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**Banking Union and the Debate on  
Proportionality: A Concept Paper**



**EBI-EALE workshop on  
'Reflections on the Design and Implementation of the European Banking Union'  
Villa Guastavillani, Bologna, 17 September 2016**

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## Proportionality as a general principle of EU law

- From standard of review of Prussian administrative law to standard of constitutional and human rights law
- Judicial recognition as general principle of EU law
  - Case 11/70, *Internationale Handelsgesellschaft* (implicit recognition)
- Express recognition in the Treaty
  - TEU, Art 5:
    - “1. The limits of Union competences are governed by the principle of conferral. The use of Union competences is governed by the principles of subsidiarity and proportionality. . . .*
    - 4. Under the principle of proportionality, the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties.*
    - The institutions of the Union shall apply the principle of proportionality as laid down in the Protocol on the application of the principles of subsidiarity and proportionality.”*
  - Protocol No 2 on the application of the principles of subsidiarity and proportionality
- Specific references in secondary Union law  
(including in the Single Rulebook!)

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## Related concepts

- **Aristotelian equity**
  - Justice in the narrow sense as equal application of a ‘fair mean’, incorporated into a definite rule *v* equity as the just result, which cannot be determined in the abstract or in advance
  - Modification-rectification of general norms in recognition of a particular case’s specific circumstances
- **Subsidiarity**
- **Better regulation**
  - Simplification
  - Better fit: differentiation / calibration
  - Impact assessment of policy options
  - Cost-benefit analysis

*Cf* ‘Better Regulation Guidelines’, COM(2015)111
- **Individual rights**
  - Both fundamental rights and Treaty freedoms!

## Proportionality in the caselaw: alternative tests

- Canonical proportionality tests in ECJ's jurisprudence contain overlapping notions of
  - suitability (fitting means for achieving legitimate objective),
  - necessity (in the sense of lack of a less intrusive alternative), and
  - *stricto sensu* proportionality (balancing of aims and disadvantages)
    - Case 120/78, *Rewe-Zentral (Cassis de Dijon)*
    - Case C-331/48, *Fedesa*
- Proportionality as the 'rule of reason' in *Cassis*
  - Emphasis on legitimate objective, factual suitability of the measure and choice of least-restrictive/onerous means (suitability and necessity)
- Proportionality as absence of 'manifest inappropriateness'
  - Negative-minimalist approach to *stricto sensu* proportionality: costs of measure must not be manifestly disproportionate to the benefits
  - Judicial deference ; resemblance to *Wednesbury* unreasonableness?

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## Variation depending on decision-makers & areas

- **Lack of consistency in the application of proportionality tests**
  - Pro-integration bias: national measures standing in the way of the single market are often deemed to fail the test!
  - More lenient review of Union measures: manifest inappropriateness test!
  - Variation depending on the nature of the issue: increasingly strict scrutiny, as we move from discretionary regulatory choices, through measures affecting rights of individuals, to the enforcement of competition rules
  - Occasional conflation with procedural considerations
    - Procedure (openness, transparency, stakeholder participation, gathering of evidence) as substitute for proportionality?
- **Generally, no recourse to fully-fledged balancing of interests**
  - But see Case C-62/14, *Gauweiler*, para 67:
    - “proportionality requires that acts of the EU institutions be appropriate for attaining the legitimate objectives pursued by the legislation at issue and do not go beyond what is necessary in order to achieve those objectives”*
- **No attempt to turn proportionality into hard-look judicial review**
  - (much less into a principle of overall economic efficiency)

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## Standard of review or organizing principle?

- **Proportionality as a Treaty-enshrined constitutional value**
  - Not merely a judicial standard of review, confined to boundary, *ex post* questions of legality & competences
  - Has a programmatic dimension, not merely a principle for the implementation or review of existing law
  - Should inform the wider discussion on the merits of the regulatory framework
- **Should serve *ex ante* as an organizing principle of banking regulation & supervision**
  - Calibration of norms (scope of application, substantive content) to the regulatory objectives: suitability!
  - Avoidance of unnecessary burdens  
(but even at the cost of simplicity & uniformity?)
  - Balancing of interests: cost-benefit analysis?
  - Coherence across policy regimes (capital & liquidity framework, resolution, accounting, securities regulation)

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## Limits & drawbacks of proportionality

- Especially when applied *ex post* (when norms are applied), proportionality threatens certainty & predictability
- Equal treatment?
  - Possibility of regulatory arbitrage
- Potential impact on regulatory effectiveness & efficiency
  - Increased administrative costs
  - Impediments to streamlined information collection & administration
- Simplicity is frequently conflated with proportionality; but resorting to simple, flat rules is not always possible or desirable
  - Simplicity cannot go very far: complex problems, complex industry
  - Regulatory complexity v differentiation?

Complexity & high administrative & compliance costs of 'one-size-fit-all' regulatory regime v more effective supervision and enforcement / calibration of norms in terms of scope & content / targeted attainment of regulatory objectives through differentiation!

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## Proportionality in banking regulation: levels

- **Critical impact of regulation in the form of Level 1 legislation**
  - Paradigmatic case of the Treaty provisions
  - Affects all subsequent levels
  - Determines the limits of discretion of subsequent decision-makers
- **Proportionality through Level 2?**
  - Proportionality of RTSs envisaged in CRDIV, rec 92
  - But RTSs must remain within the strict mandates of Level 1 rules: RTSs are of technical nature, may not involve substantial policy choices (TFEU, Art 290; EBA Reg, Art 10)
- **Open-ended regulation & opportunities for adaptation**
  - O&Ds for national legislators, NCAs and/or the regulated institutions themselves
- **Supervision**
  - Proportionality in Pillar II / SREP (CRDIV, Art 97(4))
- **Enforcement / imposition of penalties**

# Proportionality as a function of banking diversity

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- **Compliance with Single Rulebook: highly complex & costly**
  - European application of Basel III to all and sundry: disproportionate *per se*?
  - Cf US approach!
  - High costs for institutions that do not pose significant risks: unjustified burden
  - Cost of compliance (as a percentage of revenue, per employee, etc) *inversely proportional* to banks' size; benefits of the regulatory regime, ditto!
- **Regulatory significance of banking diversity: bank-level characteristics & overall financial sector structure**
  - Group size and complexity: large, TBTF banks v small & medium-sized banks
  - Business model: basic credit provision v trading activities
  - Range of activities and risk profile: systemic risk / interconnectedness (significance for macroprudential & risk-based microprudential supervision)
  - Ownership structure
  - Legal form: corporations v cooperative & savings banks
  - Potential impact of industrial structure of national banking/financial sector (including concentration, market conditions)

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## Disproportionality of the Single Rulebook?

- **Disproportionate/unnecessary burdens on smaller banks**
  - Compliance and reporting costs
  - Adverse competitive implications
- **Other relevant issues include:**
  - **Reporting requirements: required disclosures, granularity, frequency and time limits**
  - **Alignment of supervisory reporting with accounting standards**
  - **Basel III financial requirements (liquidity rules, risk models)**
  - **Proportionality in the migration to / phasing in of new rules**
  - **Corporate governance & decisions affecting individuals:**
    - fitness criteria; mandates and remuneration (incentive structure); BoD composition and functioning, structure of BoD committees, control functions (internal governance); training needs
  - **Proportionality in enforcement: preserve of national law!**

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## How to achieve proportionality?

- **To which categories of banks should differentiation / a simplified approach apply?**
  - Criterion: risk-based approach to regulation and supervision and materiality
  - Differentiation between national markets or cross-European differentiation of classes of institutions?
- **How should proportionality be factored into the Single Rulebook?**
  - Addressing disproportionality at Level 1 (including in the context of CRR review): simplification and/or differentiation of the primary norms
  - Coordination of standard-setting and avoidance of divergent, overlapping or conflicting requirements (e.g., financial requirements in CRR, MREL and TLAC)
  - Simplification *v* differentiation?
  - Improved standard-setting and proportionality as benchmark for EBA RTSs: how effective?
  - Procedural tools (open consultation, evidence, etc) for promoting proportionality at all levels

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## Single Rulebook & built-in proportionality

- **Differentiated reporting requirements?**
  - Extent/detail of reporting, periodicity, time limits for submission
  - Countervailing consideration: uniformity necessary for the collection of comprehensive statistical information
- **Proportionality of regulatory norms v proportionality in compliance & supervisory discretion**
  - Calibration of norms & rule-bound determination of their scope of application, or case-by-case waivers/derogations?
  - Increased reliance on O&Ds & supervisory waivers? Or centrally defined thresholds & exemptions?
  - Applying thresholds: open-textured (evaluative) or prescribed (quantitative)?
- **Differentiation of the steady-state requirements v differentiation of transitional/phase-in arrangements & time-frames**

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## Proportionality applied

- **Industry-led debates on regulatory simplification and diversification**
- **Heightened regulatory & industry interest**
  - EBA Banking Stakeholder Group report (Oct 2015)
  - Special EBA workshops (Jul 2015, Apr 2016)
- **Specific example of application of proportionality analysis with regard to the review of existing norms**
  - CRDIV remuneration provisions as a case study

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## Case study: CRDIV remuneration rules

- **Mandatory principles on banks' remuneration policies; CRD IV, Arts 92–95**
- **Disproportionate effect of the rules**
  - Compliance costs per staff member / relative to total administrative costs higher for small institutions than large ones
  - Cooperative banks face additional problems, because they cannot reasonably use shares/equity rights for variable part of remuneration
  - The application of remuneration principles also at consolidated and sub-consolidated levels to asset management firms & other subsidiaries can affect negatively the ability to compete for talented staff
- **Whether proportionality could be applied at Level 2 or at national level**
  - CRD IV, rec 66 & Art 92(2): proportional application of rules by NCAs; but the numerical limits still apply and the wording does not permit exemptions or waivers to the application of the principles
  - Different legal interpretations of this clause, leading to divergent implementation at national level

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- **EBA review and proposals for amendments (EBA/Op/2015/25)**
  - Readiness to contemplate differentiated solutions
  - Proportionality easier to achieve at Level 1
  - Resistance to differentiation by way of national rules
  - Unclear, whether differentiation should be based on NCAs' discretionary judgement, general criteria to be specified by way of EBA RTS or, less likely, automatic numerical thresholds in the European legislation [an approach which the EBA would appear to dislike]
  - Insistence on principle that all institutions are subject to the regulatory principles & that national authorities cannot exempt institutions
- **Commission's review of remuneration principle (COM(2016) 510 final)**
  - Draws on EBA work, two public consultations, external study
  - Finding that the rules are generally effective
  - Acceptance of disproportionality of the particular rules, but reform only as part of general CRDIV/CRR review, following an impact assessment which will examine alternatives

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## Proportionality, O&Ds & the SSM

- **CRR: key component of Single Rulebook, directly applicable**
  - Minimization of undue variability of regulatory norms
  - Greater cross-border transparency, competitive equality
- **However, the CRDIV/CRR package contains large number of national ODs**
  - Preservation of some national autonomy
  - Opportunity for achieving proportionality / better local fit?
  - Or unwarranted political bargain, diluting the uniformity of the single market?
  - O&Ds allocated variably to Member States as such and/or to their NCAs
- **In the BU, O&Ds preserved for the NCAs are exercised, in relation to significant institutions, uniformly by the ECB, stepping into their shoes**
  - ECB Reg (EU) 2016/445
  - Legal debate on the allocation of competences in Single Rulebook & SRM Reg
  - Ambiguous justification of allocating discretionary powers along such lines

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## Proportionality & the resolution regime

- **Proportionality partially factored into the BRRD regime**
  - Resolution authorities & NCAs must take into consideration bank-level & systemic-risk factors (BRRD, Art 1(1))
- **Recovery & resolution planning**
  - Particularly suitable for proportionality-based approach
  - Possibility of simplified obligations for certain institutions (BRRD, Art 4)
- **Implications for resolution tools?**
- **Need for alignment of capital regime & MREL/TLAC**
- **Proportionality in the application of bail-in, esp. with regard to scope & exclusions (BRRD, Art 44(3))**
- **Disproportionate restrictions on public assistance?**
  - BRRD restrictions: excessively restrictive?  
*Cf* debate on Italian banking system
  - Commission's state-aid conditionality approach potentially too inflexible

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**Thank you for your attention**

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