# Proportionality in banking regulation – discussions have to continue: “after the CRR/CRD review is before the CRR/CRD review”

April 2019

Joint views of the banking associations of Austria, Croatia, Denmark, Germany, Italy, Luxembourg, Poland, Slovakia and Slovenia

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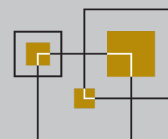

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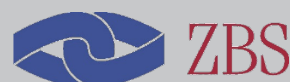
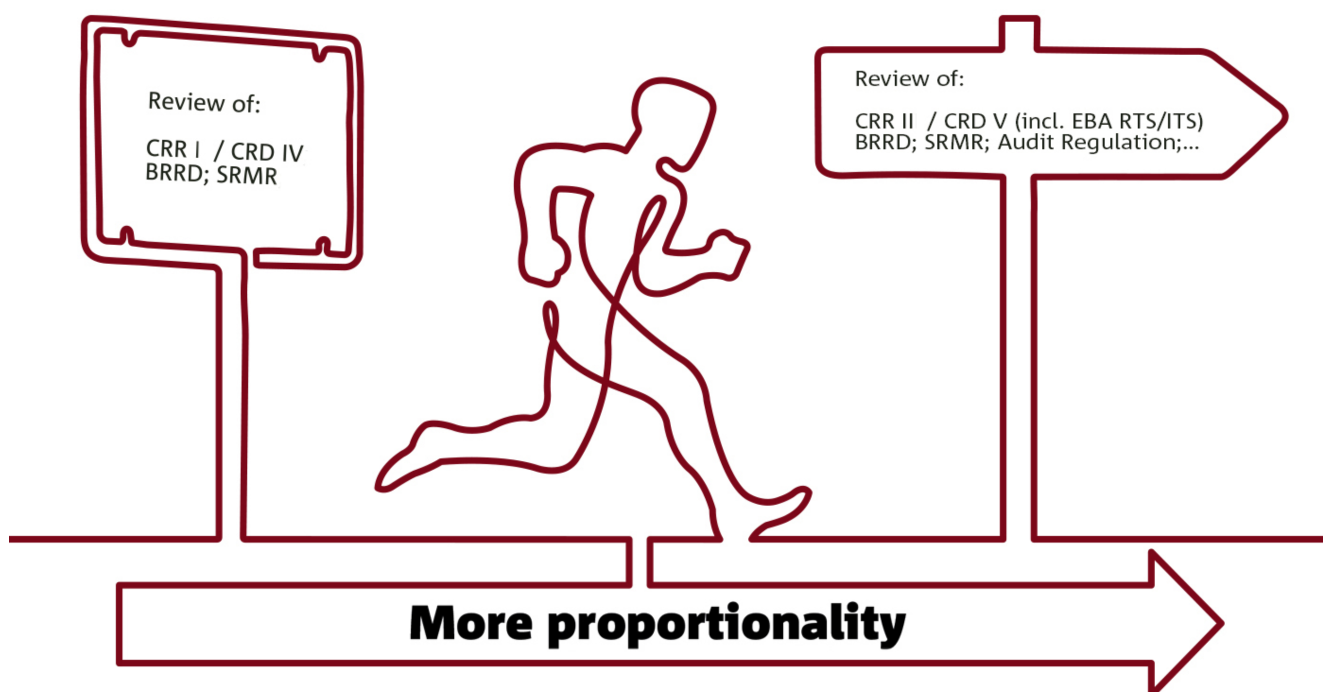


Since the 2008 financial crisis a number of new laws, rules and regulations have been introduced to increase the stability of the financial system and the protection of public funds. This was both necessary and right. The regulatory pressure in the wake of the crisis was so intense, however, that speed often had to take precedence over thoroughness. This phase is now over and it is time to take a look at the existing regulatory framework in terms of its effects and side effects.

Small and medium-sized banks in Europe are being particularly overwhelmed by the burdens associated with this regulation. Their average regulatory costs, measured against total assets, are many times higher than those of larger banks *(c.f. EBI Working paper 2018 – no. 20: Stability, Flexibility and Proportionality: Towards a two-tiered European Banking Law?)*. Greater consideration should therefore be given to the principle of proportionality, especially when it comes to administrative burdens such as information and reporting requirements. This is also of high economic relevance, as small and medium-sized banks in Europe have proven to be an important cornerstone of financial stability. The financial crisis showed that diversity in the banking market contributes to the stability and the resilience of the financial system and brings other beneficial effects in terms of competition, the provision of financial services to the economy, etc. In other words, smaller banks with low-risk business model are undoubtedly stabilising factors in the financial system. Reducing the purely administrative burden on such institutions would not result in a bigger threat to financial stability, as these will continue to apply the same quantitative capital and liquidity requirements as their bigger counterparts ("same business, same risk, same rules").

With the start of the CRR/CRD review and the European Commission's legislative proposals in November 2016, the debate on more proportional requirements for small and medium-sized and non-complex banks quickly gain-ed momentum. It has become apparent that the issue is highly relevant to many European countries and their banks. More than 80% of all Less Significant Institutions (LSIs) in Europe are located in Austria, Croatia,



Denmark, Germany, Italy, Luxembourg, Poland, Slovakia and Slovenia. The private banking associations of these countries have therefore exchanged views intensively and adopted a joint position.

We welcome the results of the banking package, and are pleased that they go beyond the proposals of the Commission. We especially support the definition of a "small" bank, the reduction in disclosure obligations and, in principle, in reporting in general, and also the setting of concrete cost-saving targets. Small and medium-sized banks are looking for proportional requirements and for predictable supervisory expectations of their implementation. Proportionality measures should be explicit in the regulatory texts at both EU and national levels in order to limit scope for different interpretations (or the need for further regulation) and to facilitate implementation.

The above-mentioned banking associations welcome the efforts made by various stakeholders in the current legislative process to achieve progress on proportionality. Despite the overall progress, however, we still see room for improvement on various issues. This concerns various legislation, such as the CRR/CRD (including EBA rules at Level 2 and Level 3), BRRD, Audit Regulation, etc. We should also like to point out in this context that, in addition to the European requirements, there are also national rules that are in some cases inconsistent and generally impose a disproportionate additional burden on banks.

Possible starting points for improving the European regulatory framework are, among other things, Pillar 2, remuneration requirements, resolution and recovery plans, reporting and the Audit Regulation.

A positive impact could be achieved by simplifying compliance with the SREP obligations, by providing institutions with simplified solutions i) to roughly assess the materiality of some Pillar 2 risks and ii) to quantify the risks that are material. In the macroeconomic supervisory stress test, as a first step, there is a need to transpose the stressed macroeconomic variables (energy costs, GDP, unemployment, interest rate, etc.) in a deteriorated credit or market risk profile. This kind of transpositions is not easy even if a bank has implemented complex satellite models related to the IRB varia-bles. For small banks it is almost impossible to estimate an impact in terms of their standardised risk factors (like number of defaults or single name concentration) and in any case the results are highly subjective. A kind of "bridge" should therefore be provided to small and less complex banks in order to let them focus on the impact analysis rather than on the first step.

Small banks (including small banks in a large banking group) should be completely exempt from the remuneration requirements of CRD IV. These rules are primarily a response to the negative consequences of perverse incentives which came to light in the financial crisis, particularly in the area of variable remuneration. This only affected a few financial institutions, however. By contrast, small banks, in particular, had appropriate remuneration policies in place. The implementation of remuneration requirements is very complex (among other things, firms have to identify material risk takers and make ex-post risk adjustments) and out of all proportion to the benefits (which, as mentioned above, are non-existent at small banks).

There is no need for recovery plans at such small banks either. This view is supported by Article 4 of the BRRD, which already provides for simplified requirements as an example of proportionality. The same principle applies to small banks with regard to resolution plans, particularly given the fact that such banks can be wound up if necessary in national insolvency proceedings in most member states. This begs the question as to what banks of this kind are supposed to plan. At the very least, consideration should be given to simplified approaches. We also see a need for a proportionate approach to the MREL requirement for small banks.

When it comes to reporting, prudential reporting requirements need to be pruned back further. Hundreds

of pages of columns of figures cause banks a massive amount of time and effort that is totally disproportionate to the gain in financial stability. Furthermore, in the light of the current debate, we strongly support completion as soon as possible of the EBA mandate to, among other things,

- assess the costs and benefits of the reporting requirements;
- make recommendations on how to reduce reporting requirements at least for small institutions with the aim of reducing the average compliance costs by at least 10% and ideally 20% or more.

The (more stringent) provisions of the Audit Regulation should apply only to publicly traded banks *(publicy traded: making use of a regulated market (e.g. within the meaning of the German Securities Trading Act) by issuing securities)*. We do not consider it appropriate to lump all banks together – even the smallest limited liability company or partnership – under the term "public-interest entity".

Against this background and also with the 2019 European elections in mind, we believe it is important, even after the CRR/CRD review has been completed, to adapt requirements in several legislative texts that place a disproportionate burden on small banks. After the (current) CRR/CRD review is before the (next) CRR/CRD review, so to speak.