Executive Summary

This study was commissioned by the association of German cooperative banks (BVR) and conducted by Prof. Dr. Andreas Hackethal and Prof. Dr. Roman Inderst. It provides an assessment of the implications of current regulatory changes for small and medium-sized German banks.

The study aims to analyze both direct regulatory costs for the respective banks, with a specific focus on potential differences between small and large banks, and indirect costs that arise, for instance, for customers. The quantitative analysis of direct regulatory costs combines a survey among more than 500 German cooperative banks with administrative data and yields, amongst others, the following insights:

1. Reporting requirements and investor protection requirements generate the highest costs among the considered regulatory changes. The former generate a particularly high burden for smaller banks. Overall costs as well as those in all specific areas are considerably higher relative to business size (e.g., balance sheet) for smaller banks.
2. For smaller banks the respective estimated regulatory costs already exceed reported revenues in some areas, notably in the area of advice and security trading for private investors, though even for banks with a balance sheet up to 250 Mio. € regulatory costs exceed 50% of reported revenues.
3. A large majority of banks, including larger banks, share the view that smaller banks are relatively more affected by regulation and that this reduces their ability to innovate and to adequately respond to customer needs, while it increases the pressure to merge. Notably, regulatory topics tie up an increasing share of board members' time: Even within the category of banks with a balance sheet up to 100 Mio. € two thirds still report that board members spend more than one third of their time on regulatory topics.
4. High indirect regulatory costs for all banks, but notably again for smaller banks, are highlighted by the reported shift of their employees' time away from direct customer contact and market activities: The reported relation between activities that are directly related to customer and market contact and other activities has dropped sizably over the last five years – by around one half for the smallest banks and still by around one quarter for banks with a balance sheet up to 500 Mio. €.
5. Banks anticipate still higher regulatory costs. Notably, in each size category 80% of all banks expect that reporting requirements will generate the highest additional costs in the future.

To further identify key problem areas and to validate the results of the survey, a workshop with twenty participants was conducted and followed up by detailed structured interviews. Furthermore, the study documents in detail regulatory changes in the two areas with the highest reported costs (reporting requirements and investor protection). Taken together, these results identify reasons for why smaller banks are more-than-proportionally affected by regulation. Simply by their size and organizational structure, small banks score low on key success factors that ensure a cost-effective implementation of an increasingly complex regulation.

Notably the disproportionately high costs for smaller banks risk affecting negatively the provision of services to average customers given the key role of small and medium-sized banks in the German financial system. Consequently, a key recommendation of this study, for which practical examples are provided, is to fully take into account all economic and social cost of existing and new financial regulation and to assess separately the proportionality of these costs. Given the identified importance of costs in this area, new reporting requirements such as those arising from AnaCredit should be carefully assessed to ensure that benefits indeed outweigh costs – and not the other way round.