EBA Discussion Paper on proportionality assessment methodology

EAPB response to consultation

20.10.2021

1. Do you agree with the two steps that proportionality assessment addresses?

The EAPB has concerns that existing internal classifications together with CRR2 classifications will not achieve sufficient granularity to identify business models and/or activities that are disproportionately affected by specific pieces of regulation. See more detailed comments in the answers below.

2. 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.

The issue of identification of relevant risks is different from and should in the methodology be separated from the issue of the measurement of the level of those risks. Classification I mainly represents a measurement of the level of certain risks. Institutions should not be disqualified from a proportional treatment based on classification I if the risks measured by this classification are not adressed by or relevant for specific pieces of regulations. See more detailed comments in the answers below.

3. 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?

The business model categories are too broad to adequately identify whether sufficient effect is given to the principle of proportionality under specific pieces of regulation that have specific relevance for individual business models or activities. This is particularly so for the categories "public development banks" and "other specialised credit institutions". See more detailed comments in the answers below.

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

The EAPB acknowledges that it could be relevant to integrate CRR2 classification of credit institutions via classification III. We also consider that it would generally be appropriate to let "small and non-complex" institutions benefit from a proportional treatment. The EAPB considers that the answers to question 1 and 2 above also apply to classification III, and in particular to the definition of "large institutions". An institution classified as "large" according to the CRR2 definition should not automatically disqualify for a proportionate treatment. On the contrary, if a specific piece of regulation or a specific requirement would be of little relevance due to the business model or (lack of) activities of an institution, a proportionate treatment would be appropriate even if the institution by the CRR2 definition was classified as large. It is furthermore unclear how classification III would interact with classification I, in particular as these classifications would seem to overlap to a significant extent. See more detailed comments in the answers below.

More detailed comments:

It follows from the EBA discussion paper that this document intends to fulfil the mandate of the EBA Advisory Committee on Proportionality for establishing a Proportionality Assessment Methodology (PAM), intended for use by the policy experts, for assessing whether the application of proportional treatment of EU institutions is necessary for specific parts of EBA regulation.

The EAPB is of the view that the discussion paper represents an important development of the methodology for applying the principle of proportionality, as it is recognized that not all parts of regulations/requirements will necessarily be relevant or essential to all business models.

The members of the EAPB are public banks, public development banks and local government funding agencies with specialized, low risk business models that justify a more proportionate application of prudential rules. In this sense, we support a stronger application of the proportionality principle in the areas mentioned by the EBA (see paragraph 2 in the discussion paper), but also in other areas. The proportionality concept should be ambitiously expanded for these areas. In particular, the EAPB supports the EBA's comments in paragraphs 6 and 7 that the level 2 regulator should use the PAM to ensure that prudential requirements are interpreted proportionately.

The EAPB would like to emphasize that the level 2 regulator should also introduce proportionate rules for certain business models, even if the primary regulation does not explicitly provide for this or only for a certain group of institutions (e.g. small and non-complex institutions, SNCI). As a principle, the level 2 regulator should be allowed to use the primary text as an inspiration for further proportionality in the level 2 text. For example, the EBA should be empowered to extend a regulatory relief that the legislator has provided for a certain group of institutions, provided that non-application would lead to an unnecessary additional burden and there are no supervisory concerns.

The EBA already applies a classification of credit institutions according to their size, systemic importance and international activity that aligns with the classification applied by the Basel Committee on Banking Supervision (classification I). In addition, the EBA applies, in selected deliverables, the business model classification (classification II). The business model categories developed by the EBA include 12 business models for credit institutions. The discussion paper introduces a new classification (classification III) for credit institutions. classification III refers to separating credit institutions according to CRR2 definition of "Large institutions" and "Small and non-complex institutions", but introduces a further degree of granularity to it.

In paragraph 6 of the discussion paper there is a description of objectives that the classifications should achieve. The intention is that the classifications should be universal, general and consistent. The EBA states that there is no priority of the application of any size classifications (classification I (BCBS) or classification III (CRR2)) over the business model classification. Instead, a size classification (I or III) should be simultaneously applied with the business models classification and the proportionality assessment results should be assessed jointly before any decision is made.

While the EAPB very much welcomes that the business model classification stands on equal foot with the size classifications, we think that the simultaneous application of size classifications (I and III) with business model/features (II) as the same basis for proportional treatment across different pieces of regulations would not achieve sufficient granularity. This is particularly so for the group of ”specialised banks”, and particularly ”other specialized credit institutions”, which it might be presumed could encompass a wide variety of business models with a great diversity of characteristics and activities. Even though the EBA states that there is no priority of the application of classification I or III over classification II, the EAPB is concerned that the methodology presented may not give sufficient effect to the principle of proportionality. Though many members of the EAPB might be considered large institutions according to classification I and/or III, the EAPB considers that these institutions due to their specialized low-risk business models should in many areas qualify for a more proportionate application of prudential rules.

A simultaneous application of size classifications (I and III) with business model/features (II) as the same basis for proportional treatment across different pieces of regulations would in EAPB’s opinion not achieve sufficient granularity, and this is particularly so for the group of ”specialised banks”, and particularly ”public development credit institutions and other specialized credit institutions”, which it might be presumed could encompass a wide variety of business models with a great diversity of characteristics and activities.

The EAPB would urge the EBA to base the qualitative assessment for proportional treatment of “specialised banks” on the specific features of the business model of individual institutions (e.g. for many of EAPB’s members, lending to public authorities or PSEs, public ownership, not taking deposits covered by DSGs, not being members of financial infrastructures or regulated markets, etc.). The exemption from the leverage ratio exposure measure for the newly introduced category of “public development credit institutions” definition in the CRR2 is an example of a proportionate implementation of the leverage ratio requirement that takes into account the low risk nature of the business model of such institutions regardless of how such institutions might score according to more general size or complexity criteria.

As a matter of principle, it should also be recognized as basis for the methodology that the nature of risks is a separate issue from the level of those risks. The EAPB considers that the size classifications would mainly address the level of risks, whereas the nature of risks would stem from the business model and the nature of the institutions’ activities. Nature of the risk should be the point of attention which is linked to the business model. Size is not telling about the nature of the risk, and hence taking size into the equation might distort the picture. If risks addressed by pieces of regulation have limited relevance or materiality for the business model or activities of a specific institution, it should be possible to apply a proportional treatment under those regulations regardless of the category of the institution under classification I and III.

For these reasons, the EAPB do not share EBA’s view that the classification should be as universal as possible. In the EAPB’s opinion it is important that the principle of proportionality is linked to relevance in the individual regulations instead of ensuring applicability and comparability across different pieces of regulation, and that the nature of risks are assessed separately from the level of those risks under each regulation when considering whether there is a basis for proportional treatment under that regulation. The approach suggested where the institution is placed in a category that will determine the treatment across regulations will in our view not ensure an application of proportional treatment of EU institutions as parts of regulations are not relevant to all business models/features.

5. 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?

NA

6. 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?

NA