Reflections on the Concept of Proportionality & Its Implications for Banking Regulation

Conference on 'Fostering a Diversified Banking Market through Proportionality: An Academic Review', Single Resolution Board, Brussels, 7 March 2018

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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!)
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

Individual rights
Both fundamental rights and Treaty freedoms!

Proportionality in the caselaw: alternative tests

Canonical tests in ECJ’s jurisprudence rest on overlapping criteria 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?
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: procedural safeguards (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!

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 relating to legality and competence
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 in the field of banking regulation, as elsewhere
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, reporting and accounting, supervisory review, resolution, securities regulation)
Limits & drawbacks of proportionality

Especially if applied ex post (as part of the concrete application of general rules to individual cases), proportionality threatens certainty & predictability

Equal treatment?
Competitive implications and possibility of regulatory arbitrage

Potential impact on regulatory effectiveness & efficiency
Increased administrative costs
Impediments to streamlined information collection & administration
Potential risks to systemic stability

Simplicity is frequently conflated with proportionality
– but resorting to simple, flat rules is not always possible or desirable
Simplicity should not go far too far: complex problems, complex industry
Regulatory complexity v differentiation? Complexity and 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!

Proportionality as a function of banking diversity

Compliance with Single Rulebook: highly complex & costly
European application of Basel standards 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 – as well as 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)
Lack of proportionality 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!

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 or soft law (guidelines, recommendations)?
- 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)

Discretionary adaptations of the regulatory framework
- O&Ds for national legislators and NCAs

Supervision
- Proportionality in Pillar II / SREP (CRDIV, Art 97(4))

Enforcement / imposition of penalties
Initiatives towards greater proportionality

**Debates on regulatory proportionality, simplification and diversification**
- Industry-based (cooperatives, small banks) and academic concerns and proposals
- EBA Banking Stakeholder Group report (Oct 2015)
- Special EBA workshops (Jul 2015, Apr 2016)
- Commission’s Call for Evidence, followed by review of the existing normative framework

**Impact on Banking Reform package of 23 Nov 2016 and the EBA’s work**
- Specific examples of application of proportionality analysis in the context of the review of existing norms:
  - CRDIV remuneration provisions
  - Supervisory reporting

**Still, the debates remain fussy**
- Proportionality as a free for all; little progress in practice
- Absence of structure: lack of clear general criteria, mapping of the technical alternatives and a convergence on priorities

How to achieve proportionality?

**Differentiation / simplified approach for which banks?**
- Criterion: risk-based approach to regulation and supervision and materiality – or simply size?
- Differentiation between national markets or cross-European differentiation of classes of institutions?

**How should proportionality be factored into the Single Rulebook?**
- Addressing proportionality at Level 1 (including in the context of CRR review): simplification and/or differentiation of the basic norms
- **Adoption of a Small Banking Box?**
- Coordination of standard-setting and avoidance of divergent, overlapping or conflicting requirements (e.g., financial requirements in CRR, MREL and TLAC)
- Improved standard-setting and proportionality as benchmark for EBA: how effective?
- Procedural tools (open consultation, evidence, etc) as means for promoting proportionality?
- Tension between simplification and differentiation?
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

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 for allocating discretionary powers along such lines
### ‘Banking Reform’ package

#### Background
- Review of existing norms based on
  - 2015 public consultation on impact of CRD IV/CRR banking prudential regime on the financing of the EU economy
  - ‘Call for Evidence’ on all post-crisis legislation on financial services
  - Specific Commission analysis on CRD IV rules on remuneration
- Need to implement FSB’s TLAC standard in EU

#### 23 Nov 2016: launch of the Banking Reform package

> “Today, we have put forward new risk reduction proposals that build on the agreed global standards while taking into account the specificities of the European banking sector”
> – Commission Vice-President Valdis Dombrovskis

#### Five legislative proposals
- Amendment of CRD IV/CRR prudential regime of 2013
- Amendment of BRRD & SRM Reg resolution regime of 2014

### Key prudential proposals

#### Completion of the Basel III prudential regime
- Binding 3% leverage ratio (LR)
- Binding detailed net stable funding ratio (NSFR)
- More risk-sensitive capital requirements for securities & derivatives trading
- No proposed amendments relating to then ongoing discussion in the BCBS (credit and operational risk, including introduction of ‘output floor’)

#### Facilitation of lending to SMEs and for infrastructure projects
– but at the cost of significant divergence from Basel standards

#### Making supervisory requirements more proportionate & easing burden for smaller and non-complex banks
- Differentiated TLAC/MREL implementation (Pillar I MREL only for G-SIIs)
- More proportional rules on supervisory reporting
- CRR disclosure requirements
- Amendment of the remuneration rules
- Phasing-in of IFRS9
Proportionality in supervisory practices & EBA standards

Supervisory reporting requirements
- Key issues: simplified reporting / lower frequency of reports for small or non-complex banks
- Already, de facto wide differentiation of reporting requirements, depending on size/complexity (including reliance on models)
- Further differentiation through exemptions and additional demands for reports
- Development of tool to monitor reporting obligations

Proportionality in Pillar 2 and Pillar 3
- SREP, stress testing: differentiation based on institutions’ classification in four categories
- Disclosures: differentiation based on materiality criteria as well as O-SIs identification, plus national discretion (EBA Guidelines 2014/14 on materiality, 2016/11 v2 on disclosure requirements)
- Alignment of supervisory reporting requirements and disclosures, including through use of EBA as information hub?

Eligibility for simplified resolution planning obligations under BRRD
- Draft RTS EBA/RTS/2017/11 on simplified obligations (19 Dec 2017)
- Potential alignment with prudential supervisory approach

Proportionality of the division of supervisory tasks!

Distribution of responsibilities between the ECB & the NCAs
SSMR and Framework Regulation
Case T-122/15, Landeskréditbank Baden-Württemberg – Förderbank v ECB, 16 May 2017
- “The logic of the relationship between [the ECB and the NCAs] consists in allowing the exclusive competences delegated to the ECB to be implemented within a decentralised framework, rather than having a distribution of competences . . .
- Direct prudential supervision by the national authorities under the SSM was envisaged . . . as a mechanism of assistance to the ECB rather than the exercise of autonomous competence . . .
- The ECB retains important prerogatives even when the national authorities perform the supervisory tasks . . . The existence of such prerogatives is indicative of the subordinate nature of the intervention by the national authorities in the performance of those tasks.”

Proportionality and subsidiarity: cannot determine the performance by the ECB of its supervisory tasks and the exercise of its powers
- Proportionality: addressed in the context of the SSMR’s division of supervisory responsibilities, reflected in the overall institutional balance
- Subsidiarity: inapplicable within the SSM, since this involves exclusive competencies of the ECB, which are performed in a decentralized manner
Proportionality & the resolution regime

Proportionality largely embedded in 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
Alignment of capital regime & MREL/TLAC (Banking Reform package)
Proportionality in application of bail-in, esp. with regard to scope & exclusions (BRRD, Art 44(3))

Disproportionate restrictions on public assistance?
BRRD restrictions on precautionary recapitalizations: excessively restrictive?
Cf debate on Italian banks
Commission’s state-aid conditionality approach potentially too inflexible

Thank you for your attention

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