Solvency ii Association
1200 G Street NW Suite 800 Washington DC 20005-6705 USA
Tel: 202-449-9750 Web: www.solvency-ii-association.com

# Solvency 2 News, September 2022


Dear members and friends,

In 2022, the European Insurance and Occupational Pensions Authority (EIOPA) carries out its first *climate stress test* to gain insights into the effects of environmental risks on the European occupational pension sector.

Sustainability and the management of environmental risks have become key considerations for long-term investors and in particular for European institutions for occupational retirement provision (IORPs).

*Scenario*

The 2022 IORP stress test is testing the resilience of European IORPs against a climate change scenario, which was developed together with the European Systemic Risk Board and the European Central Bank.

It reflects a sudden, disorderly transition to climate neutrality due to delayed policy action, which results in a sharp rise in carbon prices. This abrupt carbon price increase triggers transition risk effects to the entire economy.

*Objective*

The stress test focuses on the impact on IORPs' investments, yet also addresses the effects on IORPs' financial situation, including the financing by sponsoring undertakings. Therefore, the climate change scenario is applied to the balance sheet - both national valuations and the common balance sheet.

The scenario sets out sector-specific shocks that provide insights into the IORPs' investment portfolios, reflecting the corresponding impairment of the investments, broken down by the most relevant sectors and business activities.

The exercise also includes two specific questionnaires, one to request information following up on the ESG analysis of the 2019 IORP stress test, and another one to allow an analysis to identify and understand the potential effects of inflation on members' and beneficiaries' retirement income, focusing on the extent to which scheme characteristics and national frameworks provide for mitigating measures or adaptations to protect against inflation.

*Scope*

The stress test is a European-wide exercise, covering IORPs with defined benefit (DB) and defined contribution (DC) schemes. All EEA countries with material IORP sectors, exceeding EUR 500 million in assets, are participating in this stress test.

*EIOPA's mandate*

According to Article 32 of Regulation (EU) No 1094/2010 (EIOPA Regulation), EIOPA has to initiate and coordinate Union-wide assessments of the resilience of financial institutions to adverse market developments.

In such assessments, EIOPA should consider the effects of economic scenarios on the IORP's financial position, taking into account specificities of the scheme types, i.e. defined benefit (DB) and defined contribution (DC), for the effects on the financial position of the IORPs and on the members and beneficiaries of IORPs.

Hereby, EIOPA is mandated to assess the potential impact posed by IORPs on financial stability and the real economy. Further, environmental risks and their effects on the financial stability of the IORP sector should be analysed.

*Background information*

The exercise is carried out in close cooperation with the national competent authorities, which are the direct contact points for the participating IORPs.

Between 9th and 21st February 2022, EIOPA had obtained feedback on the draft stress test technical specifications from EU pension stakeholders, including EIOPA's Occupational Pensions Stakeholder Group (OPSG).

To read more: https://www.eiopa.europa.eu/climate-stress-test-occupational-pensions-sector-2022_en

## Entity-based vs activity-based regulation: a framework and applications to traditional financial firms and big techs

FSI Occasional Papers, No 19
Claudio Borio, Stijn Claessens, Nikola Tarashev


The policy debate about the relative merits of entity-based (EB) and activity-based (AB) financial regulation is a long-standing one (US (2010), FSB (2011).

It has recently come to the fore again, mainly due to the greater systemic importance of non-bank financial intermediaries after the Great Financial Crisis (FSB (2017), IAIS (2019), Carstens (2021)).

Non-bank financial intermediation has grown to account for roughly half of global financial assets and played a key role in the financial turmoil of March 2020 (FSB (2020)).

The foray of big techs into financial services and the digitalisation of finance have fuelled the debate further (Carstens et al (2021)).

When choosing the proper form of regulation for enhancing financial stability, the stakes are not trivial.

However, the debate has been muddied by the imprecise use of the EB and AB terms. This imprecision has made it more difficult to interpret catchphrases such as “same risk, same regulation” and “same activity, same risk, same regulation” – slogans that owe their popularity to their deceptive simplicity, but which say more about the desirability of a level playing field than about the general merits of alternative types of regulation.

In seeking to clarify the debate, we propose a framework for classifying regulation as EB or AB. We focus on regulation with a financial stability objective.

There are four main takeaways:

• **Basics**. Financial stability hinges on the resilience of financial activities that sustain the real economy – eg lending, deposit-taking, insurance underwriting, investing, trading, clearing and payments. Entities are the entry point of all regulatory measures.

• **Definitions**. AB regulation strengthens the resilience of a systemically important activity directly, by constraining entities in their performance of that activity alone.

EB regulation strengthens the resilience of activities indirectly, by imposing restrictions on their combination at the level of entities.

It reduces the likelihood and repercussions of the failure of entities, defined to include, besides insolvency, any other disruption to the entities' functioning that may affect financial stability.

• **Suitability**. There is a case for AB regulation when:

(i) an activity can fail even if the entities performing it do not, and

(ii) it is feasible to constrain this activity in isolation.

By contrast, EB regulation helps prevent systemic events due to entities failing in the performance of a combination of activities.

Since such combinations – notably, in the form of leverage or maturity transformation – are essential to much of financial intermediation, EB measures sit at the core of financial stability regulation.

• **Prioritisation and level playing field**. Within the EB and AB categories, it is useful to distinguish between micro- and macroprudential (MiP and MaP) measures.

When of a MaP nature, an EB or an AB measure should impose stricter constraints on entities of greater systemic importance.

Thus, not just EB but, contrary to a widely held view, AB regulation too need not be consistent with a level playing field.

The note is structured as follows. By way of prologue, the first section briefly recalls the relationship between three key elements of the financial system – functions, activities and entities – and defines financial stability and "failure".

The second provides definitions of EB and AB regulation.

The third considers conditions under which the pursuit of financial stability calls for using either EB or AB regulation. It also discusses when it is optimal to implement measures of each type in tandem, so that they reinforce each other.

The fourth relates the EB and AB classifications to the MiP and MaP dimensions of regulation.

The fifth applies the framework, first to the regulation of collective investment vehicles – such as money market mutual funds or open-ended bond funds – and then to that of big techs.

The last section concludes.

To read more: https://www.bis.org/fsi/fsipapers19.pdf

# Digital euro - opportunities and risks

Dr Joachim Nagel, President of the Deutsche Bundesbank, at the Center for Financial Studies (CFS) and the Institute for Monetary and Financial Stability (IMFS) Special Lecture, Goethe University, Frankfurt am Main

*1 Welcome, acknowledgement and congratulations*

Ladies and gentlemen,

Thank you for your cordial invitation to this event, which is being co-hosted by the Center for Financial Studies (CFS) and the Institute for Monetary and Financial Stability (IMFS).

I have been following the work of both institutions for many years, and I am impressed by how they have been critically observing and advancing the public debate on monetary policy and financial markets. I have learned that around 15,000 interested parties in the German-speaking world and 5,000 others from elsewhere – mostly from the financial sector, but also from politics, central banks and academe – received invitations to attend this event.

These figures show that both institutions can claim to influence the economic debate far beyond Frankfurt. The Bundesbank has been supporting the CFS and the IMFS as one of the main sponsors for many years, and I can say in my role as President that we are very happy with how the CFS and the IMFS have evolved into highly sought-after and valued institutions. You all deserve our great appreciation for this.

Since 2006, Mr Issing, you have successfully chaired the Center for Financial Studies as President for 16 years. Under your presidency, the SAFE Research Center was opened in 2013.

As a member institute of the Leibniz Association for just over two years, it has been making valuable contributions to improving the architecture of the financial system. And the impressive list of Distinguished Fellows, Senior Fellows and many other Fellows, as well as the high-profile speakers at the lectures, are also an indication of the importance of the CFS. Mr Issing, this is due in large part to your efforts.

I would like to thank you personally for your many years of work and the influential impact you have had here at the Institute. I am pleased that you

will continue to share your valuable experience as an "elder statesman" in your new role as honorary president.

Your successor has already been found, and probably everyone here in the audience knows him: Axel Weber. I am convinced that you, Mr Weber, will fill your new position as President of the CFS just as ably and with much skill. Your wealth of experience makes you just the right choice for the CFS, where you will be following in Mr Issing's great footsteps.

And you are already very familiar with the CFS, as you were its Director from 1998 to 2002 and also maintained contact during your tenure as Bundesbank President. Welcome back, just a few metres away from your old "stomping ground" in Frankfurt. Welcome home, and here's to a fruitful working relationship! I am looking forward to exchanging ideas with you.

There is no shortage of topics for an exchange of views between the Bundesbank and Frankfurt's research institutions. One of them is central bank digital currency (CBDC), specifically the digital euro. I would like to talk about this in my speech today. There are three aspects which I wish to address.

First, the opportunities and risks presented by the digital euro.

Second, the international dimensions of CBDC. Many central banks across the globe are currently working on this issue. We should take this opportunity and try to make systems compatible across currency zones.

And third, I will report on the current status of the digital euro project.

The digital euro offers a whole range of opportunities. However, I will begin with the potential economic risks of introducing it.

*2 Risks and opportunities*

Most of you certainly know what the "digital euro" project entails. The idea is to make a CBDC available to individuals and businesses: like euro banknotes but in digital form.

Alongside cash issued by central banks and "book money" created by commercial banks, the digital euro would constitute an additional form of money. This would then be the third form of money in our current monetary system that consumers can use as a means of payment.

The Bank for International Settlements (BIS) defines a monetary system as "the set of institutions and arrangements that supports monetary

exchange. It consists of money and payment systems." What quickly emerges from this definition is that a monetary system is a complex entity with many interdependencies. The ability of a monetary system to function hinges on the public's confidence in the system.

This also applies to the digital euro. If, at the end of the project, a decision should be taken to introduce a digital euro, a further component would be added to our monetary system. However, interventions in a complex system are always also associated with risks, as not all the consequences can be predicted with certainty. Two main risks to the financial system are highlighted.

One of the two risks is a well-known one: bank runs. In future, the digital euro would enable citizens, in the event of tensions in the financial system, to convert their overnight bank deposits into central bank money in seconds with a few mouse clicks or "touches".

In extreme cases, this could bring many banks to their knees if they encounter liquidity problems due to rapid outflows of deposits. US economist Perry Mehrling put it in somewhat martial terms: "Liquidity kills you quick," naturally meaning a lack of bank liquidity. Supervisors, governments and central banks have introduced insurance systems to protect against bank runs.

However, we are still well-advised to remain vigilant. Identifying and controlling risks at an early stage remains one of the key takeaways from the 2008 financial crisis. Depending on the design of the digital euro, however, I believe that these risks can be managed. More on this topic later.

The other risk is referred to as structural disintermediation: bank customers could shift a significant proportion of their bank deposits from their current or other deposit accounts to CBDC. For commercial banks, this would mean losing a cheap and stable source of funding.

Depending on the market situation, banks can use overnight deposits to obtain funding for a few basis points less than from other sources, such as refinancing operations with the central bank or bond issuance.

If commercial banks lose a significant portion of these deposits because citizens are using the digital euro as a store of value, banks' credit supply could fall and financing conditions for the real economy could deteriorate.

Further risks cannot be ruled out if the complex monetary system is expanded. In the event of an introduction, it will initially be necessary to

design the digital euro with an eye to keeping the potential risks manageable.

However, the fact that I began by looking at the risks does not mean that they should shape our perception of the digital euro. Ultimately, there are good reasons why the Eurosystem is looking at its introduction. Its advantages can be seen from several perspectives.

I would like to touch on two of these: first, the monetary and foreign exchange policy perspective; and, second, the payment transactions perspective.

From a monetary and foreign exchange policy perspective, the introduction of a digital euro is a measure that would safeguard the anchoring function of central bank money, even in an increasingly digitalised world.

Central bank money has hitherto included cash as well as the credit balances held by counterparties at the central bank. Besides central bank money, there is also book or giro money, which is put into circulation by commercial banks.

One of the reasons that citizens trust book money is because they can exchange it for cash, i.e. central bank money, at any time. Central bank money therefore acts as an anchor for private commercial bank money.

Let's assume that the trend toward digital payments continues and that central banks still do not offer consumers the opportunity to make digital payments using central bank-issued money, as has been the case so far.

The less cash were used, the less people would remember in this scenario that private commercial bank money can be exchanged 1:1 for central bank money at any time. In short, in this case, central bank money would be at risk of no longer being viewed as an anchor.

And as digitalisation continues, additional private digital forms of money, used on certain digital platforms, for instance, could emerge. Here, too, the anchoring function of central-bank issued money would remain important – it might even gain in importance.

If there were a digital euro, private commercial bank money could also be exchanged for central bank money within the digital world. This way, central bank digital currency could be an important building block for public money to continue to act as an anchor for all forms of money denominated in euro, even in an increasingly digitalised economy.

The second perspective concerns payment transactions in Europe. The introduction of a digital euro could support progress in the area of payments and increase Europe's sovereignty. There is currently no single cross-border solution for e-commerce or card payments for the euro area that is based on European infrastructure.

In order to overcome this deficit, the Eurosystem may also be able to build on work started by the private sector "European Payments Initiative," which includes a common digital wallet, amongst other ideas. One could imagine such a wallet also containing a digital euro in the future.

With a digital euro, future digital payments in the euro area could be carried out independently of non-European payment infrastructures. This would reduce risks and dependencies in payment transactions, which would also be beneficial to financial stability.

Furthermore, users' payment data are increasingly recognised as a valuable good, as some private payment service providers in online trading use them to analyse purchasing behaviour and customer characteristics. If data can be referred to as a commodity of the digital age, this is certainly also true of payment data.

In the private payment services market, there are a number of major players with market power. It is therefore difficult for users to get by without recourse to the services offered by these payment service providers. A digital euro could therefore contribute to the protection of payment data, as the Eurosystem itself has no interest in using this data commercially. One could expect better protection of privacy for this reason alone.

The introduction of a digital euro would be particularly beneficial for consumers if it would allow digital payments to be processed easily, quickly and cost-effectively as well as better protect their privacy when making payments. People would then have access to the digital euro in addition to cash. Like cash, it would be issued by the central bank and it would permit digital payment in central bank money.

Furthermore, depending on the design, the digital euro's infrastructure could open up the prospect of serving as a platform for innovation. In particular, this could apply to automated payment transactions, which are likely to become increasingly popular as digitalisation increases.

A wholesale version of the digital euro could make progress possible, especially for large-value payments, which are common amongst Eurosystem banks and counterparties. This option would be limited to a

specific user group and would provide an opportunity to process payments efficiently and automatically.

At present, discussions in the Eurosystem are mainly focused on the retail version, i.e. a digital euro for everyone, but a wholesale variant could also be provided if the need for it is there. This requires potential users to let their needs be known. However, regardless of whether people are paying large amounts or just enough for a coffee, the digital euro should help to save time, sometimes our nerves, too, and maybe even money.

Transaction fees are high particularly for payments across currency areas, which brings me to my next point – the role of CBDC in cross-border payments. The Bundesbank will soon be tackling this topic in its Monthly Report.

*3 Central bank digital currency in cross-border payments*

Nowadays, a large proportion of cross-border payment transactions are conducted through correspondent banking. During settlement, a payment often moves from bank to bank on its way to the final payee via very long transaction chains.

Throughout this process, neither the duration of the individual processing steps nor the associated fees are transparent for users. Often, they can only be quantified once the credit transfer has been completed.

The situation is not made any better by the fact that more and more correspondent banks are withdrawing from international payments – partly because the costs of preventing money laundering and terrorist financing have increased considerably.

In addition, there is a risk that individual regions or currencies will be largely cut off from international payments.

CBDC now opens up the possibility of designing settlement systems for payment transactions in such a way that cross-border payments can be processed more cheaply, faster and more efficiently than with current payment systems.

To this end, central bank digital currency systems in different currency areas need to be designed so that they enable interoperability. Put simply, the systems need to be able to talk to each other so that business can be conducted across systems. This requires close coordination between central banks.

However, implementation even in a single currency area alone is complex and fraught with many challenges, not to mention the time dimension. Good things take time. So when we talk about the interoperability of CBDC, we are looking at a medium-term goal.

But this opportunity should be taken nonetheless, because central bank digital currency is not just a means of payment – it also requires a new settlement infrastructure. Most central banks around the world are contemplating central bank digital currency. Many are considering building a new settlement structure for it. Given the right cooperation, this offers a historic opportunity to ensure interoperability from the outset.

In principle, there are two approaches to making CBDC usable for cross-border payments.

On the one hand, a unilateral approach would be conceivable: in other words, issuing digital currency according to one's own rules "without looking around" and – like cash – also making it available to holders abroad. On the other hand, one could take a multilateral approach that would rely on cooperation with other central banks.

A unilateral approach would certainly be less complex, but would have economic risks attached. If a foreign central bank digital currency became widespread domestically, this could impair the effectiveness of monetary policy. A similar phenomenon is known as informal currency substitution or dollarisation, and affects countries with unstable currencies and less stability-oriented monetary policy in particular.

However, undesirable consequences could also arise for the issuing central bank. For example, high demand for the digital euro from abroad could significantly expand the Eurosystem's consolidated central bank balance sheet.

This could increase balance sheet risks. If stocks of the digital euro rose sharply, driven by high foreign demand, the euro would be put under appreciation pressure. This stronger currency could then impair price competitiveness and therefore have an impact on the euro area economy as well.

Meanwhile, a multilateral approach involving cooperation between the issuing central banks would have the potential to make CBDC directly exchangeable in individual currency areas from the outset, i.e. interoperable. This approach does not provide for large quantities of digital money to be held in foreign currency, thereby potentially limiting the aforementioned economic risks for the participating currency areas. Varying degrees of interoperability can be aimed for.

At one end of the spectrum, minimally invasive common technical standards could be developed as a basis for compatible systems, granting system operators the greatest possible autonomy in terms of design. Message formats and programming interfaces, for instance, could be standardised.

At the other end of the spectrum, different digital currencies could conceivably be issued on a single platform, representing the maximum level of integration.

This option would require the highest degree of agreement between the central banks involved. In particular, the creation of a joint set of rules for system participation and transaction processing is likely to be no mean feat, given the different legal jurisdictions involved.

That said, such an option would probably generate the highest efficiency gains in the long term, as all payments could be processed immediately. Currency exchange functions could, in principle, be integrated directly into the platform, thereby considerably speeding up the processing of payments.

However, a degree of interoperability somewhere between the two extremes would probably be a more promising goal. For one thing, efficiency gains should be clearly apparent. For another, different legal frameworks and standards need to be taken into account.

In the European Union, for example, we rightly place high demands on cyber security and data protection. The governance structure needs to be clarified – who is involved, who decides what? And finally, we shouldn't endlessly put off making this kind of system operational.

CBDC could also offer a currency exchange solution by making processes automated, simplified and more transparent. This is another area of use for a wholesale variant of the digital euro, which is limited to a specific group of users. This group of users largely overlaps with institutions that currently already hold an account with the central bank; in other words, they are primarily commercial banks.

For example, it is conceivable for cross-border payments to be processed directly in various currencies as delivery-versus-payment transactions. Even as we speak, there is a range of pilot projects involving smart contracts and liquidity pools that promise significant advantages over traditional correspondent banking business.

After this overview, you may share my views on the topic of the interoperability of central bank digital currency: namely that CBDC

presents a special opportunity to make international payments faster, more cost-effective and more transparent.

The achievement of interoperability poses great economic, technical, legal and political challenges.

Once these can be overcome, the shortcomings of cross-border payments will decline significantly – something we should not leave to volatile crypto-assets or stablecoins in closed ecosystems alone.

In this vein, it is all the more important to proceed with great care when conducting studies for a digital euro, and also to take international aspects into account. As I see it, we should exploit the opportunities presented by CBDC. It has great potential.

*4 Current project status*

In the Eurosystem, we are currently working to establish how this potential can be harnessed. Allow me to give you a brief insight into the current status of the project in the last part of my speech.

The initial focus of the work is on using the digital euro within the euro area. Should it come to fruition, a digital euro is intended to enable simple payments in everyday life – just like we're familiar with when we use cash, but in digital form.

It should therefore be usable in both retail outlets and when making purchases online. Equally, it should be possible to use the digital euro for cashless payments from person to person or payments made between individuals and public authorities.

In the Eurosystem, we have identified two possible design options that would make the digital euro available for these purposes: an online version allowing payments to be processed by a third party and an offline version in which payments are made directly from person to person.

A digital euro that can be transferred online would be suited to all the aforementioned payment situations. It would thus slot seamlessly into the range of services offered by commercial banks and payment service providers, which would supply the digital euro issued by the Eurosystem.

It would create one payment solution that could be used to pay almost anywhere. In an ECB survey on new digital payment methods across all euro area countries, the majority of respondents expressed their preference for a single ("one-stop") solution.

The online variant of a digital euro, which would be held in a digital wallet on a smartphone, would fit this purpose.

At the same time, many respondents expressed a desire to be able to pay anonymously. An offline variant would be better equipped to meet this need. Paying via an electronic wallet without an internet connection could allow for a higher degree of financial privacy. Similarly to cash, a digital euro available offline would allow for person-to-person payments.

This is more complex from a technical perspective. And European legislators would first have to prepare the way for exempting payment service providers intending to offer it from their obligations with regard to preventing money laundering and counterterrorism.

This would certainly only apply to payments involving smaller amounts – because, at the same time, it must be ensured that the digital euro does not become a preferred payment medium for illegal purposes.

Whether it be online or offline, a digital euro could complement cash in payment transactions by providing a digital component. However, anyone who wishes to continue using cash should and will be able to do so in future. And we, as the Eurosystem, would ensure that a digital euro – if it came to fruition – could be exchanged for cash at any time, and vice versa.

At the same time, we want to prevent the introduction of a digital euro from leading to instability in the banking and financial system, as described at the start of my speech. We are therefore considering measures at this early stage to prevent an excessive and abrupt shift of deposits from commercial banks into the digital euro.

Two kinds of upper limit come into consideration for this purpose: fixed upper limits or “soft” upper limits in the form of threshold values above which the interest rate becomes unattractive – the keyword here being “tiered remuneration”.

Fixed upper limits would allow for an effective limitation of the amount of digital euro in circulation. By contrast, a tiered remuneration system would provide more flexibility to meet the demand for digital euro.

Especially in the introductory period, fixed upper limits for individuals may be better in order to rule out disruptions in the financial system. However, it must also be possible to make payments in CBDC simply and efficiently even given an upper limit. This could be achieved by automatically channelling surplus digital euro balances into a commercial bank account.

For enterprises and merchants that accept payments on a larger scale, by contrast, a tiered remuneration system would, where possible, be more suitable from the start. That being said, the threshold values would have to be chosen carefully in order to avoid large shifts from bank deposits into the digital euro.

What the specific use of such instruments might look like and what the specific upper limits or threshold values would be can only be determined for good shortly before the potential introduction of a digital euro.

First of all, it has to be established what form the overall package preparing us for a digital euro might take. In a next step, then, we will get a better idea of the specific involvement of commercial banks and payment service providers.

Commercial banks and payment service providers will play a decisive role in the potential launch of the digital euro: they will have a say in whether an attractive range of services can be created for users.

They will also be needed when it comes to the question of what a digital euro should be able to do. This holds particularly true for a potential wholesale version.

*5 Conclusion*

Developments in the financial system and requirements for a stable financial architecture are being dealt with by the Center for Financial Studies, the Institute for Monetary and Financial Stability and the Leibniz Institute for Financial Research SAFE.

I am sure that the institutions will continue their critical observation of the necessary considerations and potential steps towards digital central bank money.

The work that is being done here is extremely valuable to us as central banks. Because even in an increasingly digital environment, it remains clear that a stable, resilient financial system is crucial to prosperity in Europe.

Cooperation between central banks and state-of-the-art research institutions is of great importance if the stability of the financial system is to be ensured as best as possible going forward.

We at the Bundesbank are delighted to have several of these establishments in such close proximity – and under such excellent leadership at that.

Thank you very much for your attention. I will now take your questions.

To read more: https://www.bundesbank.de/en/press/speeches/digital-euro-opportunities-and-risks-894326

## U.S. Treasury Sanctions Notorious Virtual Currency Mixer Tornado Cash


The U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) sanctioned virtual currency mixer Tornado Cash, which has been used to launder more than $7 billion worth of virtual currency since its creation in 2019.

This includes over $455 million stolen by the Lazarus Group, a Democratic People's Republic of Korea (DPRK) state-sponsored hacking group that was sanctioned by the U.S. in 2019, in the largest known virtual currency heist to date.

Tornado Cash was subsequently used to launder more than $96 million of malicious cyber actors' funds derived from the June 24, 2022 Harmony Bridge Heist, and at least $7.8 million from the August 2, 2022 Nomad Heist.

Today's action is being taken pursuant to Executive Order (E.O.) 13694, as amended, and follows OFAC's May 6, 2022 designation of virtual currency mixer Blender.io (Blender).

"Today, Treasury is sanctioning Tornado Cash, a virtual currency mixer that launders the proceeds of cybercrimes, including those committed against victims in the United States," said Under Secretary of the Treasury for Terrorism and Financial Intelligence Brian E. Nelson.

"Despite public assurances otherwise, Tornado Cash has repeatedly failed to impose effective controls designed to stop it from laundering funds for malicious cyber actors on a regular basis and without basic measures to address its risks. Treasury will continue to aggressively pursue actions against mixers that launder virtual currency for criminals and those who assist them."

Treasury has worked to expose components of the virtual currency ecosystem, like Tornado Cash and Blender.io, that cybercriminals use to obfuscate the proceeds from illicit cyber activity and other crimes.

While most virtual currency activity is licit, it can be used for illicit activity, including sanctions evasion through mixers, peer-to-peer exchangers, darknet markets, and exchanges.
This includes the facilitation of heists, ransomware schemes, fraud, and other cybercrimes. Treasury continues to use its authorities against malicious cyber actors in concert with other U.S. departments and

agencies, as well as foreign partners, to expose, disrupt, and hold accountable perpetrators and persons that enable criminals to profit from cybercrime and other illicit activity.

For example, in 2020, Treasury's Financial Crimes Enforcement Network (FinCEN) assessed a $60 million civil money penalty against the owner and operator of a virtual currency mixer for violations of the Bank Secrecy Act (BSA) and its implementing regulations.

*MIXER: TORNADO CASH*

Tornado Cash (Tornado) is a virtual currency mixer that operates on the Ethereum blockchain and indiscriminately facilitates anonymous transactions by obfuscating their origin, destination, and counterparties, with no attempt to determine their origin.

Tornado receives a variety of transactions and mixes them together before transmitting them to their individual recipients. While the purported purpose is to increase privacy, mixers like Tornado are commonly used by illicit actors to launder funds, especially those stolen during significant heists.

Tornado is being designated pursuant to E.O. 13694, as amended, for having materially assisted, sponsored, or provided financial, material, or technological support for, or goods or services to or in support of, a cyber-enabled activity originating from, or directed by persons located, in whole or in substantial part, outside the United States that is reasonably likely to result in, or has materially contributed to, a significant threat to the national security, foreign policy, or economic health or financial stability of the United States and that has the purpose or effect of causing a significant misappropriation of funds or economic resources, trade secrets, personal identifiers, or financial information for commercial or competitive advantage or private financial gain.

*ILLICIT FINANCE RISKS*

Virtual currency mixers that assist criminals are a threat to U.S. national security. Treasury will continue to investigate the use of mixers for illicit purposes and use its authorities to respond to illicit financing risks in the virtual currency ecosystem.

Criminals have increased their use of anonymity-enhancing technologies, including mixers, to help hide the movement or origin of funds. Additional information on illicit financing risks associated with mixers and other anonymity-enhancing technologies in the virtual asset ecosystem can be found in the 2022 National Money Laundering Risk Assessment.

Those in the virtual currency industry play a critical role in complying with their Anti-Money Laundering/Countering the Financing of Terrorism (AML/CFT) and sanctions obligations to prevent sanctioned persons and other illicit actors from exploiting virtual currency to undermine U.S foreign policy and national security interests.

As part of that effort, the industry should take a risk-based approach to assess the risk associated with different virtual currency services, implement measures to mitigate risks, and address the challenges anonymizing features can present to compliance with AML/CFT obligations.

As today's action demonstrates, mixers should in general be considered as high-risk by virtual currency firms, which should only process transactions if they have appropriate controls in place to prevent mixers from being used to launder illicit proceeds.

*SANCTIONS IMPLICATIONS*

As a result of today's action, all property and interests in property of the entity above, Tornado Cash, that is in the United States or in the possession or control of U.S. persons is blocked and must be reported to OFAC. In addition, any entities that are owned, directly or indirectly, 50 percent or more by one or more blocked persons are also blocked.

All transactions by U.S. persons or within (or transiting) the United States that involve any property or interests in property of designated or otherwise blocked persons are prohibited unless authorized by a general or specific license issued by OFAC, or exempt.

These prohibitions include the making of any contribution or provision of funds, goods, or services by, to, or for the benefit of any blocked person and the receipt of any contribution or provision of funds, goods, or services from any such person.

The power and integrity of OFAC sanctions derive not only from OFAC's ability to designate and add persons to the SDN List, but also from its willingness to remove persons from the SDN List consistent with the law.

The ultimate goal of sanctions is not to punish, but to bring about a positive change in behavior. For information concerning the process for seeking removal from an OFAC list, including the SDN List, please refer to OFAC's Frequently Asked Question 897 here. For detailed information on the process to submit a request for removal from an OFAC sanctions list, click here.

For identifying information on the entity sanctioned today, as well as associated virtual wallet addresses, click here.

To report a cyber-crime, contact the Federal Bureau of Investigation's Internet Crime Complaint Center here.

For the U.S. government's 2020 DPRK Cyber Threat Advisory, click here.

For information on complying with virtual currency sanctions, see OFAC's Sanctions Compliance Guidance for the Virtual Currency Industry here and OFAC's FAQs on virtual currency at: https://home.treasury.gov/policy-issues/financial-sanctions/faqs/topic/1626

# Joint report on the extent of voluntary disclosure of principal adverse impact under the Sustainable Finance Disclosure Regulation (SFDR)


Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector (hereinafter 'SFDR') tasks the ESAs, under its Article 18, to 'take stock of the extent of voluntary disclosures in accordance with point (a) of Article 4(1) and point (a) of Article 7 (1)' and that 'By 10 September 2022, and every year thereafter, the ESAs shall submit a report to the Commission on best practices and make recommendations towards voluntary reporting standards'.

Article 18 also states: 'That annual report shall consider the implications of due diligence practices on disclosures under this Regulation and shall provide guidance on this matter'.

*Contents*

To gather information for the purposes of this report, the European Supervisory Authorities (ESAs) have launched through the Joint Committee (JC), as well as through the relevant Standing Committees of the ESAs, a survey of its members, the National Competent Authorities ('NCAs'), with the purpose of gathering feedback on the current state of entity level voluntary disclosures under Article 4 (1) point (a) SFDR.

With the view of getting a complete picture of the state of voluntary disclosures in the market, the ESAs have decided to ask NCAs for their feedback also on the disclosures for financial market participants (FMPs) choosing to explain why they do not consider adverse impacts of investment decisions on sustainability factors as per Article 4 (1) (b) SFDR, even if not explicitly requested by Article 18 SFDR.

The survey has not covered disclosures under Article 7 (1) SFDR as it is expected that FMPs will start applying those by 30 December 2022.

The ESAs have carefully analysed the 33 responses received and developed an indication of good examples of best practices observed by April 2022 and preliminary recommendations.

Those are based on a combination of responses from the NCAs, of which the most relevant extracts are reported anonymously in Section 4.3 of this report, and ESAs' staff's desk-based research.

The first report's preliminary conclusions are that the extent of compliance with voluntary disclosures under Article 4 (1) (a) varies significantly across jurisdictions and FMPs under the scope of SFDR, and it is difficult to identify definite trends.

It was not possible to draw conclusions in terms of the differences across FMPs based on size, nature, and scope of activities.

At this stage, the ESAs have identified that the disclosures for FMPs that do not take into account adverse impact of investment decisions on sustainability factors under Article 4 (1) (b) are lacking in detail, and FMPs largely fail to provide clear reasons for why they do not do so, with insufficient information as to whether and when they intend to consider such adverse impacts.

Finally, NCAs have reported overall low level of disclosure of the degree of alignment with the objective of the Paris agreement, with disclosures on the alignment being vague and high level.

Section 2 this report includes the background and rationale of this exercise and lessons learned from the first year of implementation of the voluntary disclosures, based on responses from NCAs.

Section 3 provides an overview of good examples of best practices, and other less good examples of voluntary disclosures under Article 4 (1) (a) and (b) SFDR.

The last part of this section also includes recommendations to the Commission and NCAs.

The Annex provides an overview of the questions included in the survey with some highlights from the responses received from the NCAs.

The ESAs would like to state that SFDR has become applicable on 10 March 2021. However, as the detailed Regulatory Technical Standards (RTS) on these disclosures are not yet applicable and given the still emerging NCAs' supervisory practices on voluntary disclosures by FMPs, the indications of good examples of best practices and recommendations included in this report must be considered preliminary at this stage and will be complemented further in subsequent reports.

In addition, as it is too early to offer meaningful guidance on the implications for due diligence disclosures more generally, the ESAs plan to address this in future iterations of the report.

Finally, the future iterations will also cover voluntary disclosures under Article 7 (1), which will only be fully applicable from 30 December 2022.

In terms of next steps, the Commission may consider the ESAs' findings and take those into account in any preliminary evaluation on the functioning of the SFDR.

The ESAs may also consider the findings in the work on the new mandate received on 28 April 2022 to review the PAI framework.

To read more:
https://www.eiopa.europa.eu/sites/default/files/publications/reports/jc-2022-35-joint-esas-report-on-the-extent-of-voluntary-disclosures-of-pai-under-sfdr.pdf

# FSB Annual Financial Report


The Financial Stability Board (FSB) coordinates, at the international level, the work of national financial authorities and international standard - setting bodies in order to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies.

In collaboration with the international financial institutions, the FSB also addresses vulnerabilities affecting financial systems in the interest of global financial stability.

This report contains the financial statements of the FSB, for the 12-month period from 1 April 2021 to 31 March 2022. It also provides details on the FSB governance arrangements and the transparency and accountability mechanisms.

A detailed explanation of the activities undertaken to implement the mandate and tasks of the FSB is provided in the FSB's Annual Report, which describes the FSB's work to promote global financial stability. More information about the FSB's activities is available on its website.

*Financial Stability Board in numbers*

68 member institutions, comprising ministries of finance, central banks, and supervisory and regulatory authorities from 25 jurisdictions, 10 of which are emerging market and developing economies, as well as 10 international organisations and standard-setting bodies; 6 Regional Consultative Groups reaching out to 70 other jurisdictions around the world; and 35 Secretariat staff.

The FSB was established in April 2009 as the successor to the Financial Stability Forum (FSF).

In January 2013, the FSB established itself as an association ("Verein") under Swiss law with its office at the Bank for International Settlements (BIS), Centralbahnplatz 2, Basel – 4002, Switzerland.

The FSB's membership comprises authorities from jurisdictions that are responsible for maintaining financial stability, such as ministries of finance, central banks, supervisory and regulatory authorities; international financial institutions; and international standard-setting, regulatory, supervisory and central bank bodies.
As part of its mandate, the FSB:

(a) assesses vulnerabilities affecting the global financial system and identifies and reviews on a timely and ongoing basis within a macroprudential perspective, the regulatory, supervisory and related actions needed to address them, and their outcomes;

(b) promotes coordination and information exchange among authorities responsible for financial stability;

(c) monitors and advises on market developments and their implications for regulatory policy;

(d) advises on and monitors best practice in meeting regulatory standards;

(e) undertakes joint strategic reviews of and coordinates the policy development work of the international standard-setting bodies (SSBs) to ensure their work is timely, coordinated, focused on priorities and addressing gaps;

(f) sets guidelines for and supports the establishment of supervisory colleges;

(g) supports contingency planning for cross-border crisis management, particularly with respect to systemically important firms;

(h) collaborates with the IMF to conduct Early Warning Exercises;

(i) promotes member jurisdictions' implementation of agreed commitments, standards and policy recommendations through monitoring of implementation, peer review and disclosure; and

(j) undertakes any other tasks agreed by its Members in the course of its activities and within the framework of its Charter.

To read more: https://www.fsb.org/wp-content/uploads/P170822.pdf

# Statement on PCAOB Amendments to Strengthen Auditing Standards for Audits Involving Multiple Firms

SEC Chair Gary Gensler

The Commission approved the Public Company Accounting Oversight Board's (PCAOB) updated standards for audits that involve multiple auditing firms.

I was pleased to support the amended standards because they will strengthen the requirements for lead auditors who supervise other auditors in an audit, helping to enhance audit quality and protect investors.

Over the years, the growing complexity and international operations of public companies has led auditors increasingly to rely on other auditors — working across different firms, countries, and even languages — in completing an audit.

Last year, for example, 26 percent of all issuer audit engagements used multiple auditors, and more than half of large accelerated filer audits used multiple auditors.

Given the challenges that such multi-firm audits present, it is important that there be robust standards for how lead auditors supervise, communicate with, and coordinate with other auditors on the audit engagement.

The PCAOB's updated standards make enhancements across two broad areas.

First, the amended standards specify certain procedures for lead auditors to perform when supervising other auditors.

Second, they require lead auditors to prioritize their supervisory activities around higher-risk areas in the audit.

I thank the PCAOB for their work to update this auditing standard, the first adopted since the Board was newly constituted. I look forward to the additional standard-setting work the PCAOB will undertake to live up to its founding vision under the Sarbanes-Oxley Act.

If Sarbanes-Oxley, signed into law 20 years ago, meets its full potential, trust in our markets can grow — and that benefits investors and issuers alike.

To read more: https://www.sec.gov/news/statement/gensler-statement-pcaob-amendments-081222?fbclid=IwAR05zcpyfn2UhHK61nOoP6zsVr-zVReiWquSLUV4jr9iu6bfahwkQfSypSg

# EBA launches discussion on 2023 EU-wide stress test methodology


The European Banking Authority (EBA) has published its 2023 EU-wide stress test draft methodology, templates and template guidance, which will be discussed with the industry.

The methodology covers all risk areas and builds on the one prepared for the 2021 EU wide stress test.

Some aspects of the methodology have been improved based on the lessons from the 2021 exercise. As a new feature, the projections on net fee and commission income (NFCI) will be based on a top-down model.

This is a first step of revising the EU-wide stress test framework towards a hybrid (bottom-up and top-down) approach. Also, the sample coverage has been increased.

An additional 26 banks have been added to the stress test sample compared to the 2021 exercise and further proportionality has been introduced into the methodology.

The 2023 exercise will assess EU banks' resilience to an adverse economic shock and inform the 2023 Supervisory Review and Evaluation Process (SREP).

The EBA methodology will continue to rely mainly on a constrained bottom-up approach. However, following the EBA decision to move to a hybrid framework on a step-by-step approach, projections for NFCI will be provided to banks based on supervisory top-down models.

The sample for the 2023 EU-wide stress test has been enlarged compared to previous exercises.

The banks participating in the 2023 exercise represent around 75% of the banking sector assets in the Euro Area, the non-Eurozone Member States and Norway, increasing it from 70% in the previous exercises.

As a result, the 2023 EU-wide stress test will be carried out at the highest level of consolidation covering 76 banks, of which 63 are from the Euro Area, a notable increase in coverage compared to previous exercises, in which around 50 banks from the EU and Norway were included. The methodology includes additional proportionality features for certain banks,

to foster efficiency, while maintaining relevance of results and transparency.

No single capital threshold has been set for the 2023 exercise as banks will be assessed against relevant supervisory capital ratios under a static balance sheet.

The stress test results will be used as input into the Supervisory Review and Evaluation Process (SREP), under which decisions are made on appropriate bank capital resources and forward-looking capital plans.

The final methodology will be published by the end of 2022. The EU-wide stress test will be launched in January 2023 and the results are expected to be published by the end of July 2023.

*Notes*

The objective of the EU-wide stress test is to provide supervisors, banks and other market participants with a common analytical framework to consistently compare and assess the resilience of EU banks and the EU banking system to shocks, and to challenge the capital position of EU banks.

The exercise is based on a common methodology and a set of templates that capture starting point data and stress test results.

The 2023 EU-wide stress test is initiated and coordinated by the EBA in close cooperation with the European Systemic Board (ESRB), Competent Authorities (including the Single Supervisory Mechanism – SSM) and the European Central Bank (ECB).

Scenarios, methodology, minimum quality assurance guidance, templates and template guidance will be agreed by the EBA's Board of Supervisors.

The macroeconomic adverse scenario and any risk type specific shocks linked to the scenario will be developed by the ESRB and the ECB in close cooperation with Competent Authorities and the EBA.

The draft methodology and draft templates are the starting point for an informal discussion with banks so as to receive their input, which will be taken into account when finalising both documents.

To read more: https://www.eba.europa.eu/eba-launches-discussion-2023-eu-wide-stress-test-methodology

## Disclaimer

The Association tries to enhance public access to information about risk and compliance management.

Our goal is to keep this information timely and accurate. If errors are brought to our attention, we will try to correct them.

This information:

- is of a general nature only and is not intended to address the specific circumstances of any particular individual or entity;

- should not be relied on in the particular context of enforcement or similar regulatory action;

- is not necessarily comprehensive, complete, or up to date;

- is sometimes linked to external sites over which the Association has no control and for which the Association assumes no responsibility;

- is not professional or legal advice (if you need specific advice, you should always consult a suitably qualified professional);

- is in no way constitutive of an interpretative document;

- does not prejudge the position that the relevant authorities might decide to take on the same matters if developments, including Court rulings, were to lead it to revise some of the views expressed here;

- does not prejudge the interpretation that the Courts might place on the matters at issue.

Please note that it cannot be guaranteed that these information and documents exactly reproduce officially adopted texts.

It is our goal to minimize disruption caused by technical errors. However some data or information may have been created or structured in files or formats that are not error-free and we cannot guarantee that our service will not be interrupted or otherwise affected by such problems.

The Association accepts no responsibility with regard to such problems incurred as a result of using this site or any linked external sites.

# Solvency II Association

At every stage of your career, our association provides networking, training, certification, information, updates, alerts, and services you can use. Join us. Stay current. Take advantage of the new opportunities. Read our monthly newsletter. Get certified.

You can explore what we offer to our members:

1. Membership – Become a standard, premium or lifetime member.
You may visit:
https://www.solvency-ii-association.com/How_to_become_member.htm

2. Monthly Updates – Visit the Reading Room of the association at:
https://www.solvency-ii-association.com/Reading_Room.htm

3. Training and Certification – You may visit: https://www.solvency-ii-association.com/CSiiP_Distance_Learning_Online_Certification_Program.htm

For instructor-led training, you may contact us. We tailor Solvency II presentations, awareness and training programs for supervisors, boards of directors, employees, service providers and consultants.