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EACB comments on EBA DP on Proportionality assessment methodology (EBA/DP/2021/03)

General comments

The EACB welcomes the opportunity to comment on the EBA Discussion Paper (DP) on a Proportionality assessment methodology.

We generally welcome the aim to ground the principle of proportionality in the framework with concrete tools, including having a reference point for assessing the need for applying a proportional treatment of institutions in the design phase of relevant regulatory pieces.

At the same time, the DP does not make a more detailed contribution to the question of where and how proportionality can be further applied in concrete, also in light of the elements introduced via CRR II. While we understand that this was not the aim of the DP from the onset, some further elements in that respect could have helped the discussion progress further.

It should be noted that proportionality is a fundamental constitutional principle and obligation for EU policy makers, under Article 5 of the Treaty. As such, proportionality is a right and a legitimate expectation for EU banks and not a concession from the authorities, therefore translating the principle into concrete measures should be a core policy objective.

We see that para. 9 (page 7) indicates that while the legislator considers proportionality when developing new legislative proposals, the ESAs do this when developing their Single Rulebook and are required to use their powers in the most effective and proportionate way. We indeed believe that greater balance between intended policy outcomes and required resources/efforts should be achieved in a more structural manner. In this vein, the methodology, once refined, could also support an assessment of existing technical standards and guidelines to see where they can be improved and made more proportionate.

When looking at para. 12 we agree that the assessment of proportionality should be structural and be performed not only when explicitly mentioned in Level 1 legislation. In fact, where proportionality is not mentioned and explicated, the assessment could reveal relevant information as to the costs and benefits of the envisaged policy options.

Q1 *Do you agree with the two steps that proportionality assessment addresses?*

The concrete classifications already in use at the EBA are certainly an interesting element, also from a transparency perspective. While some insight on those could be derived from certain reports produced by the EBA in the past (e.g. LCR, NSFR, Basel III impact), it is important to properly lay out the classifications and open them up for discussion, as this has not been done previously.

We do not believe that aspects which are not linked to a proportionate application of the framework to the institutions should be taken into considerations in this respect. In this regard, the benefits to customers and the benefits for authorities can hardly prove as metrics that express the regulatory burden to which banks are subject to. These two aspects do not appear relevant when assessing proportionality in banking regulation.

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Q2 *Do you agree with Classification I to be used for proportionality assessment? Given that quantitative thresholds are also being used for the classification of credit institutions, the EBA would welcome suggestions for the regular recalibration of these thresholds, in view to maintain the sample size and composition relatively stable over time.*

In addition to size, international activity and systemic importance, the affiliation/membership to a mutual solidarity system – such as an institutional protection scheme (IPS) according to Article 113(7) CRR, the group solidarity mechanisms provided under Art. 113(6) CRR, the cross-guarantee systems laid out in Art. 10 CRR – should also be regarded as a factor relevant for the assessment of proportionality.

Mutual solidarity mechanisms characterize most cooperative groups and networks and constitute a crucial difference with other institutions particularly in cases of financial difficulties. The mechanisms are contractual or statutory liability arrangements that safeguard member institutions, this includes ensuring their liquidity and solvency when needed in order to avoid bankruptcy.

The approval of mutual solidarity systems by the competent supervisory authority is granted only under strict conditions and specific expectations on how these requirements must be fulfilled.

With varying features, these mechanisms ensure a complete overview of the risk situations of all affiliated institutions as a whole – with corresponding possibilities to intervene at a very early stage in case of difficulties. On the basis of steering and intervention powers, there is the possibility to influence the risk situation of member banks in order to restrict certain activities or also to require a reduction of certain risks.

Against this background, affiliation to a such solidarity mechanisms should be considered as an important element in light of the proportionality assessment.

When looking at certain elements as described from para. 45 onwards, the descriptions are particularly dense and therefore it is difficult derive clear and concrete guidance on the intended approach.

We also believe that an approach according to which the potential compliance costs of each level 2 regulatory measure – differentiated according to institution categories – are determined, or at least estimated, before finalization of the measure, would be welcome. In addition, a commitment to examine every measure for the possibility of simplifications, e.g. what is really necessary and what is not, would be useful also to show what a simpler approach could look like. This could be seen as a development of what EBA currently does in the assessment of the policy options in the consultation papers.

We agree with the statements made by the EBA on data availability and differentiation in case of surveys as under para. 82. This goes in the right direction but is not very specific, more details would be welcome.

With regard to the determination of the implementation and compliance costs, the EBA has by now built quite some experience, especially with the recent study on the cost of compliance with supervisory reporting. At the same time such exercises have demonstrated how data collection alone can mean a great deal of effort for institutions which should be avoided or minimized.

Q3 *Do you agree with Classification II to be used for proportionality assessment? Do you consider the broad business model categories as adequately representative for proportionality assessment?*

It is not entirely clear how the business model assessment of the EBA interacts with the legally binding criteria set out in CRR II. Business model assessment considerations are already integrated in the CRR II criteria for defining small and non-complex institutions, e.g. the trading book business is classified as small, and no internal models are used to meet the prudential requirements according to Article 4(1)(145)(d) and (g) CRR II.

To express this differently, when looking at the way the institutions are added to the various clusters according to the different types of classifications described, it is unclear how this translates into different policy choices.

In para. 17 the EBA includes in the business model assessment also the ownership/governance structure. On the one hand we welcome the recognition given to the features that can be rather distinctive for cooperative banks. On the other hand, it is not fully clear how the ownership/governance structure would contribute to the EBA assessment of the business model and what this would entail for the institutions.

Legal structure and ownership are also taken into account by EBA as not quantifiable information (para. 24). This is indeed relevant when reflecting upon how to define requirements in certain policy areas (e.g. internal governance).

We would nevertheless welcome more clarity as to how EBA would reconcile this classification with other elements, including the definition of small and non-complex banks in Article 4(1)(145) CRR II, which is neutral to the legal structure and ownership of institutions.

Generally, legal structure and ownership considerations should be deemed characteristics that help in "positive" to design a proportionate regulatory approach, that is mindful of such crucial specificities and that safeguards the diversity of the EU banking sector. This should be expressed clearly in the EBA paper.

Maintaining diversity in banks' business models is a key priority for European policy makers. Therefore, additional requirements should be avoided.

It would thus be helpful to clarify how and in which respect the ownership/governance/legal structure are used when being taken into account in the proportionality assessment. This is especially true for cooperative banks which have specific structures and objectives (including the fact that while being sound and profitable businesses, it is not profit maximization the first driver of action) within the banking landscape.

In this respect, we would recall that at the time of the August 2019 EBA Policy Advice the implementation in the EU of the Output Floor (EBA-Op-2019-09c), the EBA had rightly noted that in "*groups in which many entities are authorised to use internal approaches (e.g. regional banks in cooperative groups), the cumulative impact of RWA add-ons due to the application of the output floor at the individual level could be notably higher than the impact measured at the highest level of consolidation in the EU. Such an impact would be driven not only by the calibration of the internal models, but also by group structure and whether or not capital at subsidiary level is raised internally or externally*." However, EBA concluded that an individual application of the output floor would still be the recommended policy option, although a possibility for competent authorities to make certain considerations in the waiver policy was put forward. Instead, we believe that this is an evident area where the different organizational setup of cooperative decentralized groups should have been taken into due consideration and more consequently addressed.

We also would like to take the opportunity to clarify what is stated in paragraph 7 "*a size classification (I or III) should be applied simultaneously with the business model classification and the results of the proportionality assessment should be jointly evaluated before taking any decision*". If, on the basis of the different types of classification described (size and business model classifications), the same institution is found to belong to different clusters, the EBA should always favour the type of classification that best protects the principle of proportionality. Therefore, for example, if on the basis of the size classification III, an institution does not fall within the category of "small and non-complex institutions" because it has total assets of just over €5 billion, and if on the basis of the business model classification such institution is instead found to be deserving of certain proportionality measures due the specificities of its business model and its low risk profile, the EBA should take the latter outcome into consideration, as it would better protect the principle of proportionality.

We also understand that Classification II is carried out both at the consolidated level and at the level of the individual institution. At the level of the individual institution, it is assumed that the investment firms concerned are likely to be classified as "other specialised credit institutions" within the group of "specialised banks". Since the classification as "institutions not taking retail deposits (including pass-through financing)" "BM10: No deposits" is based on the share of securities on the liabilities side of the balance sheet, it is not clear whether this categorisation would be applicable for the investment firms affected in certain banking groups.

Due to the special business model (no deposit business, limited lending business, proprietary business only for hedging purposes), it is questionable whether the inclusion of such investment firms under "other specialised credit institutions" is correct and whether this would eventually correspond to low-risk business activity. From our point of view, it would be necessary for institutions that do not conduct deposit business to be classified as CRR credit institutions exclusively via group membership and whose business is conducted exclusively for hedging purposes in accordance with Annex I Section A No. 3 MiFID II to be classified and recorded separately. In addition, due to the new meaning of group affiliation according to Art. 4 (1) No. 1 b) ii) CRR, the relationship between the qualification of business models at group and individual institution level should be clarified. It is not clear, for example, what effects would be associated with the classification into a different category at group level for the investment firms affected.

Q4 Do you agree with Classification III that integrates CRR2 classification of credit institutions?

In para. 5a (page 9) of DP, the EBA explains that it introduced a further degree of granularity to the CRR II definition, while in para. 29 et seqq. only the legal provisions of CRR are copied.

First, it is generally difficult to understand Q4, which states that classification criterion III introduces a “further degree of granularity” to what is stated in CRR2 – and paragraphs 29 (et seqq.) – where instead exclusive reference is made to what is stated in CRR2, Art. 4(1) (145) and Art. 4(1) (146).

Second, the legal definition of Article 4(1)(145) CRR II for small and non-complex institutions (SNCIs) set by the European legislator in the Level I cannot be overruled nor ignored. According to Recital 7 CRR this definition is the necessary legal link for targeted simplifications of requirements with respect to the application of the principle of proportionality. On this basis several regulatory reliefs for small and non-complex banks are already enshrined in the CRR II and CRD V (e.g. in the area of reporting, disclosure, NSFR and trading book according to Articles 430(8)(e), 433b and 428ai CRR II respectively Article 84 CRD V).

Therefore, it is difficult to understand the necessity for a higher granularity within the SNCIs definition provided in CRR II.

More granularity could rather be applied to the spectrum of institutions beyond SNCIs.

Q5 Do you agree with Classification IV for investment firms to be used for proportionality assessment, where relevant? Do you consider necessary the EBA to establish an additional classification according to the size of investment firms?

In Classification III, the classification into small and non-complex as well as large institutions is carried out according to the criteria pursuant to Art. 4(1)(145) and (146) CRR. Classification IV for investment firms is carried out in the same way depending on the size and additionally the activity of the institution.

For banks which are part (or parent) of a group, there is a risk that the securities institution companies belonging to the group would fall into the category of a large institution (Classification III when considering the consolidated group in accordance with Art. 4(1) (146) d) CRR) or into Class 1 of securities firms (Classification IV) if the legal situation is currently unclear (see EBA consultation on the group concept IFD/IFR).

The EBA's orientation towards the legal qualification according to CRR and IFR/IFD is correct in principle but does not go far enough in the view of the investment firms belonging to a banking group. In order to enable an appropriate differentiation within the framework of proportionality at the individual institution level, from the point of view of the affected investment firms, it is not only important how an institution is qualified in the end, but also why this qualification has taken place. For instance, members reported cases of investment firms in a group that have assets well below the limit of € 30 billion or the limit of € 15 billion and would therefore only be classified in the highest group on the basis of the group definition.

In view of the size, importance and risk profile of the individual institutions, we do not consider it appropriate to base proportionality solely on the general classification of the investment firms in the highest level. In our opinion, the sole view of the qualification result based on group affiliation according to CRR and IFR/IFD obscures the view of the small size and the low risk profile of the investment firms. Investment firms affected would not benefit from any possible relief for small and non-complex institutions or small investment firms. The relief rules explicitly provided for these investment firms by the IFD at the national level would come to nothing.

In Classification III and IV, no further criteria are specified to meet proportionality at the individual institution level if, as in the case of the aforementioned investment firms, these differ significantly from the assessment at the group level. The sole focus of proportionality on the qualification linked to group membership would exclude them in the future from possible relief under proportionality that would be granted to comparable institutions not belonging to the group. We do not consider this to be appropriate due to the size and risk profile of the investment firms concerned. Rather, it seems appropriate to introduce a further distinction beyond the qualification according to CRR and IFR/IFD, which takes into account whether the qualification was made on the basis of the fulfilment of the relevant criteria at the individual institution level or at the group level. As a result, in order to ensure appropriate proportionality in Classification III and IV, institutions should at least be classified and recorded separately in accordance with Art. 4 (1) No. 1 b) ii) and iii) CRR.

Q6 Do you agree with the predefined metrics above? Do you have any further suggestions for the presentation of results, the addition of new metrics or the modification of the proposed ones?

We support the idea expressed under para. 82 according to which when in need of data, already existing information should be used before additional data requests are launched. The costs on banks for data collections should be limited to the necessary minimum and proportionate to the benefits and the overall objective (para. 84 and 85).

The assessment of impacts on key figures (such as capital ratios and liquidity ratios) is understandable but the predefined metrics lack benchmark ratios. How would an expected reduction of LCR or NSFR be evaluated, would this be done via backtesting of results and assessment of volatility?

Finally, as a result of proportionality measures the implementation and ongoing costs of regulatory compliance should be reduced, in this vein the results of Cost of compliance study provided an important first insight and input for the way forward.

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