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EACB Contribution to EBA Workshop on Proportionality

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Corporate Governance

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A. General remarks

1. The starting point of the deliberations must be the Recital 46 CRR, which reads as follows:

(46) The provisions of this Regulation respect the principle of proportionality, having regard in particular to the diversity in size and scale of operations and to the range of activities of institutions. Respect for the principle of proportionality also means that the simplest possible rating procedures, even in the Internal Ratings Based Approach ('IRB Approach'), are recognised for retail exposures. Member States should ensure that the requirements laid down in this Regulation apply in a manner proportionate to the nature, scale and complexity of the risks associated with an institution's business model and activities. ***The Commission should ensure that delegated and implementing acts, regulatory technical standards and implementing technical standards are consistent with the principle of proportionality, so as to guarantee that this Regulation is applied in a proportionate manner. EBA should therefore ensure that all regulatory and implementing technical standards are drafted in such a way that they are consistent with and uphold the principle of proportionality****.*

Furthermore the principle of proportionality is expressly or implicitly stipulated in various provisions of the CRD/CRR (the "CRD IV package"):

- Capital Requirements Regulation:
  - Art 93.2 CRR: Exemption concerning the provisions for the initial capital requirement (EUR 5mln) for credit institutions already in existence on 1 January 1993;
  - Art 395 CRR: Alternative large exposure limits: 25% of the eligible capital, or EUR 150mln, whichever higher, with the absolute limit not exceeding 100% of the institution's eligible capital;
  - Corresponding to Art 93.2 CRR, a lower limit of EUR 500.000 as additional criterion for the lower limit of large exposures in Art 381 CRR would be arguable;

- Capital Requirements Directive:
  - Art 77.3 CRD: Development of internal specific risk assessment capacity;
  - Art 74.4 CRD: Development of recovery plans, with participation of the EBA;
  - Art 76.3 CRD: Treatment of risks (establishment of a risk committee);
  - Art 77.1 CRD: Internal Approaches for calculating own funds requirements;
  - Art 88.2 CRD: Establishment of a nomination committee;
  - Art 87.1 CRD: Restrictions on the combination of directorships;
  - Art 91.3 CRD: Application of remuneration policies;
  - Art 95.1 CRD: Establishment of a remuneration committee;
  - Art 97.4 CRD: Frequency and intensity of the supervisory review and evaluation;
  - Art 131 CRD: Identification of global and other systemically important institutions;
  - Art 133 CRD: Requirement to maintain a systemic risk buffer.

In addition, the principle of proportionality is also recognised as one of the general principles of the European Union law by the Court of Justice of the European Union.

2. Therefore CRR, CRD IV, as well as all (implementing) legislative acts (including national acts) and standards have to be oriented towards the principle of proportionality.

3. This commitment toward proportionality is appropriate and necessary. The European Commission acknowledges the value of the diversity of the banking market in Europe. Diversity means, amongst others, different business models, which in return ensure diversification of risks. Maintaining this diversity is possible by strict compliance with the principle of proportionality. Lower complexity tends to contribute to the reduction of risk. Thus, smaller and less complex institutions should not be strained by complex regulations, which are not proportionate to their business model and the risks they take. A "one size/ fits all rule" is not necessary, because, in case of less complex business models normally less risk potentials emerge.

4. Proportionality is regularly judged based on a number of criteria, including size, internal organisation, type, volume or complexity of business:

- Size: The primary criterion is the balance sheet total, appropriately combined with the number of employees;

- Volume of business: It is, as well as the size, primarily to be assessed on the basis of the balance sheet total;

- Internal organisation: The primary criterion is the number of management levels, except the management committee. Credit institutions, which have only one further management level besides the management, are generally speaking not complex.

- Type of business: The primary criterion is whether the credit institution is above all trying to maximize its profits, or to serve the real economy. Depending on that distinction, the risk profile (and also the complexity of business) will be different.

- Complexity of business: The primary criterion is whether the credit institution mainly operates in the less risky business. Often, it is „plain vanilla" business, like collection of savings and lending to the real economy, etc. , in which case it is not a complex credit institution. If it operates mainly in the highly complex activities, such as structured products, lending and guaranties to hedge funds, etc. , it could be considered a complex credit institution:

  - Regarding the complexity of business a further criterion is the focus on a local market, which allows for a better customer knowledge.

  - There will also be a difference if a bank operates within a network, and therefore can be supported in many ways by a central institution. It should be recognised that acting within a co-operative network is fundamentally different from acting on a standalone basis.

B. Proportionality and corporate governance structure

1. The corporate governance provisions in CRD IV often refer to the principle of proportionality.

Generally, the national legislator has to implement the CRD IV and all references to the principle of proportionality included therein into national law. In doing so, the national legislator has the possibility :

(i) to create an autonomous definition of the principle of proportionality (i.e. in terms of threshold values) or;

(ii) to leave the autonomous interpretation of the principle of proportionality to the practitioners (credit institutions or national controlling authorities), by enacting inexplicit legal terms.

In the first case, the practitioners have only small scope for interpretation. In the second case, the question is which criteria shall be applied by the practitioners for the interpretation of the notion of the principle of proportionality.

2. In view of local co-operative banks acting in a network, taking into account the principle of proportionality, the requirements are obviously to be kept lower compared to internationally operating major banks acting on a standalone basis.

3. The reasons for this become clearer when the general criteria of proportionality, as listed under A.4, are applied In this respect, we would like to draw the attention to the following characteristic features of co-operative banks.

Small Size: In many Member States, local co-operative banks often are of relatively small size[1].

Local focus of activity: The business model assumes that clients and members are living nearby. Above all, credits are granted and saving deposits are accepted. Generally speaking, these are local clients/borrowers, whose economic behaviour and business activities are well known to the credit institution. These clients operate regionally; therefore the local bank only covers a regionally limited local area.

Low risk profile because of serving the real economy: Co-operative banks do not try to maximize their profits by risk taking but to serve the real economy. Local banks ordinarily are not involved in international business, they operate merely in the retail and SME business. They usually do not have business in their own accounts when it comes to derivatives.

Distribution of tasks in a co-operative network: According to the statutes and the rules of procedure, local banks are part of a network. There are ex-ante voluntary guarantee institutions which do as such protect the individual credit institution (aiming to avoid bankruptcy). It is typical for co-operative networks that they entrust partners of the network (meaning other participating credit institutions, as well as the central body) with the fulfilment of specific tasks. Such kind of cooperation is a typical feature of many co-operative networks.

Co-operation: It is typical for the decentralised sector that specific tasks are delegated to the central body, a central credit institution or its subsidiaries, or to other partners within the co-operative network. These tasks range from joint IT, joint processing of payment transactions and product development (including product introducing process), to joint internal audit and joint compliance organisation. This has to be taken into account when it comes to the notion of proportionality. In general, it is possible and accepted by competent authorities – if and as far as the principle of proportionality is embedded within the CRD / within various EBA standards – to allow compliance with regulations (e.g. outsourcing regulations in MIFID, risk diversification in liquidity management) by individual members of the network to the appropriate extent, based on a case-by-case assessment This can be argued as follows:

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[1] *For example in Austria many local banks only have a balance sheet total around EUR 50mln and less then 10 employees*

- When it comes to delegating specific tasks by more or less uniform local banks it is not necessary that every delegating entity takes over a comprehensive control function. This is due to the special network structure and co-operative features, the uniform interests of the member co-operatives, the statutory purpose of the central institution to provide good service for the local banks, the focus on the member business and the uniform regional business model. Hence, for the safeguarding of the control function an alternating monitoring by the local bank (among the partners of the co-operative network) should be sufficient. Ultimately, this can be justified by the common and uniform interests of the partner banks in the co-operative network.

- The partner credit institutions within the network can, because of the conformity of their interests, rely on the legal entity(e.g. the central body), to which a certain task has been delegated.

- Furthermore the general assembly of the central body (consisting of the local banks) may instruct the management of the central body, to which a certain task has been delegated, whereby influence of the owners upon the control of the management is possible. Therefore members are directly in the position to carry out sufficient control.

- In concrete terms, network structures need significantly less know-how, additional staff and focus on control functions in case of delegation of these functions while delegating to the central body, the central institution and/or its subsidiaries.

Auditing: Within many EU-member states there is a material revision by the auditing entities. Due to the typical corporate law structure of the co-operative, the owners and the functionaries elected by the owners enjoy professional support of auditing institutions. Co-operatives are obliged to a more comprehensive auditing. Co-operatives shall be audited by an independent and autonomous auditor with regard to legality, compliance and expediency of their facilities, accounting and management, particularly with regard to the fulfilment of the promotion purpose and to the economic efficiency, as well as to expediency, status and progress of the company's assets and liabilities, financial position and profit or loss of their asset.

For the non executive members of the managing board and for the members of the supervisory board of co-operative banks this kind of comprehensive auditing is a big support for the fulfilment of the control function. This again reduces the level of knowledge, skills and abilities, necessary to be a good functionary of a local cooperative-bank.

C. Specific illustrations

The following examples illustrate the areas where the EBA is encouraged to pay particular attention to ensuring that the regulatory standards and guidelines in the area of corporate governance - that the EBA is mandated to issue under the CRD - fully take into account the principle of proportionality:

- In Article 91 12) b) it is stated that EBA will publish guidelines concerning “the notion of adequate collective knowledge, skills and experience of the management body”. When drafting these Guidelines the EBA should adhere to the principle of proportionality be applying higher standards to the knowledge skill and experience of banks with a complex business model/activities and a lower standard to banks with relatively simple business models/activities. In other words the required skill, knowledge and experience of the management body should be in line with the complexity of the bank.

- Mandates in supervisory bodies of local bank directors in other local enterprises were not called into question during the latest crisis. Hence, Art. 91 par. 3 CRD IV says that the number of directorships which may be held by a member of the management body at one time shall take into account individual circumstances and the nature, scale and complexity of the institution's activities. The EBA should take this into account when issuing guidelines according to Art. 91 par. 12 lit. a on the notion of sufficient time commitment of a member of the management body to perform his functions, in relation to the individual circumstances and the nature, scale and complexity of activities of the institution.

- The draft Regulatory Technical standards issued by the EBA under Art 94.2 CRD concerning the criteria to identify the 'material risk takers' would benefit from a more extensive recognition of the principle of proportionality. The proposed qualitative and quantitative criteria are extensive and strict, leaving no realistic possibility for the credit institutions to develop and apply further internal criteria. In particular, the quantitative criteria should be appropriately adjusted to fully match the objectives of the CRD (i.e. concerning variable remuneration policies), and should be used only as a final backstop.