Enhancing proportionality in EU banking regulation

The overall complexity of the current regulatory framework has some potentially very serious and undesirable effects, especially on the diversity of credit institutions. Diversity, however, supports the resilience of the financial system as well as competition and innovation and thus ensures that both businesses and individuals have sufficient access to finance. It has been acknowledged that costs resulting from complex prudential rules create a competitive disadvantage for small institutions that cannot benefit from economies of scale and are unable to allocate more resources to compliance functions, unlike their larger competitors. In order to maintain diversity and a true level playing field, the principle of proportionality needs to be respected more consistently in EU banking regulation and its application. Although small banks institutions might not *per se* be less risky, they tend to have less complex business models and operate on a regional basis. They are easier to monitor and do not pose systemic risks. Due to their local focus, small institutions perform an essential function in funding small and medium sized enterprises that otherwise might face difficulties in obtaining access to the full range of financial services.

Whereas there is general agreement that regulatory requirements as well as the supervisory approach should be differentiated according to the size and internal organisation of an institution as well as the nature, scope and complexity of its business, there is neither clarity nor consistency regarding the simplifications competent authorities across the EU will apply in practice.

Going forward, the principle of proportionality should be strengthened by classifying institutions into three different groups:

- Small and non-complex banks
- An intermediate group
- Systemically relevant or significant institutions (parent, group, or solo level, where appropriate)

While the full set of regulatory requirements implementing the recommendations of the Basel Committee on Banking Supervision and laid down in CRD IV and CRR should continue to apply to the last group, targeted measures to enhance proportionality could already be directed at the intermediate group. Small banks should benefit from a simplified regime that at the same time ensures a high level of the most important regulatory standards, but significantly reduces the complexity of the relevant requirements. This should expressly not lead to a less conservative regulatory approach. It might however include the elimination of some requirements that are not suited to this group. This classification of the banking sector would be applied consistently by supervisors throughout the Union and could serve as a point of reference for legislation, including the future implementation of new requirements.

1. Three-tier approach

The **group of small and non-complex institutions** should be defined by both quantitative and qualitative indicators. In quantitative terms, the total assets of an institution in this group must not exceed a relative threshold based on parameters linked to the member state of its establishment[1] or the absolute threshold of €3bn[2], whichever is lower. In qualitative terms, small and non-complex

[1] e. g. a percentage of the Member States' GDP or the total size of its banking sector.
[2] Corresponding to the thresholds in

- FINREP, Article 11 (6) Regulation 2015/534 of the European Central Bank, and banks should not use internal models to calculate their own funds requirements and must, following the assessment of the resolution authority, be subject to ordinary insolvency procedures in case of failure (not requiring resolution under the BRRD). This group could potentially comprise a vast majority of credit institutions based in the EU, but would only account for a relatively modest share of the total assets of the banking sector. Simplifications and waivers granted to this group would therefore have a major impact in reducing the administrative burden of regulation without putting financial stability at stake.

The **second group** should consist of institutions that can be neither categorised as small and non-complex, nor as large and significant. By nature, this mid-size group would cover a wide range of banks and business models. Hence, the application of a simplified regime as outlined above would not be appropriate. However, given their lack of systemic relevance, targeted efforts to improve proportionality should also be addressed to this group.

The **group of all large and significant institutions** of a Member State would be determined on the basis of agreed methodologies referring to systemic relevance[3] – without, however, being limited to O-SIIs – or to eligibility for simplified obligations in the context of recovery and resolution planning[4], and of size criteria comparable to those used to determine the significance of institutions within the SSM[5]. These credit institutions should generally be subject to the full set of regulatory requirements, unless specific regulation is in place e.g. to suit specific business models. This group would capture a comparably small number of institutions, but a very large share of the balance sheet assets of the European banking sector.

The classifications detailed above would be subject to

- An "opt-in" clause for the supervisor
  Based on its individual assessment the competent authority may assign any institution to a "higher" group (this assessment should take due consideration of the institutions capital market orientation, cross-border activity as well as size of the trading and derivatives book).
- An "opt-out" clause for the institution
  Institutions may fulfil requirements addressed to a "higher" group, e.g. in order to use internal models or to underpin its capital market orientation. However, institutions opting out will have to comply with all requirements applicable to the "higher" group (no cherry-picking).
- Transitory arrangements
  In case of a transition to a different group, cliff edge effects have to be addressed through suitable transitory arrangements.

- the Delegated Act with regard to ex ante contributions to resolution financing arrangements, Article 20 (5) Commission Delegated Regulation 2015/63.

[3] EBA Guidelines on the criteria for the assessment of Other Systemically Important Institutions (O-SIIs).
[4] I.e. institutions eligible for simplified obligations under Article 4(5) of Directive 2014/59/EU should not be considered as 'large', while those not eligible would not necessarily be qualified as 'large' in this sense, as the practice in Member States in this regard differs.
[5] According to Article 6 (4) of Regulation 1024/2013

2. Simplified regime for small and non-complex institution (Small Banking Box)

The group of small and non-complex institutions would be defined in the general provisions or the scope of application of CRD IV and CRR.

Small and non-complex institutions would **be fully exempted** from the following requirements:

- Disclosure
- Requirements for remuneration systems
- Recovery planning
- Requirements applicable to institutions for resolution planning purposes

It should be considered whether small and non-complex institutions could also be fully exempted from the **Net Stable Funding Ratio** or at least can apply a simplified NSFR. The supervisory reporting templates for a simplified NSFR would require fewer data fields but would be more conservatively calibrated.[6]

In the field of reporting, a **set of core reporting elements** would have to be developed within a short time frame, with a special focus on reducing the data points in COREP and revising the relevant ITS on Reporting.[7] A significant number of templates of the current COREP standard would not be contained in these core reporting elements and the data points in the remaining templates would be reduced, e.g. for Additional Liquidity Monitoring Metrics.

An **exhaustive list of core requirements** that small non-complex banks have to comply with should be included in the general provisions CRD IV and CRR. This would act as a backstop against the implementation of future requirements without due consideration of the effects on small and non-complex institutions. This particularly holds true for the implementation of upcoming additional Basel standards.

3. Targeted reduction of the regulatory burden for the intermediate group

Measures to strengthen proportionality are already under discussion in the ongoing review of CRR and CRD IV. However, the Commission proposal falls short of achieving sufficient progress in proportionality and cost reduction. Further targeted measures should be introduced in the areas of:

- <u>Reporting</u>
  Reduce complexity and avoid the duplication of reporting requirements as well as the reporting of irrelevant and outdated data; provide more supervisory flexibility with regard to waiving reporting requirements
- <u>Disclosure</u>
  Reduce or waive requirements for institutions that are not capital market oriented
- <u>Requirements for remuneration systems</u>
  Allow proportionate application for the entire intermediate group and eliminate the obligation to identify risk-takers as long as the bonus cap is applied
- <u>Net Stable Funding Ratio</u>
  Introduce a simplified NSFR

[6] A detailed proposal will be tabled in the working group on the CRR review shortly.
[7] Commission Implementing Regulation No. 680/2014.

- Trading book, market risk and counterparty credit risk
  Simplified approaches should be open to the intermediate group unless institutions present specific risks with regard to their business models
- Recovery planning
  Consistently waive or apply simplified obligations throughout this group