Proportionality in European Banking Regulation

Policy Research Meeting on Financial Markets and Institutions

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Structure

1. The case for greater proportionality in banking regulation
2. Different paths towards greater proportionality
3. Proportionality: The case of Germany
4. Debate at the European level

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Is small less risky?

→Question: Does the **cost-benefit-equation** in banking regulation differ between small and large banks?

→If it does, then we have a case for **proportionality**.

- First message: What supervision expects in terms of safeguards is not tied to the size of a bank. It is tied to the **size of its risks**. ("Same business, same risk, same rules")
- Second message: If a single small bank fails, it does not cause a global financial crisis. So it seems quite safe to say that a small bank does not pose a great risk to the financial system.
- Third message: When it comes to the costs and benefits of regulation and supervision, small banks are different. Applying to them the same approach that is applied to large banks would distort the underlying equation. The costs would be higher in comparison; the benefits would be smaller.

- Conclusion: Rules for small banks don't have to be as comprehensive as those for large banks. At the same time, small banks don't have to be supervised as intensively as large ones.
- → case to take a **proportionate approach**

The rationale of the Basel standards and consequences for smaller banks

- Need for cross-border level playing field for banks has let to harmonised **global regulatory frameworks**: Basel I (1988), Basel II (2005) and Basel III (2010).

- Rules are directed towards **large and internationally active** banks.

- In many countries, rules have become binding for a **wider set of institutions (as in the EU).**

- **Regulatory framework** since financial crisis **has become more complex.**

→ If regulations are applied widely (as in Europe), small banks are left especially with the **administrative burden** of complying with complex rules without having advantages of economies of scale that come with the size of an institution.

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Two different paths towards greater proportionality

Adjusting the existing regulatory framework

Benefits	Drawbacks
– Quicker and easier to implement politically	– Doesn't fundamentally ease paperwork for smaller institutions – Complicated; interpretation issues

Dedicated regulatory framework for small institutions (small banking box)

Benefits	Drawbacks
– Fundamentally eases paperwork for smaller institutions – Clear and uniform definition delivers genuine relief	– Regimes for small and large banks need to be coordinated with each other – Possible cliff effects at thresholds

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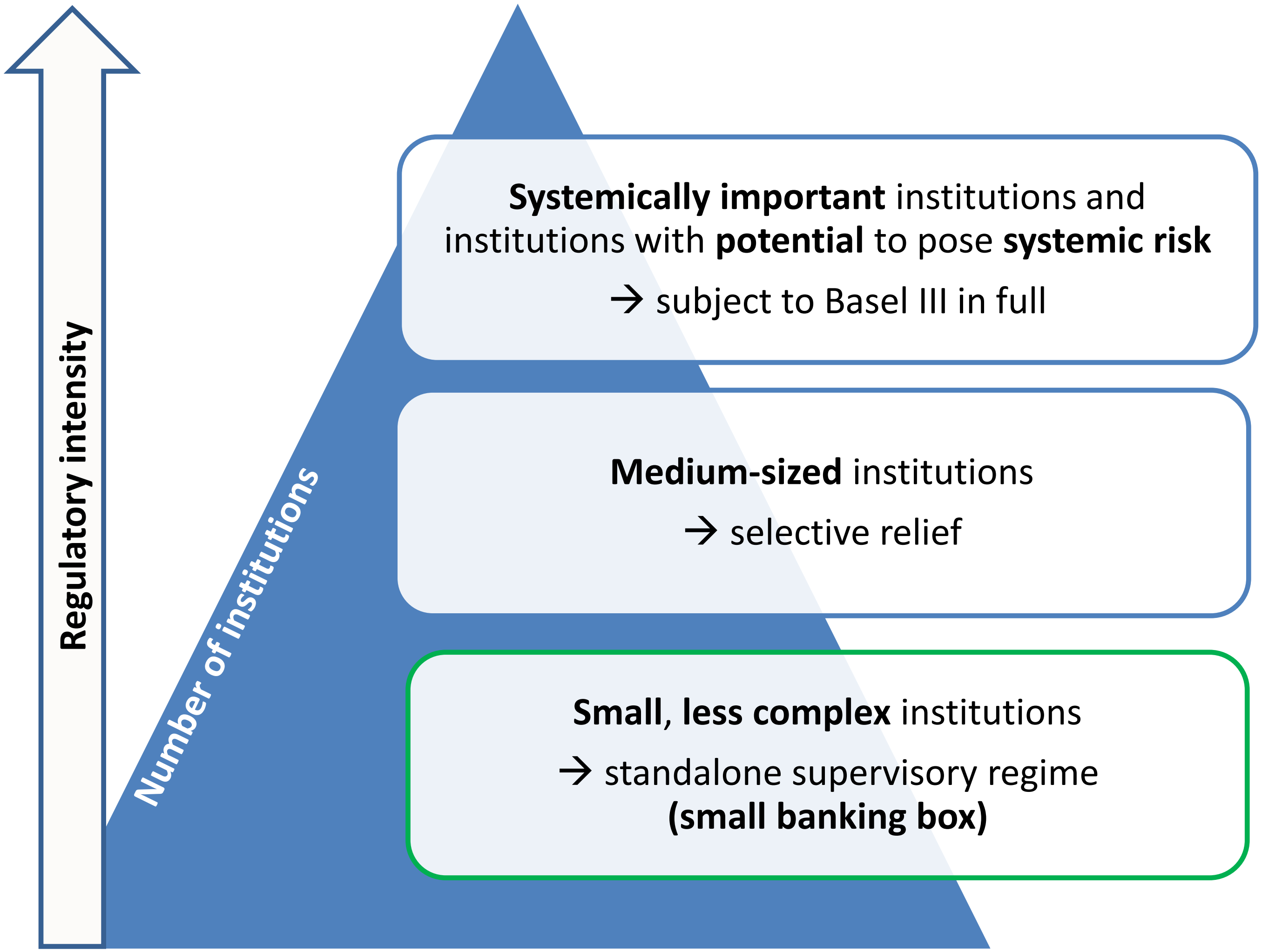
Characteristics of the German Banking sector

1 Commercial banks:	2 Public banks:	3 Cooperative banks:
• 4 big banks • 160 regional/ 106 foreign banks • Building and loan associations	• 413 savings banks • 9 federal state banks • Building and loan associations	• 1,047 credit unions • 1 central institution
Balance sheet total: 3.4bn € (44%)	Balance sheet total: 2.1bn € (27%)	Balance sheet total: 1.0bn € (14%)

Source: Statista, Bankenverband, Deutsche Bundesbank, BVR, DSGV

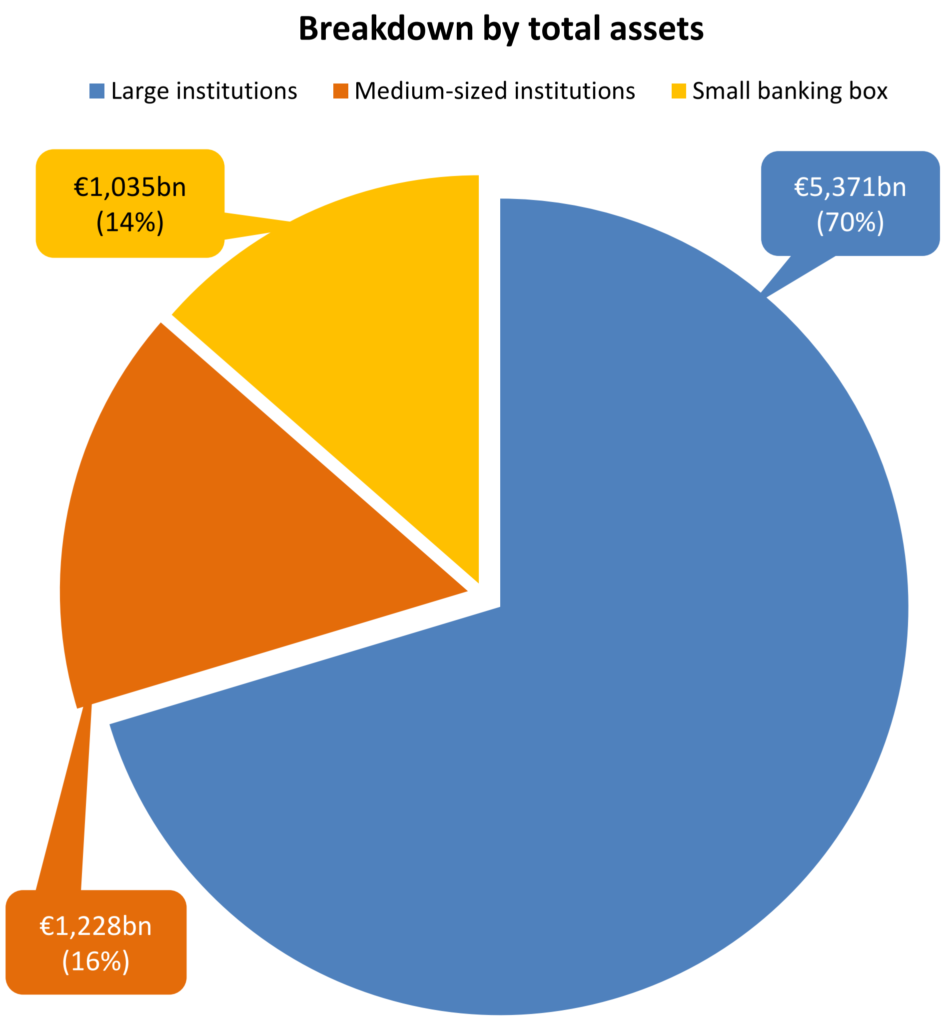
- Around 1,900 credit institutions (1/3 of total number of banks in EMU)
- Total assets correspond to roughly 230% (7.7bn €) of Germany`s GDP (in 2015)
- Heterogeneous banking sector: private banks, savings banks, cooperative banks
- LSIs (around 1,500) account for around 35% of the total balance sheet (only 15-20% in other euro area countries)

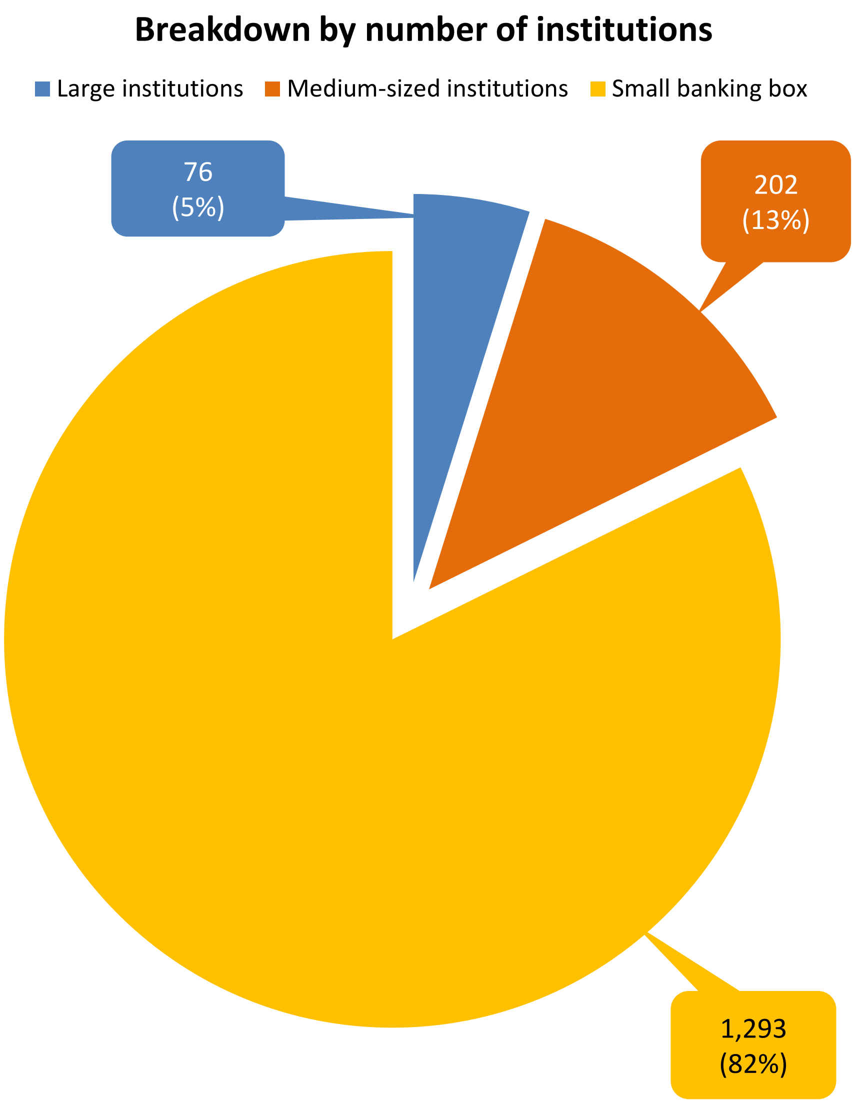
German proposal: three-tier approach for more proportionality



Example: small banking box capped at €3bn

Covers 82% of German institutions and 14% of total assets





Last updated: June 2017

Size isn't everything: additional criteria

Additional criteria for inclusion in the small banking box

1. Only institutions that would be subject to insolvency proceedings in the event of resolution may be part of the box.
2. Candidates for the small banking box may not undertake any notable capital market or cross-border business.
3. They should have, at most, a small trading book and a small derivatives book.
4. They should not use internal models, only the standardised approach.

- The supervisor’s decision is final.
- Institutions can opt to be subject to the more complex rules.

Main thrust: far less bureaucracy

Proportionality increased by ...
– **... abolishing** requirements • Remuneration rules • Disclosure • Recovery and resolution planning
– **... providing relief** • Simplified reporting • Simplified net stable funding ratio (sNSFR)

Limits of proportionality

No proportionality for …

– … risk-based **capital ratios**
– … **leverage ratio**
– … **liquidity coverage ratio (LCR)**

Proportionality and financial stability

- **Financial stability** must be preserved at all costs (**“too many to fail”**)

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The discussion on more proportionality in European banking regulation has been started by the EU Commission in 2015…

September 2015

- EU COM “call for evidence“
  - Ensuring that EU rules are as simple and clear as possible
  - Keeping regulatory burden to the minimum necessary

January 2016

- DE/ UK Non-Paper for Financial Services Committee
  - Basel standards for large and complex banks
  - Small Banking Box (SBB) for small banks with low risk profile

November 2016

- Legislative proposal by EU COM regarding CRR/ CRD IV reform
  - Enhancing the principle of proportionality
  - Introducing several - mostly operational - regulatory relaxations

June 2017

- 1. DE Non-Paper for EU COM Expert Group
  - Allocating banks into three categories with different regulatory requirements
  - Establishing SBB for smallest institutions

July 2017

- 2. DE Non-Paper for EU Working Party on Financial Services
  - Enhancing proportionality within the existing rules
  - Topics: Reporting, Liquidity, Remuneration, Disclosure

… and is now discussed in the trilogue between European Commission, Parliament and Council

August/September 2017

- Council Working Group
  - Discussions esp. concerning threshold, reporting, disclosure and remuneration
  - Ends with concrete proposals for reporting, disclosure, remuneration and liquidity

November 2017

- ECON Draft Report („Simon Report")
  - Reliefs for smaller banks within reporting, liquity („simplified NSFR"), disclosure and markt risk.

May 2018

- ECOFIN general approach
  - Definition of „small and non-complex institution"
  - Reliefs for smaller institutions in reporting, disclosure,

June 2018t

- ECON Report
  - Definition of small institution
  - Simplified NSFR

Currently

- Ongoing trilogue until end of 2018
- Implementation in CRR/CRD planned for 2021

Overview of current negotiations in EU trilogue

CRR/ CRD IV Review

Threshold / Definition of small institution (Art. 430a CRR)

- COM: total assets <1,5 bn €
- **ECOFIN/ECON: total assests < 5 bn €, plus qualitative criteria (trading, derivatives, use of internal models…)**

Disclosure

- COM: trisection of institutes/ different disclosure requirements
- ECOFIN: distinction between institutions which are (not) active in capital market
- **ECON: Disclosure of only „key metrics“ for smaller institutions**

Reporting

- COM: reduced reporting frequency, EBA mandate for evaluation/analysis
- **ECOFIN/ECON: EBA mandate, supervisory jugdement**

Market Risk

- all: Institutes with a medium-sized trading book : continuation of Basel 2.5 approach
- Different thresholds proposed (COM/ECON: 300 Mill. € / **ECOFIN: 500 Mill. €)**

Net Stable Funding Ratio

- COM/ECOFIN: no/little exemptions for smaller banks
- **ECON**: **Introduction of a „simplified“ NSFR for small and non-complex institutions:** based on less data fields

Thank your for your attention!