

PROPORTIONALITY IN SUPERVISION

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PROPORTIONALITY IN SUPERVISION

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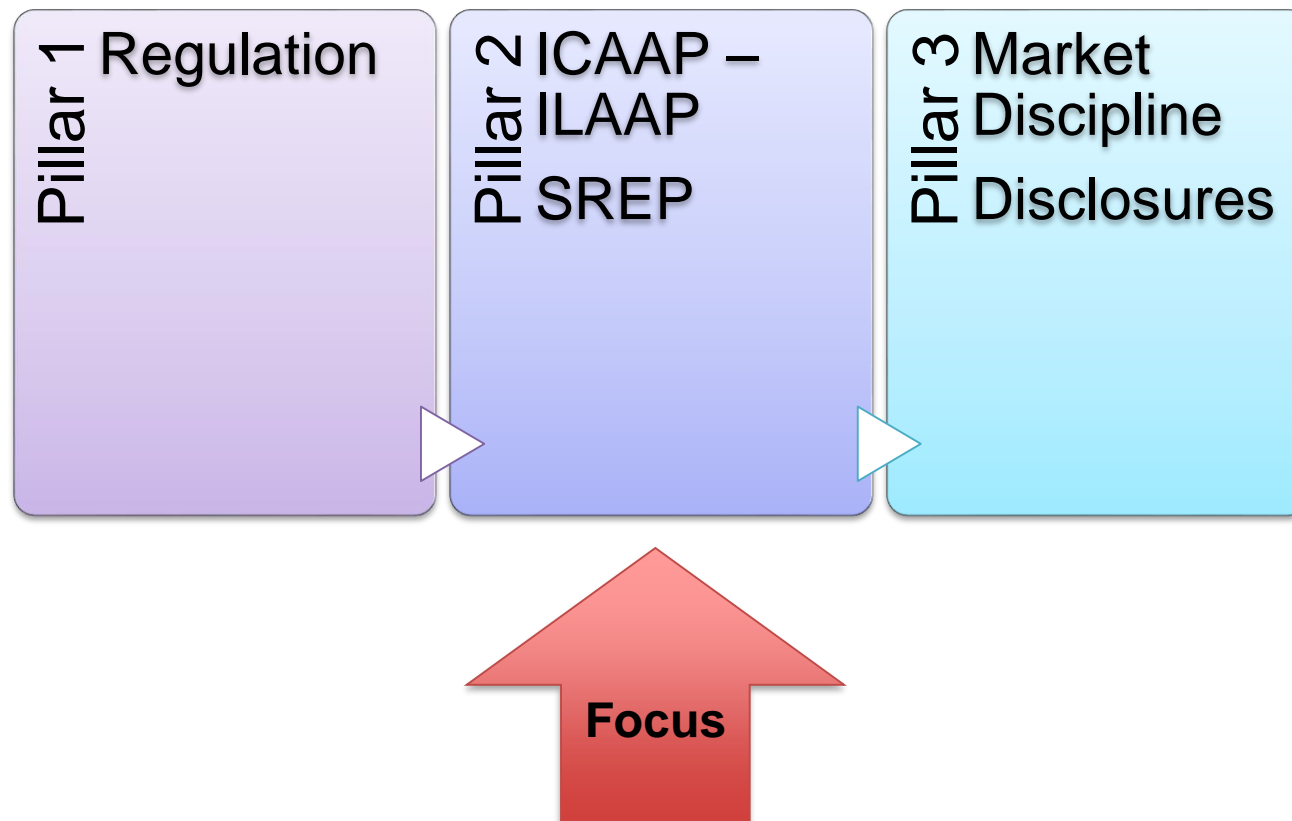


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Regulation, supervision and market discipline – striking a balance

Statement by Sabine Lautenschläger, Member of the Executive Board of the ECB and Vice-Chair of the Supervisory Board of the ECB, at a conference hosted by the Financial Stability Institute, 18 September 2017, Basel

To sum up, a stable banking sector is supported by three pillars: regulation, supervision and market discipline. Since the crisis, we have made these three pillars stronger. Now we have to make sure that they remain in good shape and share the load in a balanced way. Otherwise, we will not reap all the benefits of the transformation that has taken place in banking supervision.

So, instead of having overly detailed rules, we should have a strong basic set of rules that allows supervisors some discretion. Supervisors have the relevant skills and experience, and in-depth knowledge of the banks they supervise. We should ensure that supervisors can continue to apply their judgement. They should be empowered to assess the risks that a bank poses to its stakeholders and the financial system. This will enable them to deal with risks at an early stage.

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Mission statement of the SSM

Within the Single Supervisory Mechanism (SSM), composed of the European Central Bank and national competent authorities, the European Central Bank carries out its supervisory tasks. The European Central Bank is responsible for the effective and consistent functioning of the SSM, with a view to carrying out intrusive and effective banking supervision, contributing to the safety and soundness of the banking system and the stability of the financial system.

In pursuing our objectives, we in the SSM attach utmost importance to credibility and accountability. In performing our tasks we are transparent while fully observing the applicable confidentiality requirements. We aim for effective communication with the citizens of Europe. We are committed to conducting our relations with European and national authorities in full accordance with the relevant law and with due regard to the principle of independence.

We develop a supervisory approach that meets the highest international standards. We will implement the EU policies on the prudential supervision of banks in a coherent and effective manner, based on a best practice framework for independent, forward-looking and risk-based supervision. **We respect the principle of proportionality, the unity and integrity of the internal market and the public interest.** We observe good governance and perform our tasks in a spirit of cooperation and teamwork.

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EBA/Op/2015/25

21 December 2015

Opinion of the European Banking Authority on the application of the principle of proportionality to the remuneration provisions in Directive 2013/36/EU



22 October 2013

EBA proportionality workshop

Opening remarks by Andrea Enria, Chairperson of the EBA

London 22 October 2013

... reforms is to drive significant changes in business models; at the same time, we are very much aware that banks will react to the new standards in way that we can hardly predict. This notwithstanding, we need to draft proportionality in a way that is sufficiently precise, to avoid opening the door for regulatory arbitrage and creating loopholes that some may seek to exploit. Everyone that calls for more proportionate rule making needs to be mindful of that. And this is what I mean by pragmatism – provide us indications that correctly capture differences in business models, help us avoid loopholes in definitions, make suggestions that are sensitive to these concerns, and we will have an open door for your ideas.

PROPORTIONALITY IN BANK REGULATION

A Report by the EBA Banking Stakeholder Group

PROPORTIONALITY IN SUPERVISION: NCA'S VIEWS

“The approach we have chosen rather requires that supervisors know the banks’ business models, their risks and risk management. Indeed, an intensive supervisory process is needed. Reflecting recent experiences, we believe that this approach was appropriate, proportional and successful – at least with regard to the bank business activities of German banks in Germany.”

Proportionality as the Core Principle in the Supervision of a Heterogeneous Banking Sector; Bundesanstalt für Finanzdienstleistungsaufsicht, EBA Workshop on Proportionality London, October 22 2013



PROPORTIONALITY IN SUPERVISION: NCA'S VIEWS

DeNederlandscheBank

EUROSYSTEM

Proportionality

The multitude of post-crisis rules have also prompted a demand for supervision that is more proportionally structured. Proportionality does not mean less stringent rules but an approach that is more tailored to the specific risks an institution faces. Smaller institutions do not face risks any less than the large institutions do; the risks are above all different in nature. Smaller institutions face risks that are often concentrated on a specific activity, while they have few possibilities for lowering their risk profile by diversifying their activities.

PROPORTIONALITY IN SUPERVISION: NCA'S VIEWS

EUROPEAN BANKING SUPERVISION: THE FIRST EIGHTEEN MONTHS

Dirk Schoenmaker and Nicolas Véron, editors

Supervision of LSIs

The ECB plans SREP guidance for LSIs as of 2018, but BaFin decided to take the first SREP capital decision in 2016, in line with the EBA SREP Guidelines. Capital add-ons will be common practice in the future because of the requirements set out in the EBA Guidelines, which define a 'Pillar-1-plus' approach for the quantification of Pillar-2 risks.

Beyond the SREP minutiae, the major challenge facing the SSM is to balance the objective of a single rulebook for the euro area with the principle of proportionality. LSIs in Germany are concerned that the ECB eventually wants to apply the same rules for SIs and LSIs, which might threaten their business models.

businesses.

Bankers recognise that much centralisation of decision-making in Frankfurt is unavoidable, but they feel that some of the rules should be changed. Delegation should be made possible for lower-level decisions, such as the vetting of new directors, and changes at small subsidiaries. More generally, the view prevails that the principle of proportionality should be better applied by European banking supervision. Small subsidiaries are currently subject to the same supervisory controls as group-level entities.

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Section III

Supervisory review and evaluation process

Article 97

Supervisory review and evaluation

1. Taking into account the technical criteria set out in Article 98, the competent authorities shall review the arrangements, strategies, processes and mechanisms implemented by the institutions to comply with this Directive and Regulation (EU) No 575/2013 and evaluate:

4. Competent authorities shall establish the frequency and intensity of the review and evaluation referred to in paragraph 1 having regard to the size, systemic importance, nature, scale and complexity of the activities of the institution concerned and taking into account the principle of proportionality. The review and evaluation shall be updated at least on an annual basis for institutions covered by the supervisory examination programme referred to in Article 99(2).

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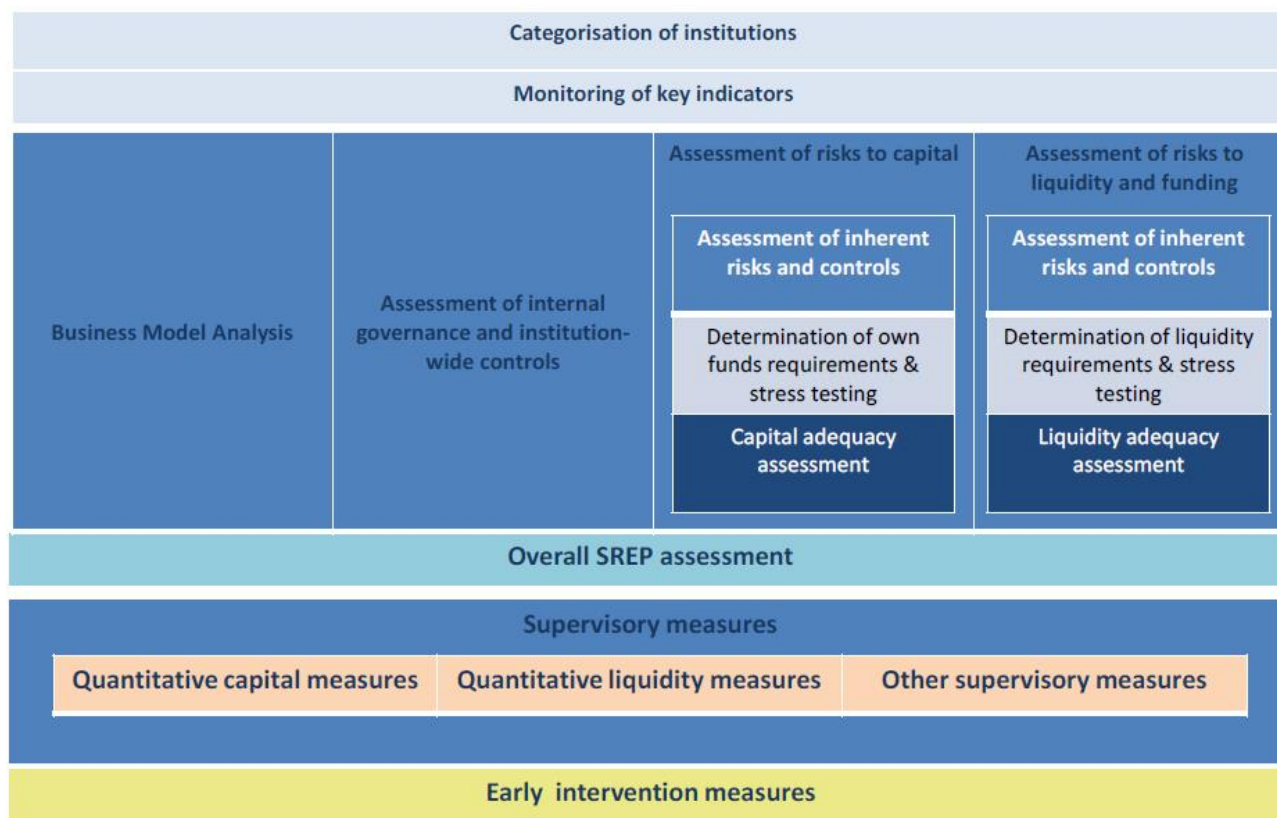
Guidelines

on common procedures and methodologies for the supervisory review and evaluation process (SREP)

These guidelines recognise the principle of proportionality by:

- a. categorising institutions (in four distinct categories) according to their systemic importance and the extent of any cross-border activities; and
- b. building a minimum supervisory engagement model, where the frequency, depth and intensity of the assessments vary depending on the category of the institution.

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Category	Criteria
1 Systemically important	G-SII-O-SII + Others
2 Medium to large	sizable cross-border activities, operating in several business lines, including non-banking activities, and offering credit and financial products to retail and corporate customers; Non-systemically important specialised institutions with significant market shares in their lines of business or payment systems, or financial exchanges
3 Small to medium institutions	non-significant cross-border operations, and operating in a limited number of business lines, offering predominantly credit products to retail and corporate customers with a limited offering of financial products. Specialised institutions with less significant market shares in their lines of business or payment systems, or financial exchanges
4 All other	all other small non-complex domestic institutions that do not fall into Categories 1 to 3

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- ✓ Competent authorities should apply the principle of proportionality in the **scope, frequency and intensity of supervisory engagement and dialogue with an institution**, and supervisory expectations of the standards the institution should meet, in accordance with the category of the institution.

	Category 1	Category 2	Category 3	Category 4
Update key indicators	Quarterly	Quarterly	Quarterly	Quarterly
Overall SREP Assessment	Annually	Annually	Annually	Annually
Update individual SREP Elements	Annually	Every 2 years	Every 3 years	Every 3 years
Outcome overall SREP Assessment	Annually	Every 2 years	Every 3 years	Every 3 years
Engagement and dialogue	Ongoing	Ongoing	Risk based	Every 3 years

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SSM SREP Methodology Booklet

- 2017 edition – to be applied in 2018 -

Level playing field - High standards of supervision - Sound risk assessment

➤ High standards of supervision:

- follows the **EBA guidelines on SREP** and draws on leading practices within the SSM and as recommended by international bodies
- **proportionality, flexibility and continuous improvement**
- supervisory decisions – **not only additional capital but also additional measures** tailored to banks' specific weaknesses

A consistent SREP methodology for LSIs

Proportionality and flexibility

While it is important to promote a level playing field in the supervision of euro area banks, **it is equally crucial to support a proportionate and adequate supervisory approach, in particular when it comes to smaller institutions.** Therefore, the methodology will, on the one hand, allow the supervisor to adjust the intensity of the assessment according to the individual characteristics of each institution, especially to their riskiness, to allow an efficient allocation of resources at NCAs. On the other hand, it will also limit the burden for the smaller, less risky banks, for example in the area of data reporting requirements.

More precisely, the SREP methodology for LSIs offers the NCAs the possibility to adjust the intensity and frequency of supervisory activities according to the banks' potential impact on the financial system and to their riskiness. This tailored approach includes different frequencies and different levels of granularity in the assessment of risk levels and risk controls, and in the review of the internal assessment processes with respect to the adequacy of capital and liquidity (ICAAP and ILAAP).

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	Exempt	Frequency	Granularity	Review
ICAAP/ILAAP	No	No difference	No difference	EBA SREP Guidelines permit differentiation
SREP	No	EBA SREP Guidelines permit differentiation	EBA SREP Guidelines permit differentiation; ECB LSI Methodology yet to be completed	EBA SREP Guidelines permit differentiation
FINREP	No	No not in accordance with Commission Implementing Regulation (EU) No 680/2014 However CRR2 99(7)	No, However CRR2 99(7)	No distinction
COREP	No	No not in accordance with Commission Implementing Regulation (EU) No 680/2014 However CRR2 99(7)	No, However CRR2 99(7)	No distinction
Recovery planning	Possibly	No clear guidance yet	No clear guidance yet	No distinction
Resolution/MREL	Possibly	No clear guidance yet	No clear guidance yet	No clear guidance yet

SUMMARY AND CONCLUSIONS



- Proportionality in supervisory practice **recognised in law and in EBA Guidelines**;
- Proportional application of supervisory routines **predominantly at discretion of NCAs**;
- Does SSM result in “**race to the top**” without distinctions to apply proportionality?
- **Concrete rules** to shape a more proportional engagement and supervisory relationship **yet to be developed** (CRR2?).

DISCUSSANTS AND DEBATE



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LOOKING FURTHER