Financial Stability Institute

BANK FOR INTERNATIONAL SETTLEMENTS

Proportionality in banking regulation

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**The views expressed in this presentation are those of the presenter and not of the BIS or the Basel-based committees.*

Overview

1. The concept

- Minimise regulatory intervention required to achieve policy objectives
- Regulation vs supervision
  - In **regulation**: about tailoring requirements to avoid unnecessary complexity leading to excessive compliance costs for firms
  - In **supervision**: about adjusting supervisory intensity based on risk profile to avoid excessive costs for supervisors.
  - Both concepts are independent. Mistake to consider them either complementary or substitutes.

2. The (declared) objectives

1. Economic: Facilitate a level-playing competitive field
2. Prudential: Avoid excessive concentration around few large banks.
3. Political: Small banks play a social role (facilitate development of local economies)

2. The objectives (cont)

- The economic (competitive) motivation is probably more robust than the prudential and the political objectives:
  - Small banks fail more frequently than large banks
  - Some failures of small banks may generate systemic implications
  - Other means (rather than alleviating prudential requirements for small firms) to cope with too-big-to-fail issues
  - No strong evidence of a link between size and number of banks and access to credit (eg different banking structures in Europe).

3. Proportionality and level playing field

3.1 Rationale:

- Basel principles are complex
- Complexity justified for rules to cope with risk generated by large-complex-international banks
- Complexity implies additional compliance costs which are disproportionately high for small institutions
- Therefore: small banks are unduly penalised

3. Proportionality and level playing field (cont)

3.2 Constraints:

- Keep resilience of all institutions
- Do not overprotect small institutions from competitive forces. Mind overcapacity and impact of technology on optimal size and optimal market structure
- Do we have too many banks in Europe?

4. The modalities

4.1 Existing proportionality regimes:

- Starting point: Proportionality already embedded in Basel III (see Annex 1)
- Standardised methods provide simplicity (but not reduced stringency)
- Beyond Basel III: Additional proportionality envisaged in a number of jurisdictions (see FSI Insights #1 and Annex 2)

4. The modalities (cont)

4.2 Main features:

- Standards:
  - Standards: Liquidity (LCR, NSFR), Counterparty risk, large exposures, market risk
  - Pillar 2 / SREP / ST
  - Reporting and disclosure requirements
- Discrimination metrics
  - Size (how small is small?)
  - Other criteria
- Two approaches (see FSI Insights #1 and Annex 3)
  - Categorisation approach
  - Specific standard approach

5. Considerations

- Alleviation of some requirements may not be prudentially irrelevant: eg reporting, SREP and liquidity requirements
- SSA (Specific Standard Approach) allow fine tuning: reasonable thresholds to exempt from FRTB or Counterparty credit risk may not be the same as for reporting requirements, STs or liquidity
- CA (Categorisation Approach) provides clarity and consistency with risk-based supervision and resolution strategies.
- Weighing economic objectives and constraints (ie competitive and prudential considerations) a moderate proportionality regime based on SSA seems prudent.
- An alternative could be Categorisation Approach for proportionality with different capital add-ons per category.

Annex 1: Proportionality is embedded in Basel III

Risk category	Approaches
Credit risk	Standardised approach Foundation internal ratings-based approach Advanced internal ratings-based approach
Counterparty credit risk	Standardised approach for measuring counterparty credit risk Internal models method
Credit valuation adjustment	Simple multiplier or counterparty credit risk requirement Basic approach Standardised approach
Securitisation framework	External ratings-based approach Standardised approach Internal ratings-based approach
Market risk	Simplified standardised approach Standardised approach Internal models approach
Operational risk	Standardised approach

Source: BCBS and FSI.

Annex 2: FSI Insights No 1: Proportionality in banking regulation: a cross-country comparison (August 2017)

Targeted issues for proportionality

Table 3

Issues	Brazil	European Union	Hong Kong SAR	Japan	Switzerland	United States
Liquidity regulation (LCR and NSFR)	Yes	Yes	Yes	Yes	Yes	Yes
Counterparty credit risk	Yes*	Yes*	Yes	No	Yes	Yes
Large exposures framework	Yes*	Yes	Yes*	No	Yes	Yes*
Credit risk	Yes*	No	Yes	No	Yes	Yes
Market risk	Yes*	Yes	Yes	Yes	Yes	Yes
Minimum capital ratios	No	No	No	Yes	No	No
Interest rate risk in the banking book	Yes*	Yes	No	No	Yes*	Yes
Capital planning and supervisory review**	Yes	Yes	No	Yes	Yes	Yes
Disclosure requirements	Yes*	Yes*	Yes	No	Yes	Yes
Recovery plan	Yes	Yes	Yes	Yes	Yes	Yes

*expected; **including stress testing

Colour code: purple: Pillar 1 elements, beige: Pillar 2 elements, blue: Pillar 3, brown: other.

Source: National regulation (see Annex); table collated by the FSI.

Annex 3: FSI Insights No 1: Proportionality in banking regulation: a cross-country comparison (August 2017)

Examples of proportionality strategies

Table 1

Categorisation approach (CAP)		Specific standard approach (SSAP)	
	Classification of banks		Exceptions in following areas
Brazil	Five categories	European Union	- Trading book - Disclosure - CCR - Large exposures
Japan	Two categories	Hong Kong SAR	- Credit risk - Liquidity framework - Large exposures
Switzerland	Five categories	United States	- Advanced approaches - Counterparty credit risk - Stress tests and capital planning - Trading book - Liquidity framework

Sources: National data (see Annex); table collated by the FSI.