# Andreas Dombret: Between global competition and the regional principle - which bank needs which rules?

Speech by Dr Andreas Dombret, Member of the Executive Board of the Deutsche Bundesbank, at the "G20 and Locally Focused Banks" conference, Berlin, 9 March 2017.

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## 1. Introduction

Finance Minister Dr Schäuble

Mr Haasis

Ladies and gentlemen

Germany is the G20's host this year, so you could say the world is our guest. Many smaller banks and savings banks sense that, following the financial crisis, the world – in the guise of global regulation – edged a little closer towards them. For quite a few of them, it was too close for comfort.

I keep hearing claims that the "little bank just around the corner" bore the brunt of the major reforms enacted by the international community in recent years.

Just to remind you: the financial crisis spurred the G20 to formulate its intention to address, to the greatest extent possible, all the risks inherent in the exceedingly complex worldwide banking system. Experience shows that a country going it alone isn't the right way to guarantee the stability of the financial system. These days, the financial system knows no national boundaries, and crises can very easily spill over from one country to the next. This prompted the Basel Committee to set about overhauling, substantially in some cases, the uniform standards that underpin the key ground rules in the banking business.

And because it has always been standard practice to do so in the EU, these rules were then applied across all institutions in Germany. A good case can be made for that. But still, I do wonder whether things really have to be that way? Do we really have to make a choice – between a functioning global competitive environment on the one hand, and the regional principle on the other?

Over the next few minutes, I will outline a number of proposals which I think can better align the supervisory rules with the low-risk operations of small credit institutions in the future while nonetheless adhering to international standards.

## 2. Proportionality in regulating small institutions

There are already many exceptions in force today to help small institutions manage their compliance workload. However, such exceptions are not special treatment motivated by industrial policy concerns. Rather, they result from what banking supervisors are there to do in the first place – that is, to shield the economy effectively and efficiently from excessive risks and financial crises. This is the rationale behind the principle that high risks necessitate a high level of provisioning. The same holds true in reverse: low risks necessitate less provisioning. It can therefore be concluded from this that relief is always warranted as long as it does not result in risks being inadequately provided for.

That is a principle which supervisors and regulators – including those in Basel, incidentally – took on board some time ago. The Basel Committee, remember, has taken into account differences in the size and complexity of institutions – just take the rules the committee devised to enable banks and savings banks to use different methods to measure their capital. Institutions are generally permitted to use complex models, but only those authorised by the supervisory authorities. Yet there is no obligation to use a model; instead, institutions can also opt for a more straightforward standardised approach. What is more, large and systemically important institutions are asked to meet additional requirements. Global systemically important institutions, for instance, need to set aside more capital in the shape of a separate capital buffer. The aim, then, is not to treat institutions equally, but risks.

We apply this principle in our day-to-day supervisory activities as well. The higher an institution's risks, the more intensively we will supervise it. The more significant, complex and risky the bank, the more frequently, extensively and intensively we will inspect it. That is why we deploy far more supervisors to inspect larger institutions in our routine SREP examinations at credit institutions. You will recognise the same supervisory strategy in the institutional reporting system. The euro area's "significant institutions", as they are known, have a standard requirement to report more than 8,000 data points to their supervisors – and to do that quarterly. The reporting templates may be harmonised across Europe, but some business areas are omitted for the smaller institutions. A typical savings bank, then, has to report far fewer data, often just half of the data points.[1]

This practice accommodates smaller institutions running low-risk business models – but perhaps not as much as it could, because there are still some rules whose point and purpose is barely relevant to a savings or people's bank "just around the corner", but which nonetheless impose too much of an administrative burden on them.

On top of that, regulation hasn't exactly got any simpler since the financial crisis. It has been significantly revised and augmented to include new requirements, expanded and stated more precisely. So in its effort to cover every single risk in the complex world of banking, the regulation, too, had to become more complex – and that is still taking a very heavy toll on smaller institutions; too much so, if you ask me.

For small institutions, especially, the work this entails is disproportionately time-consuming and costly. At the same time, many a provision grasps at thin air at small institutions. Just take the existing disclosure requirements, which are there to ensure that large publicly traded institutions are subject to public accountability. Yet market discipline hardly has any bearing for small institutions which are not publicly traded – so why force them to satisfy the same provisions?

Another point worth mentioning in this regard is that the many smaller institutions represent an important component of a diverse banking landscape. During the financial crisis, it was notably the savings bank and cooperative bank sector which proved to be an anchor of stability in Germany. Savings banks and cooperative banks, operating as they do within their own regions, were far less exposed to international disruptions. Plus, close relationships built up over time with customers exuded stability in an environment fraught with uncertainty – clearly, the diversity of Germany's banking landscape paid off on this score.

If you ask me, that alone is reason enough to systemically scour the existing rulebook for provisions that ask too much of smaller institutions and to then set about eliminating them.

In Europe, the rulebook is presently being subjected to a thorough and comprehensive review, and the European Commission has already tabled quite a few proposals for amending the rules. Some of these proposals would bring relief for smaller institutions. These are proposals I advocate in principle.

Adjustments could be made to the magnitude and frequency of disclosure and reporting requirements. The standards for remuneration systems are another area that could be addressed, while sensible exceptions might be made to the new standardised approach for market risk.

While I have a great deal of time for the legitimate interests of smaller institutions rooted in their home regions, there's one issue I would like to stress: proportionality isn't a gateway to relieving smaller institutions of regulation altogether.

It should most certainly not be about lowering quantitative requirements – for capital or liquidity, for instance – but rather a case of tracking down operational requirements that can be dispensed with.

The diversity of a banking system cannot be protected by classifying small banks and savings banks as completely risk-free. Trouble can befall any institution. If the banking industry is to function as part of our market economy, banks and savings banks need to behave like other economic agents and take responsibility for their decisions and the consequences of those decisions. Viewed from this perspective, supervisory authorities' quantitative minimum requirements – above all, capital requirements – ensure that the banking industry is subject to a minimum degree of entrepreneurial accountability.

### 3. Global competition, global proportionality in regulation

Ladies and gentlemen, how can a globally coordinated regulatory regime be reconciled with proportionality? Do rules agreed at the global level mean that small, regionally focused banks have to be treated in the same manner as large multinational institutions? Does a global regulatory regime leave no room for proportionality? My answer to this is no, there is no fundamental conflict. Relief measures for smaller banks, and even separate sets of rules, are not at odds with the aim of a global regulatory regime. The Basel Agreements never set out to establish a single regulatory framework that applies to all banks, without exception, in every corner of the world. In fact, their objective is to make large and internationally active banks more stable by implementing a uniform set of rules and to make sure that there is a level playing field worldwide.

It was only after Basel II had been implemented in Europe for banks and savings banks across the board, irrespective of their size and business activity, that subsequent international negotiations and reforms began to turn their attention to the smaller institutions. It is therefore up to us in Europe to reconcile global competition with fitting rules for institutions operating regionally.

In a globalised world, we need a uniform set of rules to ensure fair competition among those banks operating globally – only in this way can a reckless regulatory race to the bottom be prevented. For banks conducting the same business activities and bearing the same risks, this means that they should be subject to the same rules.

But what about institutions of vastly differing sizes? Germany, for me, is the quintessential example of a diverse banking landscape characterised by local and regional institutions: it is currently home to around 1,700 banks and savings banks, the vast majority of which are not global players.[2]

How can neutral competitive conditions be established in such a system? When it comes to institutions of varying sizes, do uniform rules for regulating and supervising banks not actually contribute to competitive distortion? In my view, the answer is far more straightforward than you might think, and it's not surprising: regulators and supervisors can behave in a competitively neutral manner by strictly focusing their interventions on risks that stem from an institution and pose a threat to the financial system.

This is because the same degree of competition does not exist between all banks. For instance, a regional bank operating in the area surrounding Berlin is hardly competing with its US equivalent. In my view, the argument regarding competition, as relevant as it may be in the case of big banks competing at the international level, should therefore not be overstated.

Time and again, we are finding that the approach taken to implementing the principle of proportionality varies from country to country. And that is as it should be. My advice would be to use these differing approaches as inspiration and as a catalyst for exchanging views across national borders.

For instance, the United States introduced the Basel II requirements almost exclusively for large institutions. Turning to the Basel III regulations, the US authorities have given smaller "community banks" more time to implement the rules and have also factored in some relief for these institutions regarding individual rules. In other words, there has not been a separate regulatory regime there to date. A proposal that could change this is currently on the negotiating table as part of what has been dubbed the Choice Act. What this entails, in a nutshell, is that an institution need not meet a large proportion of the detailed requirements with which it must normally comply if it has a sufficiently sound leverage ratio. This is generally in keeping with the kind of proportionality I support. Let me repeat: operational relief can only be provided if it does not come at the expense of resilience.

That said, the internationally agreed regulatory regime remains crucial for our financial system. Criticise Basel III if you like for its complexity, but you won't find a simple alternative that maintains healthy international competition while simultaneously combatting the shifting of risks into inadequately regulated areas. In a global financial framework, national regulators cannot simply dodge these responsibilities.

But it may well be possible to reconcile a separate set of rules that provides relief for regional, low-risk institutions with such a global financial framework. With that in mind, the debate on such a "small banking box" should be continued in an open-minded and constructive manner.

## 4. Conclusion

Ladies and gentlemen, I have spent the last quarter of an hour attempting to illustrate the conditions under which I believe greater proportionality in banking regulation would be both possible and sensible. Let me now conclude by summarising the key points.

1. Cleverly selected relief measures for smaller institutions can contribute to a more stable financial system.
2. These measures should focus on operational requirements and should not result in capital or liquidity being lowered.
3. We also need internationally harmonised rules for large, international banks. However, the approach taken to implementing the principle of proportionality in regulation can vary from country to country.

In the debate on proportionality, we should therefore concern ourselves less with what would appear to be policy issues and instead give greater consideration to concrete, targeted relief and appropriate criteria.

On that note, I wish you a fruitful and rewarding exchange of views at this key conference. I, for my part, support you in your call for the construction of a more appropriate regulatory architecture.

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[1] There are also institution-specific reports, eg under the large exposures reporting regime.

[2] The percentage of institutions with total assets of up to €3 billion is around 83% in Germany.