



Delivering proportionality: National Options and Discretions?

Proportionality in European Banking Regulation
Athens 13 February 2017



Hypothesis

1. The justification of use of national options and discretions is hardly motivated by the principle of proportionality as concerns banks in Europe; rather this is the case for investment firms.

2. The ability for competent authorities to apply explicit principles of proportionality of otherwise fully harmonised rules seems to be the new direction the European legislator is following to cause differentiated application of banking law (e.g. CRR2/CRD5 proposals for remuneration, reporting and disclosure).

Discussion in Europe about National Options and Discretions (NODs) in Banking Law

First Consultative Paper CEBS of 2008: 80% of Banking law NODs must be removed



Second Consultative Paper CEBS of 2009: further finetuning 2008 proposals



CRD Working Group 2008-2011: working towards Single Rule Book and removal NODs



CRD IV Impact Analysis 2011: NODs are broadly discussed as being problematic for level playing field and harmonisation efforts



ECB Banking Union 2016 work in removal Eurozone NCA NODs



EC November 2016 proposals of European Commission for CRD 5: some removal of NODs



Most recent proposals on removing NODs in CRD5 and CRR2

“Finally, the Commission, in close cooperation with the Expert Group on Banking, Payments and Insurance has assessed the application of options and discretions set out in the CRD and the CRR. Based on this analysis, the present proposal is intending to eliminate some options and discretions concerning the provisions on the leverage ratio, on large exposures and on own funds. It is proposed to end to the possibility to create new State guaranteed deferred tax assets not relying on future profitability that would be exempted from deduction from regulatory capital.”

2016, Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures, COM(2016) 854 final

Removed NODs in CRD5	Removed NODs in CRR2
2	3

Problem drivers and problems

Problem drivers	Problems
<ul style="list-style-type: none">❖ Diverging national rules due to the inclusion in the CRD of a number of national options and discretions❖ Gold-plating of the current provisions❖ Lack of detail within certain CRD provisions that allow for supervisory judgement and / or choice to be made	<ul style="list-style-type: none">❖ Diverging national rules allow for competitive distortions in the internal market and lead to a fragmented and inconsistent financial supervision, impeding legal clarity and resulting in excessive administrative burden for cross-border banks.❖ Mutual recognition of 'host' MS treatment at consolidated level creates opportunities for regulatory arbitrage whereas application of 'home' MS discretions at 'host' level hinders supervisory cooperation and level playing field

2011 Commission Staff; *Impact Assessment; Accompanying the document Regulation of the European Parliament and the Council on prudential requirements for the credit institutions and investment firms*; COM(2011) 452 final



Problem drivers and problems

“Divergences in national rules stemming from the possibility of application of national options, discretions and gold-plating are exacerbated by the process of transposition itself. Finally, national rules transposing the CRD are interpreted in accordance with local traditions and approaches thereby deepening the divergences in application of the CRD across the MS further.”

2011 Commission Staff; *Impact Assessment; Accompanying the document Regulation of the European Parliament and the Council on prudential requirements for the credit institutions and investment firms; COM(2011) 452 final*

General justification for NODs

- NODs assist Member States and NCAs to apply provisions taking into account proportionality: not applying a certain rule to a sector or institutions with similar profiles therefore allows Member States and NCAs to refrain from applying certain rules if this is considered not proportionate;
- For example:
 1. ***Dealing with small scale trading book positions.*** *NCAs may allow institutions to apply banking book rules to their trading book exposures, provided the trading book activities do not exceed certain limits. This treatment is not a risk-sensitive one but avoids requiring small institutions to implement complex and burdensome approaches.*
 2. ***Applying a simplified method for calculating risk weight positions in options.*** *The objective of the discretion, [...] allows implementation of a proportionate approach to the calculation of credit risk capital requirements for different institutions. This discretion allows more permissive treatment in the capital requirement calculation which is proportionate to the size and sophistication of the institution*

Rationale of the options and discretions in CRR and CRD IV

- ❖ There should be room for Member States or competent authorities to adopt national rules for areas not covered by CRR

(...) Dynamic provisioning, provisions on national covered bond schemes, rules on acquisition or holding of participations in both the financial and non-financial sector for purposes not related to prudential requirements (...)

- ❖ Peculiarities of markets for immovable properties justify the retention of national powers and authority to regulate at national level

Recital (12) CRR:

“the peculiarity of immovable property markets, which are characterized by economic developments and jurisdictional differences that are specific to Member States, regions or local areas, competent authorities should be allowed to set higher risks weights or to apply stricter criteria based on default experience and expected market developments to exposures secured by mortgages on immovable property in specific areas”

Rationale of the options and discretions in CRR and CRD IV

- ❖ National rules to address macroprudential risks related to the structure and size of the banking sector of a Member State compared to the wider economy and credit cycle.
- ❖ Recital (16) CRR:

“Member States retain a leading role in macroprudential oversight because of their expertise and their existing responsibilities in relation to financial stability.”

Arguments for maintaining NODs

It is however possible to imagine arguments for maintaining options and discretions at the national level. One might stress, for instance, the different economic situation of banks in the various Member States of the Eurozone.⁵⁰ These divergencies seem to require an adaption of the applicable rules to the country in question. As a corroboration of national choices, one may also point to the principle of subsidiarity enshrined in EU Treaty law, which requires that tasks are fulfilled at the lowest level possible.⁵¹ Further support may be gleaned from the economic theory of regulatory competition, which highlights the value of divergent regulatory requirements as an area of trial.⁵²

Prof. dr. M. Lehmann, *Single Supervisory Mechanism Without Regulatory Harmonisation? Introducing a European Banking Act and a 'CRR Light' for Smaller Institutions*, EBI Working Paper Series 2017 -- 03

Arguments to compensate when removing options and discretions

CEBS 2008:

- *“The possibility of removing options and national discretions rooted in local market conditions should also be examined, e.g. by looking at the possibility of achieving the same purpose by applying an existing proportionality provision.”*
- *“Consideration should also be given to the need for legal continuity for important businesses and the possible use of a transitional period or a grandfathering clause if this would allow a gradual adjustment of the business.”*

Concluding remarks

- ❖ **Majority of NODs for which proportionate application** of the CRD/CRR rules are the drivers **relate to the investment firm industry**.
- ❖ It is **rare** that the **rationale for NODs** is defended by the European legislator **to introduce proportionate rules for small and medium sized banks**;
- ❖ The **continued efforts to remove NODs** from the European Banking laws are motivated by the desire to:
 - ❖ **Create level playing field** in Europe for banks
 - ❖ **Avoid national bias** and tendencies to protect national champions or national sector
- ❖ The **real impediment** for Europe for the design **of true proportional application of banking law** (and opportunity to truly create harmonized laws for the larger cross border operating banks) **is the choice to apply Basel Capital Accord standards to all the banks in Europe**, even small banks or banks with a pure domestic focus.

