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Proportionality in banking regulation and supervision

What future for small commercial banks in Europe?

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The views of the author do not necessariliy represent the views of the Bank of Slovenia

Agenda

1) **Proportionality in theory**

2) **Proportionality in existing regulation and supervision**

3) **Proportionality in the proposal of EU banking reform (CRR / CRD IV revision)**

4) **Conclusions**

Proportionality in banking regulation and supervision

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REGULATION

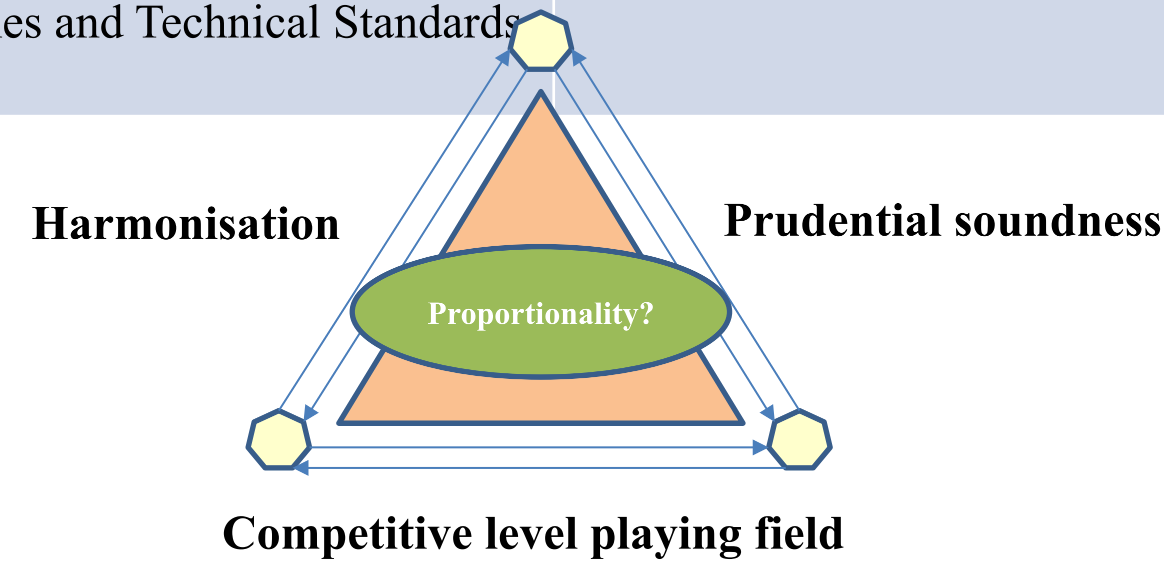
- The rules should reflect size, complexity and systemic relevance of institutions:
  - same rule for the same risk
  - stricter requirements in presence of higher risks to financial stability.
- Regulatory burden should be proportionate to the business model of the bank, and to the risks it poses to the financial sector and to the economy at large.

SUPERVISION

- The nature and intensity of supervision should be adapt to the specifics of the bank (size, risk profile, business model) and to the particular purpose being achieved ("case by case" approach).

Proportionality in banking regulation and supervision

REGULATION	SUPERVISION
▪ Basel III ▪ CRDIV/CRR (and other EU Directives and Regulations applicable to banks) ▪ National legislation (laws and by-laws) ▪ SSM Regulation ▪ EBA Guidelines and Technical Standards (RTS, ITS)	▪ Application of regulation ▪ Supervisory manual ▪ Supervisory standards and policies ▪ Supervisory Practice



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Proportionality in existing regulation

- **Different approaches for calculating capital requirements for different risks:**
  – simpler vs. complex methods
  – standardized vs. internal models

Costs vs. benefits?

Simpler rules ≠ less capital and liquidity

- **Specific prudential requirements and waivers:**
  – treatment of small trading book positions like banking book
  – limit for large exposures to institutions above 25% of capital
  – less strict corporate governance rules (combination of risk and audit committee, less restrictions on number of directorships, simplified remuneration approaches)
  – supervisory reporting (exemptions, reductions, simplifications)
  – omission of some disclosure
  – simplified recovery planning
  – G-SIIs and O-SIIs capital buffer….

Proportionality in supervision

Quantitative and qualitative criteria to determine big/small, significant…!

- **On-going supervision**
  - scope and frequency of information requests depends on the nature of the banks' business
  - intensity of supervisory action is based on banks' risk profile and potential impact on domestic economy
  - supervisory measures, including Pillar 2 requirements, are tailored to the individual risk profile and charecteristics of the bank in question
  - the size of supervisory teams is linked to the size and complexity of the bank
  - level of cooperation between ECB and NCAs and fees are influenced by banks' size and significance
- **Stress testing**
  - use of simplified approaches

"Too many to fail" problem??

Current work in international and EU fora

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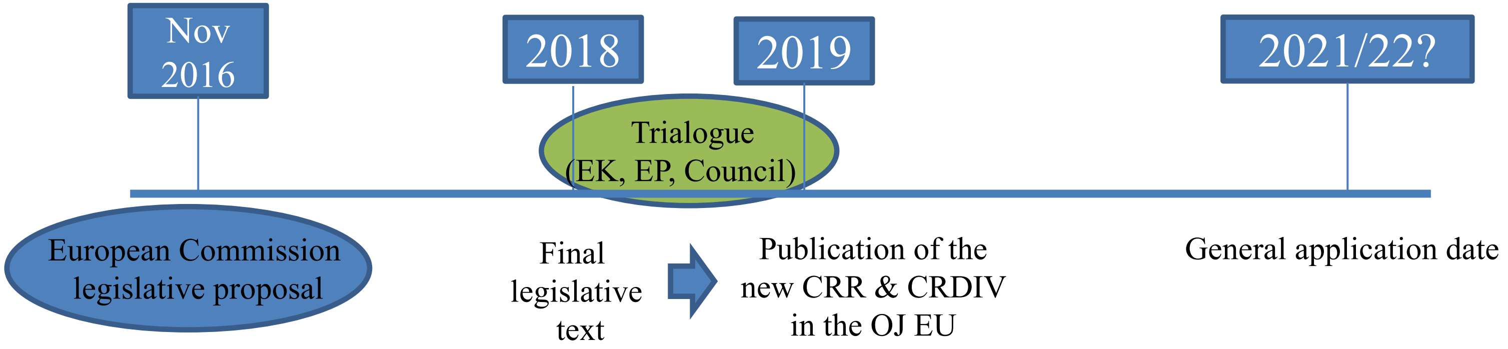
- **Basel Committee on Banking Supervision (BCBS)**
  - Several simpler approaches for calculating capital requirements (e.g. credit risk, operational risk, CVA risk) are being or have been revised;
  - BCBS meeting in December 2017: agreement on possible initiatives related to proportionality
- **EU**
  - Review of CRDIV&CRR currently ongoing
  - Timetable (tentative)



Post-crisis banking reform (CRR / CRD IV revision)

Regulatory framework should address **any outstanding challenges to financial stability**, while ensuring that banks can continue to **support real economy**.

__**Main goals**__:

- to make financial system more stable and resilient, to further reduce risks in the financial sector, to reinforce banks' ability to withstand potential schocks, to increase market confidence
- to make regulatory framework more growth-friendly and **proportionate** to banks' complexity, size and business profile
- to support SMEs and investment in infrastructure

CRR & CRDIV: Definition of a small and non-complex bank

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NOT FINAL – possibly subject to further changes!

- it is **not a large bank** (!all O-SII banks are large)
- it meets **all of the following conditions**:
  - the total value of its assets is on average equal to or less than the treshold of EUR 5 billion (!discretion of CA to lower this threshold)
  - it is subject to no obligations or simplified obligations in relations to recovery and resolution planning
  - its trading book business is classified as small
  - the total value of its derivative positions (held with trading intent) is less than or equal to 2% of its total on- and off-balance sheet assets
  - it does not use internal models for calculating its own funds requirements (exect subsidiaries using models at group level)
  - it has not comunicated to the CA the objection to being classified as small
  - the CA has not decided that the bank is not to be considered small and non-complex based on an analysis of its size, risk profile….

CRR & CRDIV: Proportionality - reporting

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1. **Purpose**: reducing costs from the perspective of reporting and strengthening proportionality with regard to the size and complexity of the institution

2. **Content:**
   a. definition of small institution: quantitative + qualitative criteria
   b. reduce granularity of reporting for small institutions
   c. EBA mandate with regard to assessment of costs and benefits of regulatory reporting
   d. clarification of duplication of reporting (potential waivers)
   e. development of IT tools for compliance by EBA

3. **Expected impact:**
   - reduction in reporting burden and costs
   - maintenance of sufficient bases for banking supervision

CRR & CRDIV: Proportionality - disclosures

1. **Purpose**: strengthening of proportionality with regard to the size and complexity of the institution, compliance with international standards and adjustment to changes in legislation

2. **Content:**
   a. classification of institutions into three categories: large, small and other, with further distinction between listed and non-listed institutions
   b. scope of disclosures with regard to categorisation (sliding scale), with differentiation in the substance and frequency of disclosures
   c. key prudential metrics table:
      - minimum standards for all banks
      - own funds, RWA, P2R, CBR, LR, LCR, NSFR, MREL

3. **Expected impact:**
   - reduction in administrative burden and costs
   - comparability of disclosures at global level

CRR & CRDIV: Proportionality - remuneration

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1. **Purpose**: elimination of disproportionality of certain existing rules for the smallest, less-complex institutions, and for staff with low variable remuneration

2. **Content:**
   a. derogations from the rules on deferral for the variable remuneration can be exercised for:
      - ~small, less-complex banks: total asset value ≤ EUR 5 billion
      - ~staff with variable remuneration ≤ EUR 50.000

   b. listed institutions may provide variable remuneration in the form of share-linked instruments

3. **Expected impact:**
   - reduction in administrative burden

To conclude…

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Small banks are generally less risky than larger ones, so a proportionate approach to regulating and supervising small banks is usually appropriate.

For small banks, the costs of implementing complex prudential rules are higher and benefits smaller than for big banks.

Consistent supervision does not mean "one-size-fits-all" supervision.

BUT

Proportionality does not mean that the rules should be generally less strict, or that banks can hold less capital or liquidity.

With simpler rules we should not create "too many to fail" problem.

Application of proportionality vs. change in business model/orientation?