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Session IV:

PAYMENT INNOVATION, FINANCIAL INCLUSION AND FINANCIAL STABILITY RISKS

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PROPORTIONALITY IN EU LEGISLATION

- Treaty on the European Union
  - *Article 5(4): "Under the principle of proportionality, the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties. The institutions of the Union shall apply the principle of proportionality as laid down in the Protocol"*
  - *Protocol (No 2), Article 1: "Each institution shall ensure constant respect for the principles of subsidiarity and proportionality…"*
- Single Rulebook
  - *Recital 46 of the Capital Requirements Regulation (CRR): "The provisions of this Regulation respect the principle of proportionality, having regard in particular to the diversity in size and scale of operations and to the range of activities of institutions"*
- SSM (Single Supervisory Mechanism) Regulation
  - *Recital 55 of the SSM Regulation: "The conferral of supervisory tasks implies a significant responsibility for the ECB … to use its supervisory powers in the most effective and proportionate way"*

PROPORTIONALITY IN REGULATION AND SUPERVISION

Proportionality means adjusting regulatory requirements in line with size, risk and complexity, and allocating supervisory resources accordingly

- Basel Accords
  - Basel I was introduced in 1988, Basel II in 2004 and Basel III in 2010
  - Methodological groundwork for identifying Global Systemically Important Institutions (G-SII) and Other Systemically Important Institutions (O-SII)

- EBA Technical Standards and Guidelines
  - Basis for identifying European G-SIIs and O-SIIs
  - The list of G-SIIs and O-SIIs is updated annually

- The purview of the SSM
  - 114* *significant institutions (SI)* directly supervised by the SSM
  - 2453 *less significant institutions (LSI)* supervised by the NCAs within national jurisdictions
    - ➢ The SSM LSI SREP methodology is similar to that for Sis, but lighter

- Additional national considerations
  - Additional requirements for larger banks in Estonia for example, to ensure the continuity of critical cash and payment services

* As at 1 July 2021; Source: ECB

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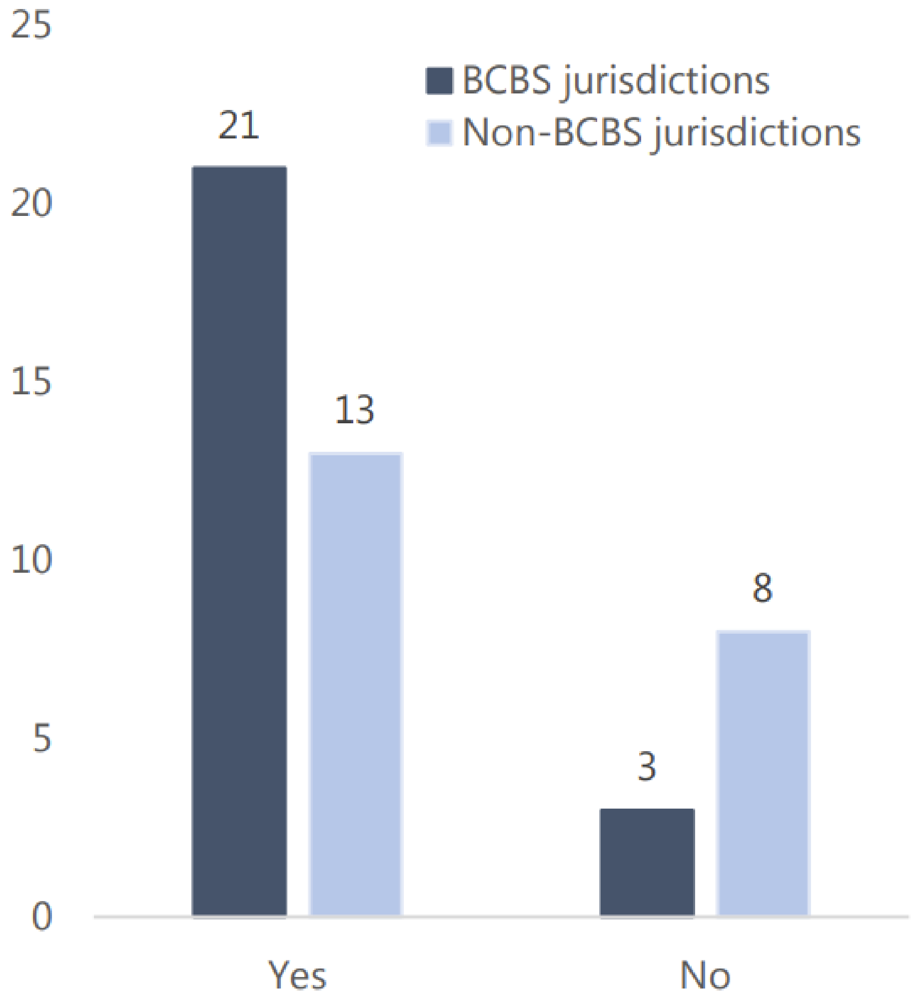
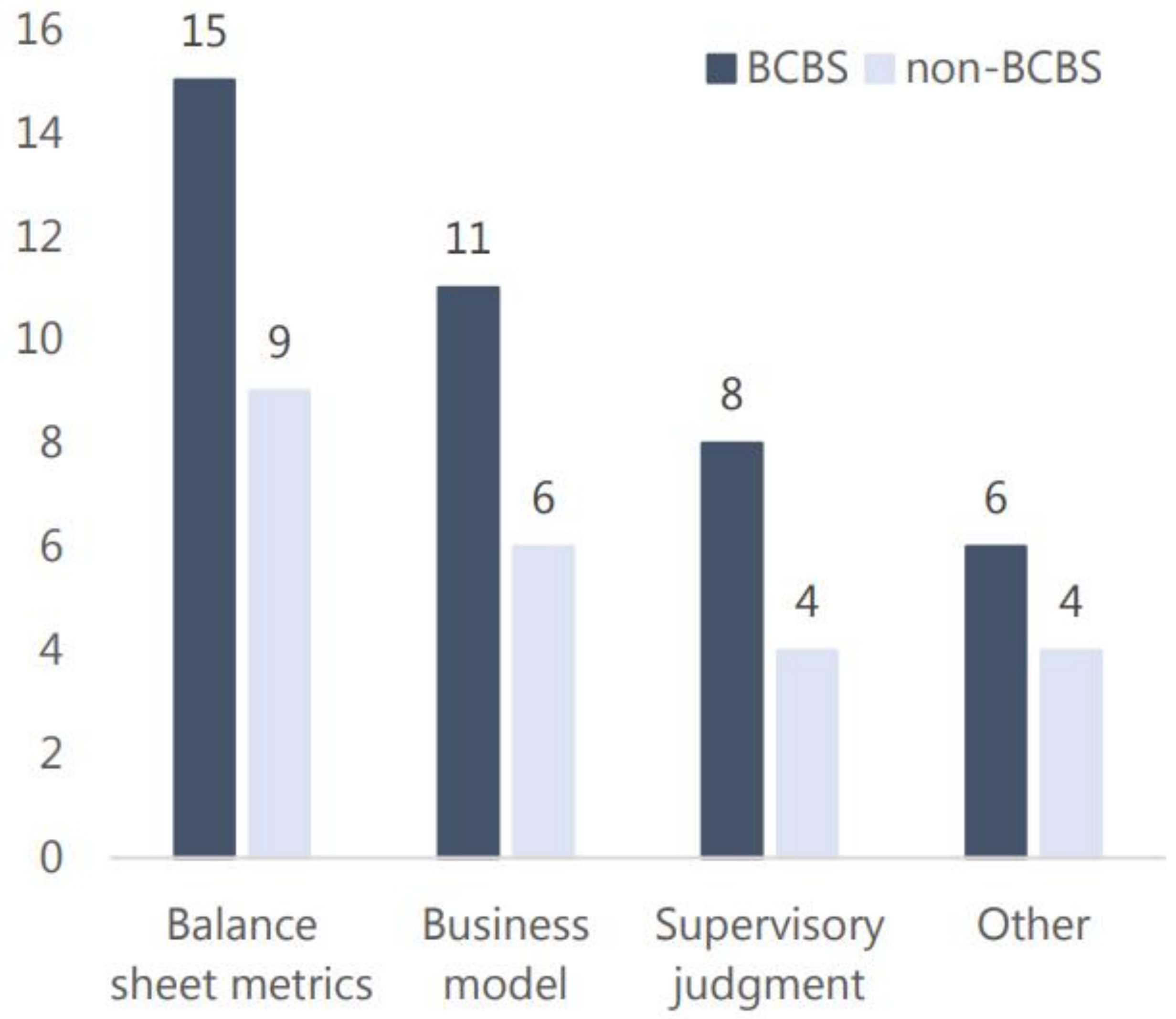
APPLICATION OF PROPORTIONALITY IN PRACTICE

- BIS survey: 75% of jurisdictions apply proportionality measures
- Balance sheet metrics dominate over other criteria

Number of jurisdictions applying proportionality



Determinants for proportionality thresholds



Source: BCBS proportionality survey (2019)

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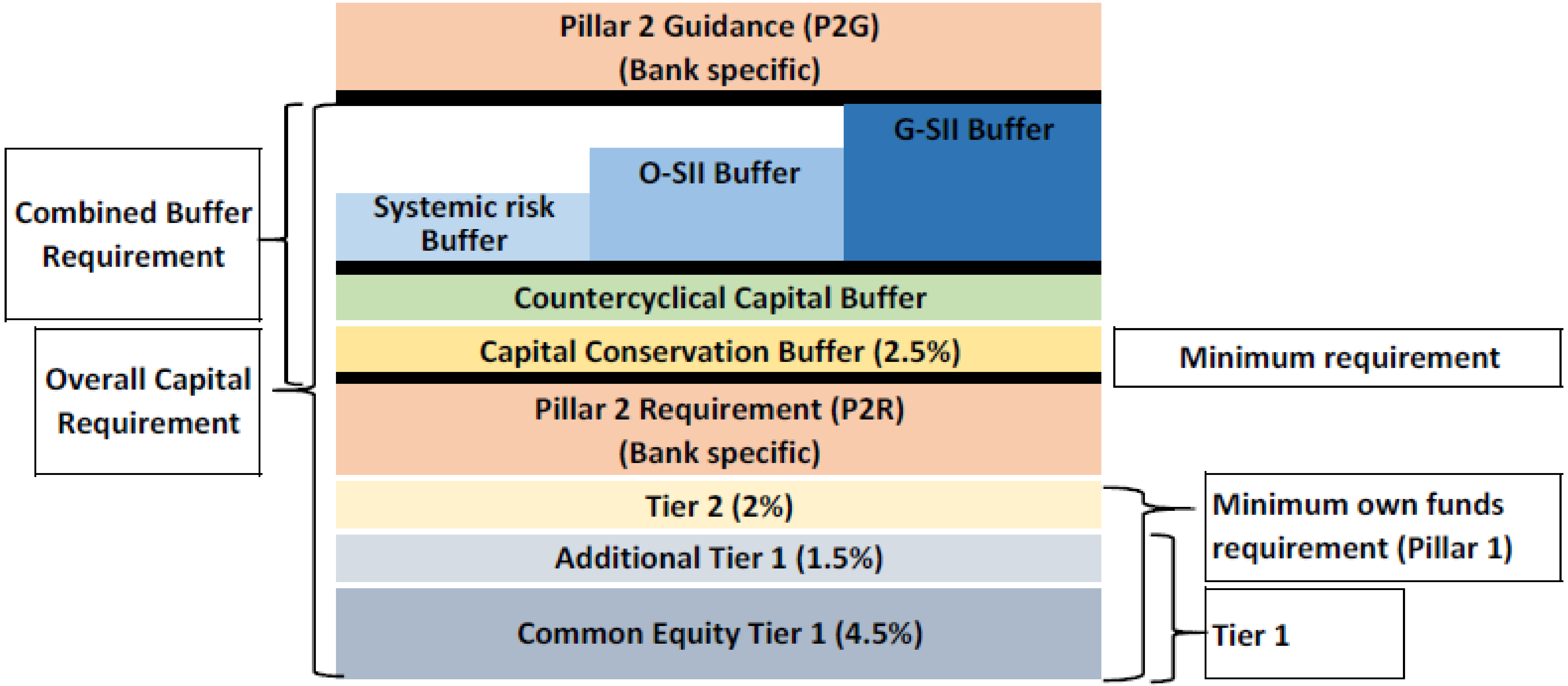
ADDITIONAL CAPITAL REQUIREMENTS FOR SIGNIFICANT INSTITUTIONS

- Buffers can be increased, while the capital of banks is also challenged during the annual SREP*
- Restrictions on dividend payouts were applied during the Covid-19 pandemic



** Supervisory Review and Evaluation Process*

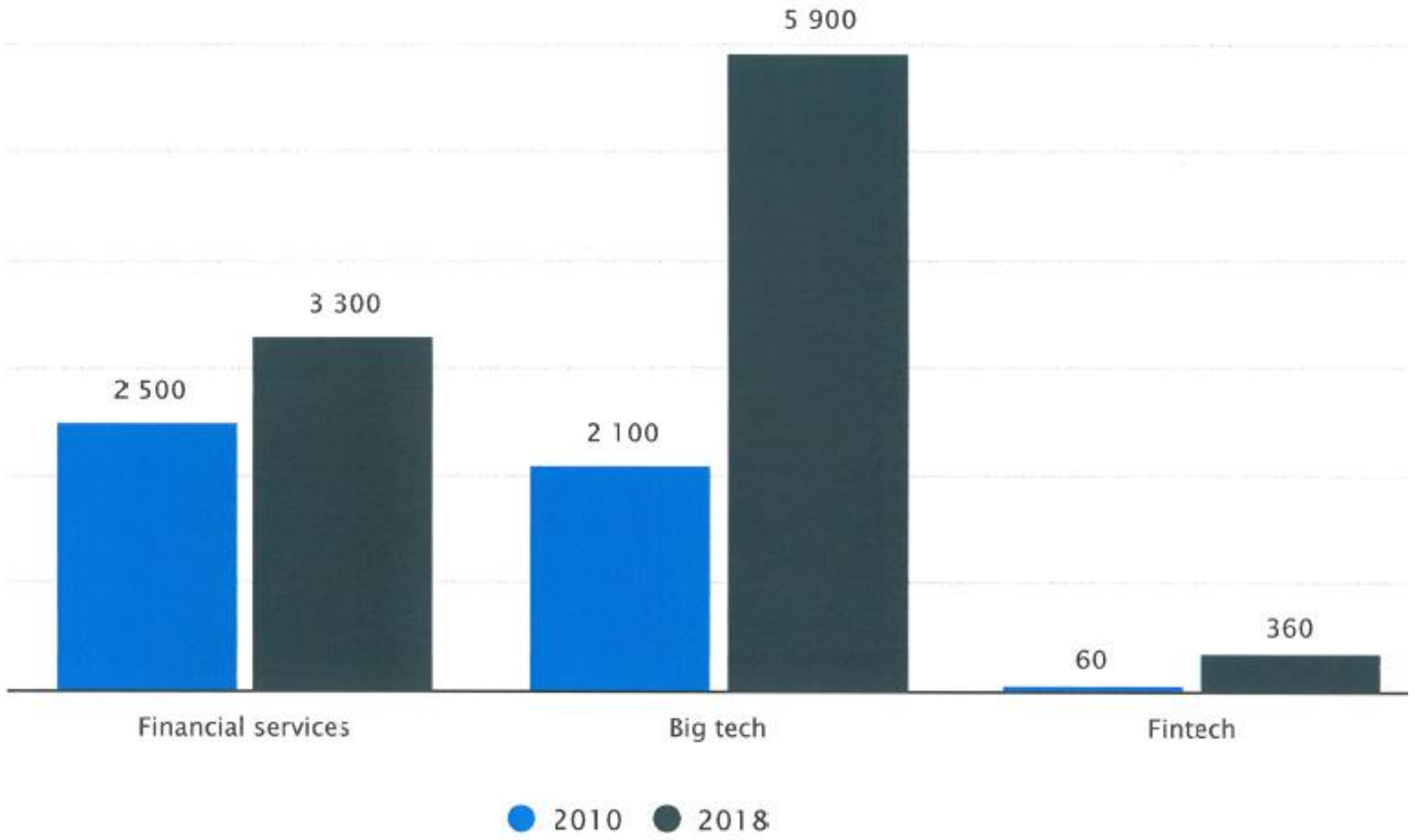
Source: ECB, KPMG

THE TOP BIG TECHS OUTWEIGH THE TOP BANKS

- The Big Techs are growing fast, while their core business lies outside financial services
- Capital markets favour Big Techs over banks

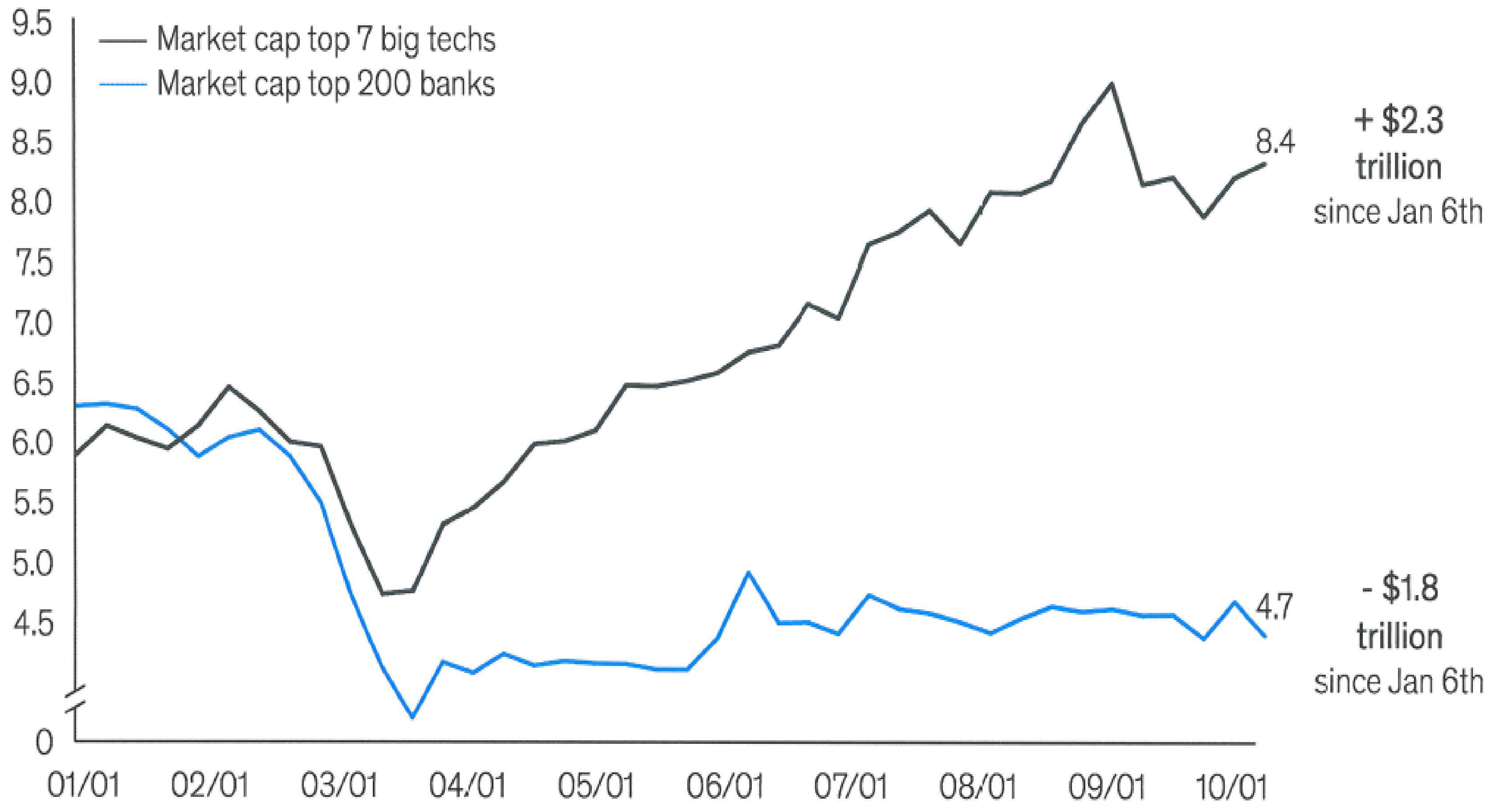
Market cap of financial services, big tech and fintech companies[1]

$ billion, 2010 and 2018



Market capitalisation of the seven largest tech companies[2] and 200 largest banks

$ trillion, 1 January 2020 – 9 October 2020



[1] The 20 largest firms in each sector worldwide; Source: https://www.statista.com (2020)

[2] Alibaba, Alphabet, Amazon, Apple, Facebook, Microsoft, Tencent; Source: McKinsey (2020)

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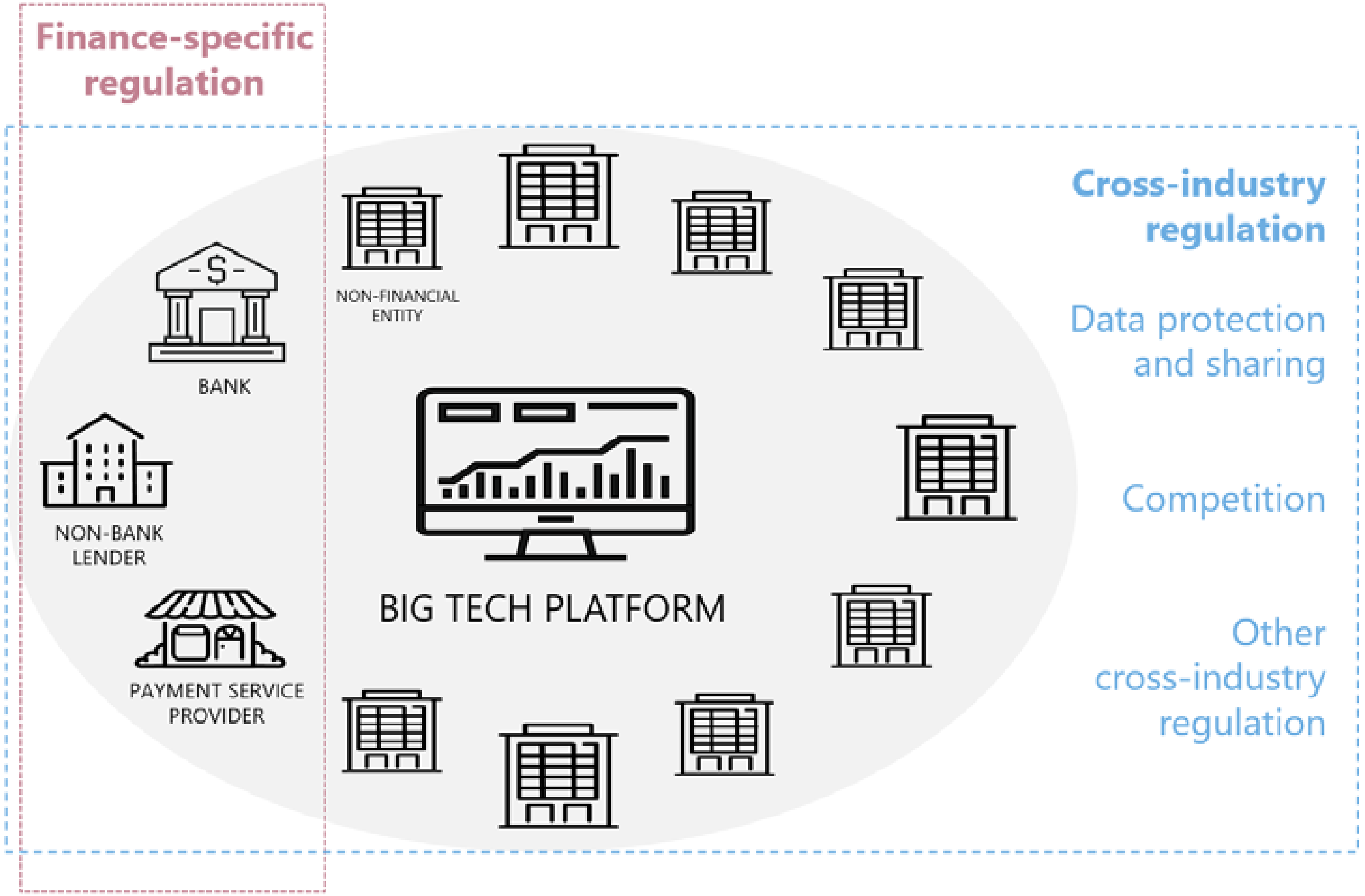
ACTIVITY-BASED OR ENTITY-BASED REGULATION



Source: “Big techs in finance: regulatory approaches and policy options“, FSI Briefs, no 12: March 2021

- “Same activity, same regulation”?
  - Banks are globally subject to tight regulations that have been created over time
  - Big techs must apply for a banking licence to offer banking or financial services in each jurisdiction
- Uncharted waters
  - Big techs are growing very fast globally
  - Their complexity is similar to or greater than that of banks, but their risk profile might be different
  - Same concerns for regulators – data/customer protection, a level playing field, financial stability
- Moving target
  - Crypto-asset companies

CONCLUDING THOUGHTS

- **Proportionality principle** should remain valid for both activity-based and entity-based regulation, also in an increasingly digital financial ecosystem.
- **Activity-based regulation is a starting point** to ensure a level playing field for market participants. It needs to be applied in particular in areas of consumer protection and AML/CFT.
- **Entity-based regulation** needed to manage risk in other areas, in particular for large Big Techs:
    - Operational resilience – in the EU a proposal from the European Commission for a Digital Services Act (2020)
    - Competition – to address possible anti-competitive practices of “gatekeepers”; a proposal from the European Commission for a Digital Markets Act (2020)
- Particular challenges for regulating the **crypto-asset companies**. Regulation, consumer and investor protection currently very light; in the EU a proposed regulation on Markets in Crypto-Assets

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THANK YOU