figures and even Switzerland exceeding the SNB's inflation target of 2% for the first time since 2008 – inflationary pressures appear to have eased. While advanced economies started 2023 with inflation rates averaging 7.5%, at the beginning of this year, these have dropped to 3.2%. For emerging economies, rates dropped from 8.1% to 4.1% over the same period. In Switzerland, inflation now stands at 1.20%. However, as it is still above central bank targets in most countries, it needs to fall further.

> "Following record rates of inflation in 2022, inflationary pressures appear to have eased

In order not to hamper global economic development which, after rapid growth rates in 2021-2022, slowed further in 2023, the consistent raising of policy interest rates over the past two years, described by the BIS as "the largest and most synchronised global monetary policy tightening in a generation"[1], seems to have been brought to an end.

In the Eurozone, economic activity in 2023 is estimated to have expanded by only 0.5% and the growth outlook for 2024 has been revised downwards to 0.9%. We now know that the UK economy entered a technical recession in the fourth quarter of 2023 but the expectation is still that its GDP will grow by 0.9% in 2024. Meanwhile, economic growth in the US was 2.5% last year and is estimated at between 2.2% and 2.4% for 2024. In Switzerland, whose economy grew at 1.2% in 2023, the expected growth rate for 2024 lies at 1.3%.

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On 7 March 2024, the ECB announced that it would keep its key interest rates unchanged at 4.50%, 4.75% and 4.00%, respectively, with a first reduction being expected in June this year. On 20 March, the US Federal Reserve also decided to maintain its current range of 5.25% to 5.50% and, a day later, the Bank of England said that it would keep its interest rate unchanged at 5.25% for the fifth time in a row. But both US and UK policymakers signalled three interest rate cuts later this year after seeing "encouraging signs" of falling inflation. The SNB, as the first major central bank, felt that it could already act and, on 21 March, cut its main interest rate by 25 basis points to 1.50% with the expectation for this to be reduced further in the course of the year. This marks the first rate cut by the SNB in nine years.

Market performance

Swiss capital markets

In 2023, the SIX Swiss Exchange saw the lowest trading activity in over a decade. It recorded a trading turnover of CHF 1,046.3 billion, 13.4% lower than in 2022, and a 24.2% drop in transactions.[2]

There were ten new listings of equity securities, most prominently, that of the Novartis spin-off Sandoz and of the first Swiss Special Purpose Acquisition Company (SPAC), R&S Group. Eight Chinese issuers listed Global Depository Receipts (GDRs) on SIX, bringing the number of Chinese companies that have listed GDRs in Switzerland since the launch of the China-Switzerland Stock Connect between the SIX Swiss Exchange and the Shanghai and Shenzhen stock exchanges in July 2022 to 17. In addition, existing issuers raised around CHF 8.3 billion via capital increases (CHF 1.3 billion more than in 2022).

1. Where are we on the journey towards price stability? (bis.org)
2. BIG Numbers 2023: Key Figures from SIX Swiss Exchange (six-group.com)

On the debt capital side, there were 436 new bond listings, 90% of which were denominated in Swiss francs, and the total volume of debt capital instruments (bonds and money market papers) was around CHF 116 billion (up from CHF 114 billion in 2022). Also, the number of outstanding green, sustainable, sustainability-linked and social bonds traded on SIX increased from 108 with a volume of CHF 28 billion in 2022 to 136 and a volume of CHF 31 billion in 2023.

M&A activity

After two record-breaking years, 2023 saw 25% fewer M&A transactions in Switzerland than in the previous year (484 transactions with a deal volume of around USD 72 billion in 2023 compared to 647 transactions and a deal volume of USD 139 billion in 2022) with the highest levels of activity in the industrial goods, media, technology and telecommunications and the pharmaceuticals and life sciences sectors.

For 2024, expectations are positive, however. While the market still needs to adjust to higher interest rates and tightening lending standards on the one hand and the increasing complexity of M&A transactions, due to both higher sustainability requirements and technological developments, on the other, early indicators point to a gradual increase in dealmaking as the year progresses.

Swiss banking sector - Optimism among Swiss banks

EY Switzerland gave its Banking Barometer 2024 the subtitle "Confidence" which, on the one hand, was intended to allude to its overall positive assessment of 2023 and its optimistic outlook for 2024 but also to the pivotal role confidence plays in the financial system.

With one notable exception, Swiss banks did well in 2023. For the first time since the 2008 financial crisis, banks recorded a rise in their interest rate margin in the previous 18 months resulting in a notable increase in profitability. Also contributing to the positive outlook is the expectation of the majority of Swiss banks that impairment losses on residential mortgages and SMEs will remain low. Mortgages notably make up around 75% of the loan portfolio of Swiss banks and, despite the challenging environment, the forecast for SME credit defaults is considerably lower than in previous years.

However, total Swiss bank assets contracted by 4.8%, client lending by 3.0% and client deposits by an estimated 5.5%, the latter mainly due to the large-scale deposit outflows from Credit Suisse in the final weeks and days before its takeover.

According to Fitch Solutions, client deposits are expected to grow again by 3.2% in 2024. Swiss bank assets, almost half of which are now held by UBS, are expected to increase by a mere 0.2% by the end of the year and client lending by only 0.7%.[3] After the considerable accounting gain experienced by UBS from its acquisition of Credit Suisse which led it to report a record-breaking USD 29 billion of pre-tax quarterly profit in Q2 of 2023, the bank is now expected to divest itself of high-risk and non-performing Credit Suisse assets, in particular, in its foreign loan portfolio and see its profitability further impacted by other costs associated with the merger, especially as it has declined to draw on the CHF 9 billion loss guarantee offered by the Swiss government. The predictions for UBS's long-term prospects are positive, however, despite the bank having to meet more onerous regulatory capital requirements from 2030 due to its changed systemic importance.

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> Against this backdrop of cautious optimism in Switzerland, it is difficult to ignore escalating geopolitical tensions.

3. Swiss Banking Sector Will Return To Growth In 2024, But UBS-Credit Suisse Merger Will Weigh On Performance (fitchsolutions.com)

Geopolitical developments – From the war in Ukraine to conflict in Gaza and the US elections

Against this backdrop of cautious optimism in Switzerland, it is difficult to ignore escalating geopolitical tensions. Two years after Russia's full-scale invasion of Ukraine, the conflict seems far from resolution and its impact on elevated and volatile commodity and energy prices is still being felt across the world, albeit less strongly than in 2022. However, financial and military support for Kiev appears to be dwindling and the relationship between Washington and Kiev, or rather Washington and Moscow, may be redefined depending on the outcome of the US elections. The recent death of Alexei Navalny, one of Vladimir Putin's most prominent critics, in an Artic penal colony is yet another demonstration of the Russian president's scrupulousness and lack of concern for his country's standing in the international community.

> "Globally, 2024 can be considered as the ultimate election year.

The current Israeli military operation in Gaza which followed on from a dramatic attack by Hamas terrorists on Israeli civilians on 7 October 2023 has resulted in an unprecedented death toll, mass displacement and destruction of civilian infrastructure. Economic activity across all productive sectors has ground to a halt and it is estimated that Gaza's annual GDP in 2023 declined by USD 655 million with unemployment having reached 79.3 per cent by December 2023.[4] According to the IMF, while the impact of the conflict on energy prices and financial markets has been limited and temporary, tourism-dependent economies in the region, where the sector accounts for between 35-50% of the total economy, were hard-hit.[5]

In alleged support of the Palestinian cause, Iranian-backed Yemeni Houthi rebels have been attacking commercial ships in the Red Sea and the Strait of Bab al-Mandab since mid-November 2023, leading to US and UK airstrikes on Houthi bases and further increasing tensions in the region.

The US presidential elections in November will potentially have a large impact on US economic policy, regulatory frameworks and investor sentiment. A transition of power from one administration to another can lead to important shifts in fiscal policy, healthcare and environmental policies, international trade and foreign relations, affecting global trade flows, supply chains and investment behaviour. Globally, 2024 can be considered as the ultimate election year with national elections in a minimum of 64 countries (as well as on EU level) representing 49% of the world's population. The outcomes of those elections will undoubtedly have significant macroeconomic and geopolitical implications.

An international minimum tax

In December 2021, the members of the OECD's Inclusive Framework on Base Erosion and Profit Shifting reached an agreement on reforms to the international tax system (Pillar 2). One of the agreed measures consisted of the introduction of top-up tax rules to ensure a minimum effective taxation of 15% in each jurisdiction where multinational enterprises with a minimum global turnover of EUR 750 million have a taxable presence (the Global Anti-Base Erosion Rules / GloBE Rules). Pillar 2 consists of a series of interwoven measures, including an Income Inclusion Rule (IIR), an optional Qualified Domestic Top-up Tax (QDMTT) and an Undertaxed Profits Rule (UTTPR). The introduction of these measures will significantly change the international tax system.

4. Preliminary assessment of the economic impact of the destruction in Gaza and prospects for economic recovery | UNCTAD
5. Middle East Conflict Risks Reshaping the Region's Economies (imf.org)
6. How AI can help improve business | PwC Switzerland

Switzerland, together with 139 other countries, committed to implement Pillar 2. The domestic implementation of the GloBE Rules in Switzerland required a national referendum to approve the necessary constitutional amendment. It was approved on 18 June 2023. On 22 December 2023, the Swiss Federal Council decided to implement the QDMTT as of 1 January 2024. The introduction of IRR and UTTPR will be decided upon at a later date.

Artificial intelligence

The potential impact of artificial intelligence on the world cannot be overstated. According to PwC, AI is not "just a new set of tools. AI is changing the way we work, live, and connect with the world." AI was also the key theme at this year's World Economic Forum in Davos from 15-19 January 2024. Antonio Guterres, the UN Secretary-General, warned of the "existential threat" posed by "the runaway development of AI without guardrails", whereas the Managing Director of the IMF described AI as "transformational, with a lot of promise, but also risk associated with it".

On 9 December 2023, the European Parliament and the Council reached provisional agreement on the Artificial Intelligence Act (AI Act) which had been initially proposed by the European Commission in April 2021 as the first-ever comprehensive legal framework on artificial intelligence worldwide. According to the Commission, the AI Act "aims to provide AI developers, deployers and users with clear requirements and obligations regarding specific uses of AI" while, at the same time, seeking to "reduce administrative and financial burdens for business".[7]

The AI Act will be fully applicable within two years. In order to facilitate the transition to the new regulatory framework, the Commission has launched the AI Pact, a voluntary initiative that encourages AI developers from Europe and beyond to comply with the key obligations of the AI Act ahead of time. On 2 February 2024, the draft text of the AI Act received unanimous approval from the Council, with the final vote expected in April. The European AI Office, which was established in February 2024 within the Commission, will be tasked with overseeing the AI Act's enforcement and implementation in member states. Meanwhile, Switzerland has not yet adopted any legislation specifically dealing with AI and there is also currently no such proposal in the legislative pipeline. However, in November 2020, the Swiss Federal Council adopted guidelines for the use of AI in federal departments and agencies and has launched a national research programme on digital transformation. In addition, the revised Swiss Federal Act on Data Protection deals, among other topics, with data privacy in relation to automated decision-making. The expectation is that, as so often, Switzerland will analyse the impact of the EU AI Act before embarking on harmonisation efforts of its AI regulations with EU law. The Federal Council has advised that it will be publishing further information on potential sector-specific regulatory measures by the end of this year.

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> The potential impact of artificial intelligence on the world cannot be overstated.

According to the EY Banking Barometer 2024, 82% of Swiss banks surveyed said that they were currently concerned with the topic of artificial intelligence in one way or the other, with 32% having developed initial applications or conducted pilot projects but only 6% effectively using AI applications operationally.

7. AI Act | Shaping Europe's digital future (europa.eu)

ESG reporting and due diligence requirements in Switzerland

Non-financial reporting

In November 2020, the so-called "Responsible Business Initiative" – which had aimed to strengthen respect for human rights and environmental standards by introducing a vicarious liability regime for Swiss companies for harm caused by controlled entities abroad – failed to win a majority of the Swiss cantons and was thus rejected. Instead, EU-style ESG reporting and due diligence requirements were introduced in the form of new provisions included in the Swiss Code of Obligations (CO) (arts. 964 et seqq. CO) which entered into force on 1 January 2022 for the 2023 financial year, with the first reports having to be published this year.

> "Companies need to report on environmental (in particular, climate, i.e. CO2 targets), social and labour matters, human rights and anti-corruption measures.

The new reporting requirements, which are modelled on the European Non-Financial Reporting Directive (NFRD), apply to Swiss-domiciled public interest companies (including banks, insurance companies and securities firms) which, together with their controlled companies in Switzerland and abroad, (i) have at least 500 full-time employees on annual average and (ii) assets in excess of CHF 20 million or revenue in excess of CHF 40 million in two consecutive years.

Potential in-scope companies are exempt from the reporting requirements only if they are controlled by another entity to which the Swiss non-financial reporting obligations apply or which is required to prepare an equivalent report under foreign law.

Companies need to report on environmental (in particular, climate, i.e. CO2 targets), social and labour matters, human rights and anti-corruption measures. The annual report which must be approved by the company's AGM has to address the company's business model, the concepts which it applies with respect to the relevant ESG matters, including a description of its due diligence procedures, the measures taken by it as well as an assessment of the efficacy of such measures, KPIs, the impact of its activities on the relevant ESG matters as well as the risks of such matters on the company (double materiality). The Swiss reporting requirements currently use a "comply or explain" approach, i.e. it is possible that some companies may choose not to report on certain topics if they are of the view that a certain topic or matter is not relevant to their business. What will be considered acceptable will also very much depend on investor expectations and it is expected that certain industry-specific standards will develop.

In the area of climate disclosure at least, the Swiss legislator has offered additional guidance. On 23 November 2022, the Swiss Federal Council adopted its Ordinance on Climate Disclosures which governs disclosures on climate issues in accordance with art. 964b CO and requires in-scope companies to publish their climate risks based on the recommendations of the Task Force on Climate-Related Financial Disclosure (TCFD). The ordinance entered into force 1 January 2024.

For the largest Swiss banks and insurance companies which fall into FINMA's supervisory categories 1 and 2, these obligations have already been in force since July 2021 under revised FINMA Circular 2016/1, which will be the subject of a further review this year. Also, on 1 February 2024, FINMA has launched a consultation on a new "nature-related financial risks" circular which is due to enter into force on 1 January 2025 and will specify risk management requirements for banks and insurance companies in relation to material financial risks resulting from climate change and nature degradation.

The relevance of the CSRD to Swiss companies

The European Corporate Sustainability Reporting Directive (CSRD) which entered into force on 1 January 2023 and pursuant to which certain in-scope companies will need to report for the first time in 2025 with respect to the 2024 financial year substantially amends the NFRD both in terms of scope and reporting requirements.

The CSRD abolishes the "comply or explain" approach adopted by the NFRD and introduces a "double materiality" standard which means that in-scope companies need to report on both the financial risk of ESG issues for their company (financial materiality) and the impact of the company's business on people and the environment (impact materiality). In addition, the CSRD expands KPIs and target requirements (including alignment with EU taxonomy), introduces new European Sustainability Reporting Standards as well as an external audit requirement.

In terms of scope, the CSRD no longer applies only to public interest companies but, based on a phased approach, also to large private companies (as of 2026 with respect to the 2025 financial year), listed SMEs (as of 2027 with respect to the 2026 financial year) and, finally, undertakings with a non-EU parent with EU-wide sales in excess of EUR 150 million (as of 2029 with respect to the 2028 financial year).

Swiss companies, or their EU parent companies or subsidiaries, may fall within the scope of the CSRD. Also, the Swiss legislator is expected to further align the Swiss rules to the EU requirements. In the meantime, many large Swiss companies may anyway already choose to report according to CSRD or other international regulations or standards, which will be deemed acceptable from a Swiss perspective provided that such foreign regulations address all of the Swiss requirements and the report clearly identifies the regulations and/or standards on which it is based.

It is unfortunate that the new Swiss ESG reporting requirements, having been closely modelled on the NFRD, are now already superseded at European level.

Berne Financial Services Agreement

On 21 December 2023, Switzerland and the United Kingdom signed an eagerly anticipated agreement on mutual recognition in financial services, the Berne Financial Services Agreement.

Following the UK's effective departure from the EU after the end of the transition period on 31 December 2020, existing bilateral agreements between Switzerland and the EU have been substituted with nine new agreements with the UK government, including, on trade, citizens' rights, service mobility, social security, air and rail services and direct insurance. What had been notably lacking between the two countries that are home to two of the most important European financial centres was a broader financial services agreement.

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> On 21 December 2023, Switzerland and the United Kingdom signed an eagerly anticipated agreement on mutual recognition in financial services, the Berne Financial Services Agreement.

The Berne Financial Services Agreement provides for recognition of equivalence of national legislation and regulations in the areas of banking, insurance, investment services, asset management and financial market infrastructures for professional and sophisticated clients.

It has been hailed as "ground-breaking" by the UK government, providing a "new and innovative model of mutual regulatory recognition" and establishing a "new global best practice for regulatory and supervisory cooperation". The purpose of the agreement, according to the Swiss government, is to "facilitate cross-border business activities, while at the same time ensuring financial market stability and integrity and guaranteeing client protection".

Following its signature, the agreement is now awaiting parliamentary approval in both countries.

Separately to the Berne Financial Services Agreement, Switzerland and the UK are also currently negotiating an enhanced Free Trade Agreement.

L-QIF

On 31 January 2024, the Swiss Federal Council decided that the revised Collective Investment Schemes Act (CISA) and the amended Collective Investment Schemes Ordinance (CISO) shall enter into force on 1 March 2024, creating the legal basis for the Limited Qualified Investor Fund (L-QIF). The introduction of the L-QIF aims at strengthening Switzerland's position as an asset management and fund distribution hub.

The main advantage of this new fund category is that it is not subject to the licensing and approval requirements of FINMA, resulting also in less stringent investment regulations. However, the L-QIF must be managed by entities which themselves are supervised by FINMA, it is only available to qualified investors and, from a tax perspective, is treated like other Swiss regulated collective investment schemes.

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> According to Dun & Bradstreet, corporate insolvencies in Switzerland increased by 8% in the first three quarters of 2023.

Credit defaults & bankruptcies and the failure of 'too-big-to-fail'

Corporate insolvencies in Switzerland

Alongside the worldwide increase of government debt, companies have also significantly boosted their debt ratios in recent years. The impact of such high debt on the economy was apparent again in 2023 with the number of corporate defaults up 80% (from 85 defaults in 2022 to 153 defaults in 2023). The US accounted for 63% of all defaults globally with 96 defaults, whereas Europe saw 30. Prominent corporate defaults include WeWork, Covis, Diamond Sports, Bausch, Mallinckrodt and Adler Group as well as the bankruptcies of Rite Aid, Bed Bath & Beyond, Yellow Corp. and Signa. For 2024, S&P are expecting further global credit deterioration, particularly at the lower end of the rating scale ('B-' or below) where almost 40% of issuers risk further downgrades. Financing costs are expected to remain elevated despite anticipated rate cuts and there are upcoming maturity walls for a considerable amount of speculative-grade debt in 2025 and 2026. In Switzerland too, a slowdown in economic growth, a drop in share prices and higher interest rates have been creating a challenging environment for many companies, in particular, those that were already reliant on governmental support to get them through the COVID-19 pandemic and that now find that loan financing is becoming again more difficult and more expensive.

According to Dun & Bradstreet, corporate insolvencies in Switzerland increased by 8% in the first three quarters of 2023. Between 1 January and 30 September 2023, 3,845 Swiss companies had to file for bankruptcy, compared to 3,552 in the same period in 2022.

Nevertheless, as mentioned above, the majority of Swiss banks surveyed for EY's Banking Barometer 2024 expect SME credit defaults in 2024 to be considerable lower than in previous years.

It should also be noted that the overall increase in corporate insolvencies in Switzerland has been accompanied by a slight rise in the incorporation of new businesses. Dun & Bradstreet record 38,325 new company registrations in the commercial register in the first three quarters of 2023, compared to 37,091 in 2022 (+3%).

Credit Suisse – A failure of 'too-big-to-fail'?

In March 2023, the Swiss Federal Council, the Swiss National Bank and FINMA intervened amidst a growing crisis of confidence and instituted various measures in order to safeguard Credit Suisse's solvency and assist its acquisition by UBS, which was announced on 19 March 2023 and took legal effect on 12 June 2023. The Swiss financial services sector and the country as a whole not only had to come to terms with the disappearance of one of Switzerland's two large global banks but also the reality that, after the bail-out of UBS in 2008, the carefully designed "too-big-to-fail" regulations had once again failed. A thorough analysis of events was demanded and very much warranted.

On 1 September 2023, the group of experts on banking stability under Prof. Lengwiler submitted its eagerly awaited report entitled "Need for reform after the decline of Credit Suisse" requested by the Swiss Federal Department of Finance. The report stresses the macroeconomic significance of systemically important banks and the financial centre as a whole and notes that the government-supported takeover of Credit Suisse by UBS represented a key contribution to international financial stability. It notes that the fact that the restructuring option was not chosen in the case of Credit Suisse did not mean that resolution planning had failed and that the existing "too-big-to-fail" regulations were certainly helpful in terms of ensuring adequate levels of capital and liquidity. The expert group believes that no regulation can rule out a crisis with complete certainty and recommends reforms in crisis management, the broadening of liquidity provision and a significant strengthening of the tools and authorities of the financial supervisor.

This assessment was shared by FINMA itself which, on 19 December 2023, published its report on "Lessons Learned from the CS Crisis" in which it analyses the development of Credit Suisse between 2008 and 2023 with regard to the bank's strategy, business performance, management decisions, risk management and crises preparation as well as FINMA's supervisory work with the bank.

In the report, FINMA identifies the main reasons for the failure of Credit Suisse. According to the supervisory authority, certain required strategic changes (such as downsizing the investment bank, reducing earnings volatility and a greater focus on asset management) were not consistently implemented. FINMA states that Credit Suisse's reputation was undermined by recurrent scandals resulting in irreparable reputational damage. Despite extensive adjustments over the years, deficiencies in risk management identified by FINMA were never sustainably remedied. FINMA also notes that, although the bank met regulatory capital and liquidity requirements, neither the regulatory capital nor the liquidity buffer could contain the loss of confidence in the bank.

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> For the Swiss lending market, the disappearance of Credit Suisse may well lead to the major cantonal and regional banks increasingly using syndicated lending to jointly finance larger loans.

Using Credit Suisse as an example, FINMA further examines problematic areas in its supervisory practice and suggests potential solutions. It notes, among other things, its limited influence in matters of strategy and governance. According to FINMA, these deficiencies could be remedied by establishing a stronger legal basis, e.g. through (i) a senior managers regime, (ii) powers to impose fines, or (iii) the option of publishing enforcement proceedings on a regular basis. In addition, FINMA will also adapt its supervisory approach and step up its review of whether stabilisation measures are ready for implementation.

For the Swiss lending market, the disappearance of Credit Suisse may well lead to the major cantonal and regional banks increasingly using syndicated lending to jointly finance larger loans. A number of foreign banks may also consider expanding their activities in the Swiss corporate client business.

Special insolvency regime for insurance companies

In addition, in 2022, the Swiss parliament adopted a special insolvency regime for insurance companies in order to enable the restructuring of an insolvent insurance company instead of the direct opening of bankruptcy proceedings. The aim of this revision is to protect the interests of the insured parties.

The revised Insurance Supervision Act, together with the associated implementing provisions, has entered into force on 1 January 2024.

New legislation to combat bankruptcy abuse

In March 2022, the Swiss parliament passed the Federal Act on Combating Abusive Bankruptcy which contains amendments to several laws, namely the Swiss Code of Obligations, the Debt Enforcement and Bankruptcy Act, the Criminal Code and the Swiss Federal Act on Direct Federal Taxation. The purpose of the new rules is to combat the abusive use of bankruptcy proceedings by preventing debtors from using such proceedings to free themselves from their financial obligations thereby damaging their creditors und unfairly competing with other companies.

While the Swiss Federal Council had originally proposed for the amendments to enter into force at the beginning of this year, cantonal authorities had asked for this to be postponed until 1 January 2025 in order to provide them with the necessary time to adapt their internal processes.

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BIO

James Huang is a partner at the Banking and Capital Market Department of Lee and Li.

Mr. Huang has extensive experience in syndicated loans, acquisition finance, project finance, disposal of non-performing loans by financial institutions, and loans securitization. He has been representing borrowers and financial institutions in numerous syndicated loan transactions involving various industries, including the 2016 NT$80 billion syndicated loan to Micron group, the 2018 NT$43.75 billion syndicated loan to Innolux Corporation. Recently, and the 2023 NT$118 billion (approximately US$4 billion) syndicated loan to Hai Long offshore wind project. Mr. Huang has advised many syndicated loans to developers of solar energy projects as well as contractor/supplier in off-shore wind farm project.

Mr. Huang also advises local and international banks, securities firms, insurance companies, financial holding companies and other financial institutions on relevant transactions and regulatory compliance issues. In addition, he has been representing clients in many high profile M & A transactions, including transactions by SinoPac Financial Holding Company, China Development Financial Holding Corp., and Morgan Stanley PE.

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BIO

Odin Hsu is an associate partner at Lee and Li. He graduated from the law school of National Taiwan University with double degrees in LL.B and BB.A in accounting. He also completed two LLM programs respectively at Fu-Jen Catholic University (Taiwan) and Boston University (U.S.). He is admitted to practice law in Taiwan. He specializes in company act, securitisation, mergers and acquisitions, trust act and financing.

He advises local and international banks, securities firms, securities investment trust enterprises, securities investment consulting enterprises, financial holding companies and other financial institutions on drafting and review of relevant transaction documents, regulatory compliance issues and applications and permits for relevant business. He also has extensive experience in syndicated loans, securitization, and merger of financial institutions.

He has been representing clients (both banks and borrowers) in many syndication loan transactions and project financing transactions, including many solar energy project financing transactions, battery electricity storage system project financing transactions, onshore windfarm project financing transactions, and most of Taiwan offshore windfarm project financing transactions which have been reached financial close.

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Taiwan's Renewable Energy Policy and Development

Taiwan is a resource-scarce small island nation, making energy supply an important issue. In order to reduce dependence on imported energy, minimize environmental impact and become nuclear-free by 2025, Taiwan government actively promotes the development of renewable energy. The main objective of Taiwan's renewable energy policy is to increase the proportion of renewable energy in the energy structure and reduce reliance on fossil fuels. The government has implemented a series of measures and policies to encourage the development of renewable energy, including providing subsidies and incentives, as well as establishing relevant regulations and standards.

> "Taiwan government has launched a solar energy development plan to encourage individuals and businesses to install solar power systems.

Taiwan's installed capacity of renewable energy continues to increase, and the generation of solar and wind energy is also increasing year by year. In addition, the proportion of renewable energy in Taiwan's energy structure is gradually increasing. These achievements are due to the government's policy support and the active participation of investors. As of today, solar energy and offshore wind power are the main forces driving renewable energy development in Taiwan.

Solar Energy

Due to abundant sunshine and sufficient sunlight, Taiwan has excellent conditions for solar power generation. Therefore, solar power generation is the most promising renewable energy source and also a clean power generation method that takes into account environmental protection and ecology.

Taiwan government has launched a solar energy development plan to encourage individuals and businesses to install solar power systems. The government provides subsidies and tax incentives and has established standards and certification systems for solar power generation. These measures have led to rapid development of solar power in Taiwan, making it one of the main sources of renewable energy in the country.

Wind Energy

According to a study conducted by international engineering consultancy firm 4C Offshore in 2014 on global "23-year average wind speed observations," it was surprisingly found that out of the top 20 offshore wind farms with the strongest wind power in the world, 16 of them are located in the Taiwan Strait. Furthermore, the majority of these wind farms are situated off the coast of Changhua County. Based on the above advantages, Taiwan government has been continuously developing onshore wind power in recent years, and also has plans to gradually develop offshore wind power. Taiwan remains at the forefront of offshore wind power in the Asia Pacific region. This can be attributed to the "Thousand Wind Turbines Project" initiated by Taiwan government, aiming to produce 5.7 GW of offshore wind energy by 2025, equivalent to around 20% of Taiwan's overall electricity production, and 15 GW by 2035. Currently, nineteen offshore wind projects have been granted grid capacity and are in the process of signing grid allocation contracts with Taiwan government.

In addition to the development of offshore wind power itself and addressing the electricity demand, Taiwan government is also promoting the localization of the upstream and downstream industries of offshore wind power through policy guidance. It aims to establish a complete industrial chain for the offshore wind power industry through this policy guidance, maintain the leading advantage in the Asia-Pacific region, and hope to become a technology exporting country in the offshore wind power industry in the future.

Other Renewable Energy

In addition to the main development of solar and wind power, Taiwan government also encourages the development of tidal, bioenergy and geothermal energy. The government provides corresponding subsidies and incentives, and supports related research and development projects. In addition, Taiwan has also begun actively developing energy storage plants in recent years.

In general, Taiwan's promotion and development of renewable energy policies have achieved certain results. The proportion of renewable energy in Taiwan's energy structure continues to increase and has become an important driving force for Taiwan's energy transition. In the future, Taiwan government will continue to increase its support for renewable energy and further promote its development to achieve sustainable energy development.

The development of renewable energy drives the development of project financing in Taiwan

The development of project financing in Taiwan began in the 1990s. However, before Taiwan government began to vigorously develop renewable energy in 2017, there were not many project financing cases in Taiwan and the more well-known ones were only project financing in relation to the construction of the Taiwan high speed rail and several traditional private power plants. Since Taiwan government began developing renewable energy in 2017, project financing has provided financial support for various renewable energy projects. The construction and operation of renewable energy projects require significant financial investment, including equipment procurement and engineering construction. However, due to the long-term returns and higher risks associated with renewable energy projects, traditional bank loans often fail to meet their funding needs. The emergence of project financing fills this gap by raising funds from the financial institutions to provide necessary financial support for renewable energy projects.

Despite this, due to lack of experience in project financing and ability to assess the risks associated with the renewable energy industry, there were not many Taiwanese banks involved in project financing for renewable energy in the initial stage of its development. However, as time passed, Taiwanese banks began to acquire the necessary capabilities, and as a result, there are now more and more project financing cases for renewable energy – among them, the largest number of cases is for solar energy projects, while the project financing for offshore wind power projects has higher amounts (with financing amounts for individual projects being at least over US$1 billion and the project with the highest amount is the Hai Long offshore wind project, which just completed the signing of financing documents in September 2023. The project financing amount is approximately NT$118 billion (approximately US$4 billion), making it the largest offshore wind power project financing in Taiwan and the Asia-Pacific region to date).

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In general, Taiwan's promotion and development of renewable energy policies have achieved certain results.

Solar Energy Project Financing

For solar projects with lower construction costs, banks may tend to choose to provide funding through a bilateral loan. However, for larger projects, project financing is usually adopted. In addition to traditional ground-mounted and rooftop solar power plants, there are also fishery-solar power plants that involve more complicated risk assessment and regulatory compliance analysis. Some solar projects still involve sponsors' guarantees even though the financing arrangement is generally structured as project financing.

Wind Energy Project Financing

Compared to solar energy project financing, the project financing for wind power in Taiwan (both onshore and offshore) mostly follows a typical project financing structure, especially for offshore wind power plants. Starting from the project financing of the first offshore wind power plant in 2018, due to the unfamiliarity of Taiwanese banks with the risks of offshore wind power plants at that time, the process was initially led by foreign banks with relevant experience. Taiwanese banks had very limited participation (in terms of the number of transactions and loan amounts). However, as time passed, Taiwanese banks have become more capable of understanding the risks of offshore wind power generation. Some Taiwanese banks are even capable of serving as financial advisors for offshore wind power project financing cases.

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> It is also worth mentioning that, with the increasing demand for green energy in the industry, there are currently more and more corporate power purchase agreements (CPPAs) being signed.

In addition, localization requirements also create financing needs in the offshore wind power industry (typical financing structures, rather than project financing).

It is also worth mentioning that, with the increasing demand for green energy in the industry, there are currently more and more corporate power purchase agreements (CPPAs) being signed. However, under the framework of project financing, some companies that require green energy do not meet specific financial requirements, resulting in power generators in project financing unable to sell electricity to such companies. In order to solve this problem and assist small and medium-sized industries in obtaining green energy, Taiwan government announced in June 2023 the “National Financing Guarantee Mechanism Promotion Plan”. Under such plan, a corporate offtaker who participate in such plan may apply for a guarantee from the financial institutions authorized by the National Credit Guarantee Administration in respect of its obligations to purchase renewable energy under a CPPA.

In general, in recent years, with the vigorous development of the renewable energy industry, Taiwanese banks have been handling more and more project financing cases in addition to traditional financing. They have become more familiar with the structure of project financing. Overall, besides a few private banks that were already active, some other private banks and insurance companies that had concerns about the risks of renewable energy have also started to participate in related (project) financing. However, currently, the main large state-owned banks have not yet participated in offshore wind power project financing. As local private banks already provided significant amounts of loans to offshore wind power projects and may have limited ability to participate in similar projects in the future due to risk management requirements under the banking regulations, the policy of these large state-owned banks may be an important factor for future offshore wind power project financing.

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