



EBA proportionality workshop

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## Opening remarks by Andrea Enria, Chairperson of the EBA

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Check Against Delivery  
Seul le texte prononcé fait foi  
Es gilt das gesprochene Wort

Ladies and Gentlemen, dear Colleagues,

I would like to welcome you today to the EBA's second proportionality workshop. We had unprecedented demand in registrations for this event. Such demand demonstrates the importance of this topic and the emphasis that industry, public bodies and certainly even banks' customers or consumers place on proportionality to make rules effective but targeted. Many changes have taken place since our last conference. Complexity of banking structures and business models has been better recognised in the regulatory framework: a tighter regime has been introduced for systemically important institutions – the EBA issued Technical Standards on the identification of GSIs and OSIs; business models are now a core focus of the Supervisory Review and Evaluation Process (SREP) according to the EBA guidelines and supervisory handbook; we have used a variety of techniques to embed proportionality in our deliverables, as I will try to show you in a minute. The Banking Union, with the establishment of the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM), has brought at the European level the exercise of supervisory and resolution functions for significant banks.

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One of the central tasks of the EBA is to contribute to a European Single Rulebook in banking, i.e. a set of rules directly applicable across all EU Member States. The objective is to provide a level playing field to all credit institutions as well as an equally high standard of protection for depositors, investors and consumers. Let me stress that the Single Rulebook must not be mistaken for a “one-size-fits-all” approach to regulation. Quite the contrary, the main idea underlying the regulatory approach of the Single Rulebook is “same rule for the same risk” or, better said, “stricter requirements in presence of higher risks to stability”. While ensuring excellent prudential safeguards for all banks, the rulebook should reflect size, complexity and systemic relevance of the institutions, with a proper application of the proportionality principle. The European supervisory community is strongly convinced that the regulatory burden should be commensurate to the business model of the bank, and to the risks it poses to the financial sector and to the economy at large. As it often happens, the difficulty lies in the practical application of the principle. We have done our best to decline the principle of proportionality in our draft technical standards, guidelines, opinions and Q&As. But we are open to criticism, suggestions for improvements and new ideas. This is the very reason of our meeting today. We are sure that the quality and the diverse backgrounds of our speakers and panellists will bring us some solid suggestions on how we can best enhance proportionality in our ongoing regulatory work.

Let me mention some examples of the approaches we have used to concretely apply the principle of proportionality. First, I would like to mention the Regulatory Technical Standards (RTS) on Prudent Valuation, where we differentiated between a core and a simpler approach. These RTS set out a new approach – referred to as the ‘Core Approach’ – to calculate additional valuation adjustments (AVAs). A detailed methodology is specified to determine prudent values for the different elements of valuation uncertainty (i.e. the different types of AVAs, such as market price uncertainty, close-out costs or model risk). Though considered as the most appropriate approach to capture valuation uncertainty, the ‘Core Approach’ presents some complexity as well as requires substantial investments in (human as well as IT) resources. We considered this excessive for institutions with small fair-valued portfolios, subject to limited valuation uncertainty. It was felt that those institutions should be permitted to apply a simpler approach to estimate AVAs than those institutions with larger fair-value portfolios.

As a result, the RTS specifies a proportionality threshold below which a ‘simplified approach’ can be used to calculate AVAs. Institutions, for which the sum of the absolute value of fair-valued

assets and liabilities is less than EUR 15 billion, may take their total AVA as equal to 0.1% of the aggregate absolute value of fair-valued positions. This total AVA is deemed to cover all types of AVAs specified in the Capital Requirements Regulation (CRR) and detailed in the Core approach. The simplified approach ensures a lower regulatory burden for institutions that are not particularly exposed to the risks the RTS is addressing, even though institutions below the threshold keep the option at any time to move towards the more complex approach.

The RTS on the Countercyclical Capital Buffer also include proportionality provisions. The main principle is that the geographical location of the obligor should determine the calculation of the countercyclical buffer rate. However, to alleviate the burden for smaller institutions which tend to have limited foreign and trading activity, these RTS specify that institutions that have a credit or trading book exposure below 2% of the aggregate of credit, trading and securitisation exposures can choose to allocate these exposures to the area where the institution has its headquarters. For securitisation exposures, institutions may determine the geographical location at the place of the institution if information on underlying securitisation exposures is not easily obtainable.

With regard to the RTS on Asset Encumbrance, the proportionality principle was applied to lower the reporting burden for smaller institutions that have no material levels of asset encumbrance, due to their business models, lower complexity or other circumstances. As a consequence, these institutions will not be required to report all the templates.

The Technical Standards on Own Funds differentiate on the basis of business models and apply specific requirements to cooperative banks, bearing in mind the specific features of the European cooperative banking sector.

In particular, the fourth set of those Technical Standards – which have recently been published in the Official Journal - relates to preferential and multiple distributions. Those rules aim at ensuring that the existence of different categories of common equity tier 1 (CET1) instruments issued by the same bank does not give rise to preference of some holders above others, and also that multiple distributions do not result in a disproportionate drag on capital. While the objectives of these RTS have to be met by all institutions, specificities of non-joint stock companies justify a different treatment in two cases. The first case is when only the holders of the voting instruments

may subscribe to the non-voting shares, and the voting rights of any single holder is limited. In that case, there is no deprivation of voting rights for holders of non-voting instruments. The differentiated distribution on the non-voting instrument of non-joint stock companies is not driven by the absence of a voting right in the same way as for joint stock companies. The second case is when there is a cap on the distribution of the voting instrument set under applicable national law. In those two cases, the limits devised for joint stock companies are replaced by other rules that ensure the absence of a preferential right to payment of distributions, such as a limit on the overall pay-out ratio for CET1 instruments.

Our Risk Assessment Report, as I am sure you are aware, was recently published. In our key risk parameters (KRIs) and answers to our risk assessment questionnaire we see a clear trend: “back to the basics” in banking business. This trend takes the form of an increase in household and corporate (especially SME) lending, and a parallel reduction in trading and derivatives business, commercial real estate lending and exposures to financial institutions and sovereigns. Bankers and market analysts replying to our questionnaires and participating in our discussions have argued that this trend is mainly driven by regulation. It shows that regulation can have impact on changes in business models, and in this case on reducing complexity in banking business and risks. These changes are in line with the expectations of regulators. At the same time, we must also monitor the new set of incentives to risk taking, as the increased competition in traditional business lines, in a period of exceptionally low interest rates, has a depressionary effect on bank profitability.

Another trend observed is that the biggest banks have been shrinking their balance sheet in recent years. Deleveraging, and the reduction on the ratio of loans to deposits, was a necessary correction of imbalances that led to the crisis. Although the general trend of deleverage of the banking sector reverted to asset growth in 2014 again, market analysts expect that the largest banks will continue downsizing their business for some time. On the other hand, there is a trend towards ongoing consolidation of mid-sized and small banks. These developments are helping to reduce the excess capacity generated in the build-up of the crisis and are creating a new landscape for European banking.

The principle of proportionality was also considered in our stress testing. For example, there is a simplified approach for the calculation of effects from market risk. Banks for which trading is not a

significant business component may refer to this simplified approach. Furthermore, the complexity of a bank's business shall be considered in the calculation of the impacts from credit risk.

One of our breakout panels today will focus on resolution. We have a large number of mandates stemming from the Bank Recovery and Resolution Directive (BRRD). As a general approach, our standards and guidelines draw a clear distinction between banks that can be managed through ordinary liquidation procedures and those that would require the deployment of resolution tools; the latter are expected to comply with a much broader range of requirements, which become even tighter for banks that are systemically relevant and will in all likelihood have to rely on the support of the resolution fund. Our Guidelines and implementing technical standards on simplified obligations also specify the criteria for identifying institutions that are eligible for simplified requirements in the area of recovery planning, resolution planning and resolvability assessment. Hence, there is a general red line across our products, which aims at giving practical content to the principle of proportionality. Let me go more in detail with an example. In order to ensure banks can be resolved without costs to the taxpayer or disruption to the financial system the BRRD set out the Minimum Requirement for Eligible Liabilities (MREL). The objective is to ensure that banks have enough capital and liabilities which can be 'bailed in' (i.e. be written down or converted into equity) to absorb losses and, if necessary, recapitalise the bank so it can carry on some parts of its business - this can be done through the formal bail-in powers of the BRRD, or through a bridge bank or sale of business in resolution. Our view, which is in line with the work going on in the FSB at global level, is that this requirement should be especially binding on systemically important institutions, which were so far considered "too big to fail" due to the complexity of closing them down and which are therefore likely to need a much greater degree of recapitalisation after resolution. For smaller and medium-sized banks, it should not be necessary to keep the whole business going after resolution and so a lower level of MREL should be sufficient. In particular, for the smallest banks, it may be possible to completely close down the bank through normal insolvency, with the deposit guarantee scheme paying out covered depositors. In these cases, MREL only needs to absorb losses, which should be adequately covered by the existing capital requirements. Our draft RTS also define criteria for resolution authorities exercising the option envisaged in the BRRD to adjust the MREL when the deposit insurer would be able to make a contribution to the costs of resolution. This is particularly

important for banks with a very simple liability structure, mainly funded by covered deposits; the criteria we have defined make also sure that the risks to the DGS excessively.

Overall our approach to MREL illustrates our broader take on proportionality: the objectives of our rules (in this case, resolvability) apply to all banks, but it is easier for smaller and simpler banks to meet these objectives.

While proportionality is a key topic for the EBA we are not free to define proportionality as we please. We are bound by our legislative mandates, which are set for the EBA by the co-legislators. In keeping with our role of developing and maintaining the Single Rulebook there are times when differences in application are not appropriate. For instance, the basis for contributions to the DGS is uniform, because all institutions benefit from the existence of the DGS and, in fact, pay-out is more likely for smaller institutions. Finally, where differential application is possible, the EBA's approach must be evidence-based and backed up by thorough cost benefit analysis (an integral part of our impact assessment) and so the EBA needs sound evidence to inform its work. There have been occasions where the EBA has advocated for the application of the proportionality principle in certain areas of the level 1 text. For example on the application of proportionality to the remuneration principles, the draft Guidelines on sound remuneration policies follow a legal reading of the CRD IV, supported by the European Commission, that the requirements on deferral and payment in instruments have to be applied to all institutions. On this point, the EBA is of the view that specific exemptions should be introduced for certain institutions that do not rely extensively on variable remuneration and, if confirmed by further analysis, also for identified staff that receive only a low amount of variable remuneration. To this regard, the EBA intends to send its advice to the European Commission suggesting legislative amendments that would allow for a broader application of the proportionality principle.

When we develop our work and start public consultation on our draft RTS, ITS and guidelines we always conduct a high level, impact assessment. Part of our effort is always devoted to ascertaining the effect of relevant regulations on different business models. In the past, this distinction in the analysis led the EBA to recommend some derogations in the treatment of the Liquidity Coverage Ratio for institutions with certain specific business models. We are currently conducting similar impact assessments on the net stable funding ratio and the leverage ratio.

On this point it is vital that stakeholders when engaging with the EBA, for instance through the consultation process on draft technical standards, demonstrate the case for possible differentiations in approach. At all stages of the regulatory process, the opportunities for dialogue should be taken in order to work together and create a proportionate and fit-for-purpose Single Rulebook.

For us all, one of those opportunities for dialogue is today. We look forward to rigorous and healthy debate a fruitful discussion.