Importance

* Basel 4 implementation
  + Higher standard for proportionality
  + Case: proportionality is rejected in most of the cases
* Consequences of not strict application of the principle of proportionality
  + Overburdening smaller institutions => competition distortion
    - Increased Compliance Costs: Smaller banks might face disproportionately high compliance costs relative to their size and resources. This could strain their financial health and operational capabilities.
    - Competitive Disadvantage: Smaller banks might be at a competitive disadvantage compared to larger institutions that can more easily absorb compliance costs. This could lead to reduced competition in the banking sector.
    - Access to Services: Smaller banks often serve niche markets and underserved communities. Over-regulation could limit their ability to operate effectively, reducing access to financial services for these segments of the population.
  + Inefficient Resource Allocation
    - Regulatory Resources: Regulators might allocate resources inefficiently by applying the same level of scrutiny to all banks, regardless of their size, complexity, and risk profile. This could result in inadequate supervision of larger, more complex institutions that pose greater systemic risk.
    - Bank Resources: Banks might divert resources from core business activities to meet regulatory requirements, potentially stifling innovation and growth.
    - LSIs tend to focus on the domestic market of the country where they are based. This makes the local expertise and geographical proximity of the NCA supervisors particularly useful in ensuring the efficient monitoring of prudential soundness.

Research questions and objectives

* Objectives: đánh giá adequacy… of the principle of proportionality in xây dựng pháp luật và implementation trong banking supervision chưa
* Research questions:
  + proportionality in banking supervision đã đáp ứng theo được tinh thần và mục đích của nhà làm luật chưa và
  + việc áp dụng trong cases có đáp ứng được tinh thần và hiệu quả kỳ vọng bởi nhà làm luật chưa

Methodology

* Doctrinal
* Theoretical
* Comparative

Scope and limitation

Structure

* Literature review
* Theoretical framework
  + Proportionality là gì
  + Trong EU law
  + Trong EU banking regulation
  + Trong banking supervision
    - So sánh với các jurisdictions khác (Mỹ, Brazil, Thụy Sỹ, Nhật)
    - Assessing the significance of institutions
      * Size (TITLE 3 Article 50, CRR, CRD)
      * Pillar 2 3: Deposit Guarantee Scheme, SRF
    - Requests relating to authorisations, *proposed acquisitions of qualifying holdings and passporting*
    - Collecting supervisory data
    - Resolution (Case T-502/19, Corneli v ECB,) three special dministrators and with a supervisory committee formed of three members
* Application of proportionality

Conclusion

Definition

proportionality does not mean lower or less conservative standards. Rather, it reflects the idea that rules and supervisory practices are commensurate with banks' systemic importance and risk profiles, and that they are appropriate for the broader characteristics of a particular financial system

The objective of proportionality is to reflect jurisdictions’ circumstances and supervisory capacity, not to dilute the robustness of the standards

Why application of proportionality is important:

* applying the principle of proportionality can help regulation to avoid negative side effects on financial inclusion. This is true for both activity-based – such as AML/CFT – and entity-based regulation – such as that for banking or insurance firms.
* If the simplified rules are properly defined, they could remain effective at preserving the safety and soundness of small institutions, but they would also reduce an otherwise disproportionately costly regulatory burden. To the extent those firms are often active only in specific local communities and provide financial services to agents that could have difficulties obtaining the same services from larger institutions, proportionate prudential regulation would facilitate financial inclusion.

Ở EU thiếu application

* With some notable exceptions, we currently more or less apply the same rules and procedures to all banks, irrespective of their size and their relevance for financial stability. In practice, this puts small institutions at a disadvantage compared to their larger peers. It runs counter to the idea of a level playing field and creates problematic incentives in terms of uniformity and size in the banking sector.
* When assessing potential areas for simplifications, we must weigh the benefits of regulation - that is, ensuring financial stability - against the burden it creates for the private sector. As a rule of thumb, we can say that any rules that are dispensable for effective supervision are up for debate.
* In short, the Court grants considerable deference to the policy goals determined by the Council and refrains from conducting a thorough substantive review of individual restrictive measures. As a result, the application of the proportionality principle loses significance, even in the face of violations of fundamental rights protected by the Charter.
* when carrying out the proportionality assessment, the Courts assign significant weight to the objective of the restrictive measure determined by the Council. A weighty and inherently vague objective will justify almost any act, and in a balancing test will always outweigh private interests. This renders the proportionality principle ineffective and creates an indirect restriction to judicial review

EU da khac phuc

* Fee methodology: EC comment 2023: ECB could have considered embedding more proportionality in its fee methodology. This has largely been achieved via the review of the Supervisory Fee Regulation10 that was implemented from the 2020 fee period onwards. The new process introduced, among other methodological improvements, a discount on the minimum fee component of the ECB supervision for smaller LSIs.

**Challenges:**

* Larger segments: In addition, successful financial inclusion policies may sometimes entail strengthening rather than alleviating some regulatory safeguards. For example, increasing the access of larger segments of the population to credit or payment facilities without sufficiently effective consumer protection rules could increase rather than reduce the vulnerability of some of the newly financially included individuals.
* NCA: Very importantly, national authorities may be reluctant to introduce a proportionate approach in their regulatory frameworks, if they perceive that this could affect their international standing. Their concern is that this approach may be perceived as less rigorous, thus tainting the jurisdiction’s reputation as a safe and sound place to do business. That could lead to efforts to adopt the full package of international standards with insufficient tailoring to the specific domestic situation and needs.
  + Turmoil: The turmoil also highlighted how the design of proportionality frameworks can impede effective supervision by reducing standards, increasing complexity and promoting a less assertive supervisory approach.
* **Reporting:**
  + As a general rule, smaller banks have to report fewer data points than larger banks. In numbers, that means 600 data points as opposed to almost 40,000. Still, I admit that the reporting burden remains too high for many smaller banks with simpler business models.
    - ways of streamlining our ad hoc requests for data
    - improve our advance communication to banks, so that our requests for information become more predictable and the feedback from our analyses more useful, also for internal risk management purposes
* **Climate change** 
  + climate change certainly poses risks to banks. There are two broad categories of new risk drivers. First, there are the physical risks. With climate change we will see more heatwaves, droughts, storms and other natural disasters. We already do. These disasters will lead to economic and financial costs, which might very well have an impact on the balance sheets of banks. Second, there are transition risks. Given that the economy will go from “brown” to “green”, some sectors might suffer – those which are carbon-intensive, for instance. And to the degree that banks are exposed to these sectors, they might suffer as well.
  + ECB is a member of the Network for Greening the Financial System. This network comprises 42 members – regulators, supervisors and central banks – from around the world.
* t is noteworthy to point out that certain competencies are attributed to the ECB irrespective of the dimensions and significance of the entity. An important example of an area in which the ECB is the sole competent authority concerns authorizations for new banks and financial institutions, as well as the authorization to acquiring qualifying holdings or control in such entities.2

Landeskreditbank

the landmark case of Landeskreditbank Baden-Württemberg (L-Bank) v. ECB, which centered on the ECB's classification of L-Bank as a "significant institution" subject to direct ECB supervision under the SSMR. L-Bank contested this classification, arguing that the ECB failed to adhere to the principles of proportionality and subsidiarity enshrined in Article 5(4) TEU.[[1]](#footnote-2)

L-Bank challenged the ECB's decision through the lens of proportionality. They asserted that the ECB, prior to designating them as significant, should have undertaken a nuanced assessment considering their “particular circumstances” within the meaning of Article 6(4) SSMR, including (i) their low-risk profile, (ii) among their multiple supervisory authorities, Germany NCA may satisfy the objectives of SSMR. Therefore, L-Bank should have been classified as a less significant institution under Article 70(1) of the SSM Framework Regulation for the best effect of safeguarding the objectives of the Basic Regulation.[[2]](#footnote-3) This assessment, according to L-Bank, would have necessitated an evaluation of whether national supervision could effectively achieve the objectives outlined in the SSMR to ensure the least onerous approach. If such an evaluation yielded an affirmative conclusion, L-Bank contended they should have been exempted from direct ECB oversight, thereby adhering to the principle of proportionality as enshrined in Article 5(4) TEU.[[3]](#footnote-4)

Furthermore, L-Bank invoked the principle of subsidiarity, arguing that the ECB's claim of supervising all entities under the SSMR, regardless of significance, clashed with this principle. They maintained that the ECB should prioritize national supervision unless it could demonstrably prove that direct ECB oversight served the objectives of the SSM more effectively. Here, L-Bank relied on Article 5(3) TEU, which outlines the principle of subsidiarity.

**The Court's Response:**

Both of the GC and CJEU acknowledged L-Bank's arguments, but ultimately ruled in favor of the ECB. With regards to proportionality, the Courts maintained that the only potentially jeopardized principle was the one enshrined in Article 291(1) TFEU, which assigns the responsibility of implementing Union law to MSs. The Courts further disagreed with L-Bank's interpretation of Article 70(1) of the SSM Framework Regulation. They argued that a case-by-case proportionality assessment was unnecessary due to (i) proportionality has already been considered by the EU legislature when establishing the SSM framework[[4]](#footnote-5); and (ii) the existence of clear criteria for identifying significant institutions within Article 6(4) of the SSMR[[5]](#footnote-6), including the €30 billion total asset threshold. Article 70(1) of the SSM Framework Regulation allows reclassification as "less significant" only in specific situations where national supervision can demonstrably achieve the goals of the Basic Regulation better than the ECB[[6]](#footnote-7). CJEU’s judgement aligns with AG Hogan's opinion that the EU legislature had already factored in proportionality when establishing the SSM framework:

the legislator has established a legislative scheme that needs to be respected and which envisages the conditions under which the banks are qualified as significant, and that the principle of proportionality cannot be deployed in a manner which would effectively undermine the *effet utile* of the legislative scheme.[[7]](#footnote-8)

On the issue of subsidiarity, the Court acknowledged its applicability but ultimately deemed it irrelevant. Their rationale rested on the premise that subsidiarity only applies in areas that do not fall within the EU's exclusive competence. Since the SSMR concerned the exercise of the ECB's exclusive competence in ensuring financial stability, the Court concluded that subsidiarity was inapplicable in this instance (Article 5(2) TEU).

without delving into whether conferred powers upon the ECB are well-founded in the Treaty provisions comply with the principles of subsidiarity and proportionality.

Annunziata elucidated that the applicant, L-Bank, concentrated its arguments on the interpretation of specific provisions within the SSMR and the Framework Regulation, rather than contesting their legitimacy. Consequently, it is unjustifiable to fault the GC and the CJEU for not examining the principle of proportionality's legitimacy. Nonetheless, the author contends that this case law has established a strong precedent for courts in recent cases involving ECB supervisory banks, indicating that there is no necessity to rigorously apply the three-limb test of proportionality. Markwardt argued that the ECB retains exclusive competency to assess an entity's significance and the adequacy of national supervision, with the EU courts likely favoring the ECB in future disputes. Crédit Mutuel Arkéa v ECB

Crédit Mutuel, a decentralized banking group, consists of local cooperative branches affiliated with regional federations, which in turn are affiliated with the Confédération nationale du Crédit Mutuel (CNCM). Crédit Mutuel Arkéa, a cooperative finance company, challenged its prudential supervision by the ECB through the CNCM and opposed the ECB’s SREP decision to increase the CET 1 capital ratio from 8% to 11%, later reduced to 10.75%, in accordance with Article 97 CRD IV, should it leave the Crédit Mutuel group. The applicant argued that this requirement was erroneous and disproportionate.

The GC.

Firstly, the GC determined that a joint and several liability mechanism exists within the Crédit Mutuel Group. This is evidenced by the CNCM's 10 March 1992 decision, which confirmed such a mechanism for distressed branches, including the applicant, necessitating CNCM intervention through interest-bearing advances, grants, or guarantees, applicable at both regional and national levels.[[8]](#footnote-9) Moreover, the applicant's rating agency report also acknowledged the presence of this joint and several liability mechanism.[[9]](#footnote-10) Therefore, the Court concluded that the ECB did not make a manifest error in assessing the potential adverse impact on the applicant's ratings and refinancing costs if such joint and several liability mechanism was no longer existed.

Secondly, the GC evaluated the adverse effects of transitioning the applicant's capital calculation method from the 'advanced approach' or 'Internal Ratings Based Approach,' which necessitates approval from the competent authority, to the 'standardised approach.' This shift would not only automatically escalate CET 1 capital requirements[[10]](#footnote-11) but also potentially result in a rating downgrade and a recognized decrease in CET 1 capital, as acknowledged by the applicant. Therefore, it is neither a manifest error nor disproportionate for the ECB to conclude that the applicant must prepare for this eventuality by establishing appropriate capital reserves.

***PNB Paribas v ECB[[11]](#footnote-12)***

The 2024 dispute revolves around the ECB's SREP decision mandating BNP Paribas, a French SI, to deduct the cumulative IPC amount intended for DGS or resolution funds from its CET 1, citing concerns about overstated CET 1 capital and inadequate risk management. The applicant submitted four pleas grounded in fundamental rights principles, including the principle of proportionality. However, none of them were upheld.

The applicant challenged the ECB’s decision through the lens of proportionality, advancing a three arguments. Firstly, the ECB failed to account for the improbable invocation of IPCs rendered the risk associated with them largely hypothetical and mitigated by prudential measures such as risk-weighted assets.[[12]](#footnote-13) Secondly, ECB's rejection of less onerous alternative measures, solely to obtain adequate information on the risks, resulted in unjustifiably adverse effects.[[13]](#footnote-14) Thirdly, the ECB's dismissal of the relevance of the applicant's capital adequacy, suggesting a blanket application of the deduction measure irrespective of individual capital sufficiency, contradicting the principle of proportionality.[[14]](#footnote-15)

The GC dismissed the applicant's initial contention regarding the speculative nature of IPC calls, asserting that it indeed resulted in the loss of economic resources.[[15]](#footnote-16) In response to the second argument, the GC found that (i) ECB did consider alternative measures such as those aimed at increasing capital requirements or restricting dividend distribution under Article 16(2)(a) and (i) respectively, but (ii) deemed them inadequate for ensuring the reporting of solely risk-bearing CET 1 capital.[[16]](#footnote-17) Lastly, the classification of capital adequacy as 'medium-low risk' was deemed irrelevant in challenging the proportionality of the deduction measure, as it failed to address the identified risk of capital overstatement.[[17]](#footnote-18)

This decision appears to present a discrepancy in outcomes compared to the 2020 decision PNB Paribas v ECB. However, this disparity is not attributable to conflicting judicial interpretations or interventions by the General Court, but rather to the factual distinctions between the cases. Both cases involve the deduction of IPC value from CET1 capital, alongside consideration of offsetting factors and application of the principle of proportionality by the GC. Nonetheless, in 2020 case, the ECB's failure to fulfill its obligation to conduct an individual supervisory review of the applicant, as required by Article 4(1)(f) and Article 16(1)(c) and (2)(d) of Regulation No 1024/2013, is evident. This deficiency stemmed from the ECB's narrow examination, which solely focused on identifying potential risks associated with IPC treatment as off-balance-sheet items, overlooking crucial aspects of the applicant's specific circumstances, such as its risk profile, liquidity level, and potential risk-mitigating factors.[[18]](#footnote-19) At that time, the risk is not identified as in the 2024 case.

***Ukrselhosprom PCF and Versobank v ECB***

The dispute was between Versobank AS, a less significant institution in Estonia whose primary shareholder is Ukrselhosprom PCF LLC and the ECB withdrawing the former’s authorization based on persistent breaches of anti-money laundering and counter-terrorism financing (AML/CFT) laws. Under Regulation No 1024/2013, the Finantsinspektsioon (FSA) identified these breaches during multiple inspections from 2015 onward. Despite a precept issued in 2016, Versobank failed to rectify the issues. Consequently, the ECB, following the FSA's proposal, determined that the withdrawal was appropriate, necessary, and proportionate due to the severity and continuity of the violations, and the ineffectiveness of less onerous measures.

Six out of twenty five pleas alleged by the applicants related to the breach of principle of proportionality. The applicants contended that (i) ECB’s withdrawal of authorization imposed an excessively severe measure for the regulatory non-compliance at issue under the objective of legality restoration, (ii) ECB misinterpreted the necessity criterion for the measure, and (iii) ECB's examination of the reasonableness of the measure was too abstract and failed to compare a specific regulatory objective (or public interest) with the private interests of the bank which was disproportionate. The applicants raised some alternative measures should have been done for less onerous effect, including change in the board of directors and suspension of the voting rights of shareholders, imposition of penalties or fines, cessation only unlawfully high-risk activities, self-liquidation or sale to other investors.

After reiterating the three-limbs test of proportionality[[19]](#footnote-20), the GC rejected all of these pleas. The GC concluded that the public interest, particularly restoring the public confidence in Estonian and European financial markets as soon as possible, overweight the private interest of the applicants considering their severe breaches.[[20]](#footnote-21) This assessment considered the number of breaches, the gravity and duration of the applicants' conduct and the opportunities afforded to rectify such unlawful behavior.[[21]](#footnote-22)

The GC contended that the ECB’s withdrawal of authorization was both necessary and proportionate, following a comprehensive and appropriate assessment of alternative measures in terms of their effectiveness and alignment with the intended objectives. Except for self-liquidation and sale to another investor, the alternative measures proposed by the applicants were deemed less effective than the withdrawal of authorization and inadequate for achieving the objectives within the shortest possible time[[22]](#footnote-23).

Firstly, Versobank's deficient corporate governance is both structural and irremediable[[23]](#footnote-24), rendering it impervious to mere alterations in commercial strategy, such as modifying the BOD or suspending voting rights. Firstly, despite three changes to the BOD, the breaches persist.[[24]](#footnote-25) Secondly, the cessation or suspension of voting rights of certain shareholders would be ineffective, as the controlling shareholders, who are also members of the supervisory board, could still exert significant influence over the bank's strategy, even without their voting rights[[25]](#footnote-26).

Secondly, penalties or fines are administrative pecuniary penalties, not equivalent to the withdrawal of authorization, especially cannot “achieve the objective of restoring confidence in the Estonian and European financial markets within the shortest possible period of time”.[[26]](#footnote-27)

Thirdly, the partial cessation of unlawful high-risk activities is impractical and ineffective. Versobank’s business strategy has consistently focused on non-resident and high-risk customers, as evidenced by its primary revenue being derived from these clients.[[27]](#footnote-28) Terminating this principal revenue source could lead to significant monthly operating losses, thereby jeopardizing the institution's viability[[28]](#footnote-29) and, consequently, posing a risk to its depositors. Furthermore, the applicants’ arguments disputing the second applicant’s non-compliance with the FSA’s first precept, by claiming vagueness and infeasibility, are rejected.[[29]](#footnote-30)

Self-liquidation or acquisition by another investor, despite their potential similar outcomes, would obscure the aims of withdrawing authorisation, encompassing both the restoration of legality and deterrence.[[30]](#footnote-31) These voluntary alternatives were deemed reasonable only for minor and/or mere constraints, but not for addressing severe infringements by the applicants.[[31]](#footnote-32) Additionally, the proposal for such alternatives were belated and only for the purpose of responding to FSA’s draft decision and ECB’s notification on withdrawing authorisation without any imminent signals of implantation.[[32]](#footnote-33)

***BAWAG PSK v ECB***

The case of *BAWAG PSK v ECB* centers on the ECB's oversight of banking operations, particularly concerning large exposures and the imposition of absorption interest. BAWAG PSK, an Austrian CI within the BAWAG group, acquired a portfolio of residential real estate loans in France in 2016. This acquisition prompted scrutiny by the ECB regarding the institution's overall exposure concerning the Vermeer portfolio. The ECB conducted an on-site inspection and found that BAWAG PSK lacked sufficient data to identify individual borrowers within the portfolio, thus affecting its compliance with the large exposure requirements stipulated in Article 395(1) CRR. Consequently, the ECB levied absorption interest totaling EUR 19,332,923.82 on BAWAG PSK for exceeding exposure limits, leading to legal proceedings disputing the proportionality of this action.

The GC's analysis primarily focused on the proportionality of the ECB's decision to levy absorption interest. It delved into several key aspects, including the discretion afforded to the ECB, the legal framework under Directive 2013/36, and the interpretation of national law, particularly Point 2 of Paragraph 97(1) of the BWG.

Initially, the court emphasized the discretion available to the ECB in applying administrative measures, highlighting the imperative to consider all relevant circumstances[[33]](#footnote-34). It recalled the *VTB Bank*’s teleological interpretation of Article 70 of Directive 2013/36 mandates such consideration, implying that the ECB has flexibility in deciding on the appropriateness of absorption interest based on the specifics of each case[[34]](#footnote-35). Furthermore, Article 65(1) of the same directive emphasizes that administrative penalties and other measures must be effective, proportionate, and dissuasive.

Subsequently, the court analyzed the legal foundation for discretion, finding support in both the wording of the BWG and Paragraph 99e of Section XXII, which aligns with Directive 2013/36.[[35]](#footnote-36) This alignment underscores the importance of a comprehensive assessment of circumstances before imposing administrative measures.[[36]](#footnote-37) Furthermore, the court dismissed the notion that acknowledging a margin of discretion would negatively impact the rights of the applicant[[37]](#footnote-38), asserting that legal principles do not restrict such discretion, regardless point 2 of Paragraph 97(1) of the BWG appeared to mandate automatic imposition of absorption interest.[[38]](#footnote-39)

The court criticized the ECB's reliance on an incorrect premise—the automatic application of Point 2 of Paragraph 97(1) of the BWG—which prevented it from fully considering the circumstances of the case.[[39]](#footnote-40) This failure compromised the lawfulness of the decision[[40]](#footnote-41). The court underscored the importance of the ECB employing its discretion to consider all pertinent factors, thereby ensuring conformity with relevant EU directives and upholding principles of fairness.

Finally, the court disregarded the ECB's argument on the proportionality of absorption interest, deeming it irrelevant due to the lack of proper consideration of circumstances in the decision-making process.[[41]](#footnote-42)

VQ v ECB

**SANCTION**

The sanctioning power of the ECB plays a crucial role in reinforcing its supervisory authority, as explicitly stated in recital 36 of the SSMR. To ensure that supervisory rules and decisions are adhered to by CIs, financial holding companies, and mixed financial holding companies, the ECB must impose effective, proportionate, and dissuasive penalties in cases of non-compliance. In line with Article 132(3) TFEU and Council Regulation (EC) No 2532/98, the ECB is vested with the authority to impose fines or periodic penalty payments on undertakings that fail to meet their regulatory obligations. This sanctioning power of the ECB is divided into direct and indirect powers.

Firstly, Article 18(1) of the SSMR, together with Article 124(1)(a) of the SSM Framework Regulation, grants the ECB direct supervisory power to impose administrative pecuniary penalties on ‘credit institutions, financial holding companies, or mixed financial holding companies,’ but excludes individuals from this scope. Consequently, infringements committed by natural persons are subject to the discretion of the NCAs rather than the ECB. However, the CRD VI amendments to Articles 65 and 66 address this gap by establishing maximum administrative penalties of EUR 5,000,000 and maximum periodic penalty payments of EUR 50,000 for individuals, particularly for members of the management body, senior management, key function holders, and other staff whose professional activities significantly impact the institution's risk profile as defined in Article 92(3) of the CRD. This legislative development reflects a broader trend towards increasing individual accountability within the EU and its MSs regulatory framework. An illustrative example of this trend is the introduction of the Senior Executive Accountability Regime and amendments to the Administrative Sanctions Procedure of the Central Bank of Ireland within the Individual Accountability Framework.

The ECB's 2021 guide on the methodology for setting administrative pecuniary penalties, in accordance with Article 18(1) and (7) of the SSMR, provides a more detailed framework. This methodology employs a two-step approach: first, determining the base amount of the penalty, and second, adjusting this base amount based on specific circumstances. In the initial step, the assessment factors include (i) the impact of the breach and the degree of misconduct, categorized as 'low', 'medium', or 'high', and (ii) the profits gained or losses avoided from such misconduct. In the subsequent stage, the base amount of the penalty may be adjusted considering factors such as cooperation with supervisory authorities, repetition of the offense, and the impact of the sanction on the financial capacity of the entity being penalized. The ECB is mandated to ensure that the penalties are effective, proportionate, and dissuasive.

However, it is difficult to say this guideline provides a comprehensive approach. Firstly, it lacks the suggestion of an automatic classification into one category of factors to the severity of penalties.[[42]](#footnote-43) This is evident from the language indicating that a breach 'may' be considered as belonging to one category or another, thereby implying that classification is neither automatic nor fully predetermined. Moreover, the proposed system anticipates only some of the possible scenarios, leaving the final classification undetermined for other potential configurations. Secondly, the methodology outlined in the 2021 ECB guideline does not account for infringements by natural persons. This omission is understandable, as the guideline was published prior to the enactment of CRD VI.

CRD VI has amended Article 66 to introduce periodic penalty payments and broaden the scope of penalties. This expansion covers not only issues related to authorization and acquisition of qualifying holdings, but also includes material transfers of assets and liabilities, mergers, divisions, and unauthorized activities. These changes aim to tailor penalties to specific types of misconduct, distinguishing between minor infractions and major violations. Moreover, CRD VI clarifies that periodic penalty payments do not exclude the imposition of administrative penalties or other measures for the same breach.[[43]](#footnote-44)

On the one hand, this provision enhances regulatory flexibility by allowing different types of penalties to be applied concurrently. On the other hand, the broadening of scope and the potential simultaneous implementation of periodic penalty payments indicate an enhanced significance of the compliance function within banks, thereby fostering increased regulatory enforcement activities. This supports Chaikovska’s proposition that as regulatory authorities in banking intensify their enforcement efforts, the role and importance of regulatory compliance within banks will correspondingly expand.[[44]](#footnote-45)

In particular, financial institutions are likely to encounter several significant challenges. Firstly, there will be an escalation in compliance costs as institutions strive to adhere to the expanded scope of regulations and avoid penalties. This will necessitate substantial resource allocation towards compliance departments, legal counsel, and external consultants. Additionally, the implementation and maintenance of systems to monitor and report compliance may elevate operational expenses. Secondly, smaller financial institutions may face a disproportionate burden compared to larger counterparts due to their limited resources. This could potentially place them at a competitive disadvantage, as SIs with greater resources are better equipped to manage the regulatory demands. Moreover, the increased regulatory burdens may prompt market consolidation within the industry, as LSIs could consider merging or being acquired as a strategy to cope with the escalating costs of compliance. Simply put, to some degree, the revision of Article 66 in CRD VI amplifies the consequences of the proportionality principle not aligning sufficiently with its intended purpose and legislative expectations.

Secondly, ECB has indirect sanctioning power as stated in Article 18 (5) SSMR:

‘the ECB may require national competent authorities to open proceedings […] appropriate penalties […] any relevant national legislation which confers specific powers which are currently not required by Union law. The penalties applied by national competent authorities shall be effective, proportionate and dissuasive.’

This means that the NCAs hold the discretion to decide on the existence and, a *fortiori*, the type and level of the sanction. In other words, the imposition of penalties is governed by national procedures, influenced by two factors: the relevant national legislation and the commitment of the NCAs in prosecuting the case.

Fromage raises significant concerns regarding the discretionary power vested in NCAs. A notable discrepancy exists between the ECB’s responsibilities for supervising SIs and its capacity to sanction them when they fail to meet their obligations. This discrepancy is further exacerbated by the divergent rules, practices, and regulatory cultures across different MS.[[45]](#footnote-46) Such a fragmented regulatory environment facilitates legal arbitrage and *forum shopping*, allowing entities to exploit differences between national regulations and supervisory practices to reduce their regulatory burden. Moreover, the potential for legal arbitrage introduces inconsistencies in enforcement and supervision, as NCAs may interpret and apply directives variably based on national contexts. These interpretive discrepancies result in an uneven regulatory landscape, subjecting SIs to varying degrees of scrutiny and potential sanctions depending on their geographic location. Howell aptly describes this situation as a ‘struggle to have any deterrent impact,’ highlighting the fundamental weaknesses in the current supervisory framework that undermine its efficacy and uniformity.[[46]](#footnote-47)

Allegrezza and Lasagni contended that the principle of proportionality is inadequate without the foreseeability of illicit conducts and their respective severity.[[47]](#footnote-48) Despite the SSMR's provision of a detailed procedure for fine calculation and the combination of various factors, the regulation fails to address this issue due to the absence of a clear taxonomy of infringements.[[48]](#footnote-49) This omission prevents potential infringers from anticipating which behaviors constitute infringements and the potential severity of penalties.

To address the above deficiency, the authors suggest looking to the ESMA and Commission guidelines in the competition sector as models.[[49]](#footnote-50) For instance, the Commission Guideline in competition law includes a list of behaviors deemed 'most harmful restrictions of competition' that are subject to 'heavy fines.'[[50]](#footnote-51) Similarly, ESMA provides an even more detailed framework, specifying not only the minimum and maximum penalties but also clearly defining and listing mitigating and aggravating circumstances along with their coefficients in the calculation method.[[51]](#footnote-52)

Besides measures listed in the Article 18 SSMR, Allegrezza and Voordeckers contended that the publication of decisions regarding administrative sanctions, including those under appeal, as ‘an additional form of punishment’, should be considered in light of the presumption of innocence under Article 6(2) ECHR to ensure proportionality.[[52]](#footnote-53) Early publication may expose entities to reputational risks that could lead to insolvency or severe financial distress.[[53]](#footnote-54) However, Recital 11 of Directive 2016/343 explicitly states that the presumption of innocence does not apply to administrative proceedings in financial services. Furthermore, Hayden argued that ECB sanctions do not qualify as 'civil rights and obligations' under Article 6 ECHR, as they do not fit into the ECHR’s established case groups.[[54]](#footnote-55) ECB sanctions have a criminal nature due to their punitive aspect but lack the severe societal condemnation typical of 'core criminal law' violations. Despite potential negative publicity, these sanctions are not considered part of the 'hard core' of criminal law and are thus seen as peripheral.[[55]](#footnote-56)

Furthermore, after analyzing the CJEU’s decision in VQ case, Lasagni contendeded that establishing the imperative of anonymization to mitigate disproportionate harm during the publication of sanctions poses considerable difficulty, underscoring persistent ambiguities in harmonizing regulatory measures with the principle of proportionality.[[56]](#footnote-57) According to Article 132(1) SSMR, non-anonymization is permissible only when there is a risk to financial market stability or ongoing criminal investigations, or when it might disproportionately harm the supervised entity. In practice, the CJEU places the onus on the credit institution to provide evidence that anonymization is necessary to avoid disproportionate harm, yet the criteria for ECB assessment lack clarity.

Direct sanctioning power allows the ECB to directly impose administrative pecuniary penalties on legal entities, while indirect sanctioning power involves requesting NCAs to impose penalties on natural persons and other cases outside the ECB’s immediate jurisdiction. This dual mechanism ensures a comprehensive enforcement framework that upholds the integrity of the supervisory system and enhances compliance across the Eurozone.

**ASSESSING THE SIGNIFICANCE**

The principle of proportionality is upheld in the classification of CIs through a structured assessment process, where Joint Supervisory Teams (JSTs) evaluate Significant Institutions (SIs) based on their fulfillment of established significance criteria, while NCAs assess Less Significant Institutions (LSIs) based on specific criteria, including size, economic importance, cross-border activity, public financial assistance, and ranking among the top three credit institutions in an MS.[[57]](#footnote-58)

A CI is designated as a SI if it meets any of the following conditions outlined in Article 6(4) of the SSM: (i) possessing total assets exceeding €30 billion; (ii) holding substantial economic importance for the EU or a participating MS; (iii) having total assets over €5 billion with cross-border assets/liabilities in more than one MS exceeding 20% of total assets/liabilities; (iv) either requesting or receiving funding from the ESM or EFSF. Furthermore, a CI can be classified as significant if it is among the three most significant banks in a particular MS.

***High-risk and high-impact LSIs***

The ECB's revised methodology of classifying LSIs exemplifies the application of the proportionality principle by tailoring regulatory scrutiny based on an institution's risk and impact.[[58]](#footnote-59) Previously, the ECB categorized LSIs into low, medium, and high priority based on size, intrinsic risk, economic impact, and interconnectedness with the financial system. However, since 2022, the ECB, as part of its guidelines in compliance with EBA Guidelines for SREP,[[59]](#footnote-60) has refined this approach by distinguishing LSIs into high-risk and high-impact categories.

The impact is annually evaluated based on criteria including size, economic importance, cross-border activities, and business model and publicly disclosed.[[60]](#footnote-61) In 2022-2023, a LSI is classified as high-impact if it meets any of the following criteria:

1. its total assets exceed €15 billion;
2. its total assets constitute more than 15% of the country’s GDP, or it qualifies as an "other systemically important institution" (O-SII) under the CRD;
3. it is categorized as a "large institution" according to CRR II;
4. it owns one or more credit institutions in other participating countries; or it functions as a financial market infrastructure with a banking license, central savings bank, central cooperative bank, or as the central institution of an institutional protection scheme.
5. If fewer than three high-impact LSIs are identified using these criteria, the minimum coverage rule is invoked, requiring additional LSIs to be selected based on size until at least three high-impact LSIs are identified within the jurisdiction.

In contrast, the risk is quarterly assessed through evaluations conducted by the relevant NCA and their adherence to capital and leverage requirements. The risk assessment remains confidential to ensure financial stability and maintain confidentiality.[[61]](#footnote-62)

The designation of an LSI as high-impact and high-risk is a critical consideration for NCAs in determining the scope and frequency of supervisory activities, such as the SREP and on-site inspections. This classification also mandates that NCAs notify the ECB of significant supervisory actions or decisions they plan to undertake regarding these institutions, as outlined in Articles 97 and 98 of the SSMFR. By implementing distinct risk and impact assessments, the ECB ensures that regulatory efforts are tailored to the individual characteristics of each institution, promoting proportionate supervision that enhances financial stability.

***Small and non-complex institution***

Besides high-impact and high-risk LSI, Article 2(145) of the CRR II introduces the definition of a small and non-complex institution (SNCI). A SNCI has the discretion to choose a simplified version of the NSFR requirement.[[62]](#footnote-63) Accordingly, a SNCI must satisfy certain criteria, including not being classified as a large institution under Article 2(146), adhering to specific asset thresholds, limitations on the size of the trading book and derivative positions, constraints on geographic activity, and compliance with simplified regulatory requirements.

Nevertheless, these criteria appear insufficient to align with the high level of proportionality envisioned by BCBS in Basel III Reform 2017. In particular, the criteria fail to encompass all exposures to all financial products and would benefit from utilizing a volume threshold rather than an exposure threshold.

Firstly, the current definition of SNCI inadequately captures the full spectrum of financial products that can introduce significant risks. Instruments such as stocks, securitizations, and derivatives each have distinct risk profiles, encompassing market risk, liquidity risk, and counterparty risk. The principle of proportionality, as stipulated in Article 2(145)(i), mandates that regulatory requirements should be commensurate with an institution’s size, complexity, and risk profile. Focusing solely on derivatives exposure, without incorporating specific thresholds for stocks and securitizations, may lead to an incomplete assessment of an institution's risk exposure. Basel III Reform’s call for a broader risk segmentation framework, encompassing securitizations and stocks alongside derivatives, acknowledges the diverse risk profiles of different instruments. Implementing specific thresholds for these products would enable regulators to establish a more comprehensive and nuanced framework for risk measurement within the SNCI category.

Secondly, Joosen and Lehmann argued that volume thresholds offer a more nuanced approach to proportionality for SNCIs in derivatives regulation compared to exposure thresholds.[[63]](#footnote-64) The current exposure thresholds, while simpler to measure, may underestimate the complexity and operational risks associated with high-volume trading. In contrast, volume thresholds capture the intensity and operational complexities of derivatives trading, providing a more precise picture of market engagement and risk exposure. This ensures regulatory oversight aligns with actual trading activities, avoiding the potential obfuscation of risks inherent in solely considering net exposure. By reflecting the true scale and frequency of market activities, volume thresholds facilitate a more accurate assessment of an institution's risk profile. This targeted approach ensures that regulatory burdens are commensurate with the institution's level of activity and complexity.

Both aforementioned approaches strengthen risk management precision and effectiveness while upholding proportionality. They ensure regulatory fairness by tailoring oversight and requirements to an institution's actual risk profile. This targeted approach fosters a more robust financial system by comprehensively addressing diverse risks in a nuanced manner.

**NPL**

The ECB's Guidance to banks on Non-Performing Loans (NPLs) pertains primarily to SIs and banks characterized by elevated NPL ratios exceeding the EU average and varying coverage levels, as indicated in the quarterly published EBA risk dashboard. These CIs are instructed to allocate an appropriate and proportionate degree of managerial focus and resources towards the resolution of NPLs and the enhancement of related internal controls.[[64]](#footnote-65) The guidance emphasizes the implementation of internal targets and rigorous JSTs’ oversight, aimed at ensuring sustained advancements in NPL resolution.[[65]](#footnote-66)

In terms of internal targets, the ECB guidelines predominantly incorporate qualitative criteria aligned with the proportionality principle. This principle ensures that banking protocols and responses are suitably calibrated relative to the intricacies, scale, and complexity inherent in each scenario. Notably, customized procedures tailored to distinct arrear stages (pre-arrears, early arrears, and late arrears) and diverse debt recovery options (such as voluntary asset sale, foreclosure, and debt collection) exemplify the customized approach to varying severity levels and complexities. Secondly, explicit approval thresholds and authority levels governing write-offs and forbearance solutions are established to match the magnitude and risk profile of exposures, thereby moderating impacts on capital while ensuring commensurate oversight. Thirdly, the allocation of human and technological resources, alongside the involvement of specialized professionals (including credit officers, legal experts, and real estate specialists), is calibrated according to the complexities and scale of NPL portfolios. This ensures that resources are commensurate with the demands of each case. Fourthly, decision-making processes are grounded in comprehensive assessments encompassing collateral assessments, legal documentation, borrower profiles, market conditions, and historical recovery rates, thereby ensuring actions are contextually appropriate and proportionate to specific circumstances and potential outcomes. Lastly, regular adjustments in risk management and provisioning practices are underscored through regular back-testing of financial loss, annual methodological reviews, and meticulous monitoring and reporting obligations. These practices collectively underscore how the ECB's guidelines on NPL management integrate the principle of proportionality, thereby tailoring interventions to the distinctive attributes of each situation.

Regarding oversight through JSTs, ongoing engagements reveal divergent approaches among banks concerning the identification, measurement, management, and write-off procedures for NPLs.[[66]](#footnote-67) Indeed, a high-level group on non-performing loans was commissioned by the ECB's Supervisory Board in July 2015, comprising staff from the ECB and NCAs, tasked with developing a unified supervisory approach to NPLs.[[67]](#footnote-68) High NPL banks are mandated to furnish their NPL strategies, including operational plans, to their JSTs annually by each year first quarter.[[68]](#footnote-69)

Besides the Guidance on NPLs, the ECB utilizes primarily moral persuasion to prompt banks to adopt cautious provisioning practices related to credit risk, encompassing NPLs.[[69]](#footnote-70) The ECB articulates supervisory expectations as a means to convey the intended objectives. For instance, amid the onset of the COVID-19 pandemic, the ECB sent letters to CEOs of SIs, providing supplementary guidance and outlining supervisory anticipations pertaining to the management of credit risk.[[70]](#footnote-71)

The necessity for the ECB to consider carefully the proportional reduction of NPLs to manage credit risk effectively without adversely impacting smaller banks is crucial. While EU financial regulations allow some discretion for NCAs in supervising NPLs of LSIs, the ECB's increasing inclination towards direct supervision of LSIs suggests that future guidance on NPLs may need to include specific provisions to protect these smaller entities.

A case in point is the Bank of Italy's 2018 guidelines for Italian LSIs, which emphasize the expectation of realistic and well-supported NPL disposal strategies, such as direct selling of NPL portfolios and securitization. However, these approaches pose significant challenges for smaller banks due to investor preference for larger portfolios and the high fixed costs of securitization.[[71]](#footnote-72) Furthermore, the inherent time pressures associated with aforementioned strategies can create tension with the requisite timeframe for identifying qualified counterparties, performing comprehensive portfolio evaluations, and honoring exclusivity agreements commonly demanded by investors.[[72]](#footnote-73) In contrast, Ireland's more measured approach, acknowledging the protracted nature of NPL resolution even during economic growth, has yielded positive results. This strategy, which aligns with accepting NPL resolution as a long-term endeavor, led to a substantial reduction of NPLs by €50 billion, or 58% from peak levels in its crisis, over fourteen consecutive quarters.[[73]](#footnote-74)

Therefore, future ECB NPL management guidelines should strike a balance between the urgency of NPL reduction and the operational realities of smaller banks. This ensures that NPL management practices do not disproportionately disadvantage these institutions.

1. Case C-450/17 P *Landeskreditbank Baden-Württemberg v ECB* [2019] ECLI:EU:C:2019:372, para. [↑](#footnote-ref-2)
2. Ibid, para.36. [↑](#footnote-ref-3)
3. Ibid, para.35. [↑](#footnote-ref-4)
4. Ibid, para.59. [↑](#footnote-ref-5)
5. Ibid, para.76. [↑](#footnote-ref-6)
6. Ibid, paras.80-81. [↑](#footnote-ref-7)
7. Ibid, Opinion of AG Hogan, paras 57, 61 and 62. [↑](#footnote-ref-8)
8. Ibid, paras. 135-137. [↑](#footnote-ref-9)
9. Ibid, para. 196. [↑](#footnote-ref-10)
10. Ibid, para. 203. [↑](#footnote-ref-11)
11. Case T-186/22 *BNP Paribas v ECB* [2024] ECLI:EU:T:2024:353. [↑](#footnote-ref-12)
12. Ibid, para. 107. [↑](#footnote-ref-13)
13. Ibid, para. 108. [↑](#footnote-ref-14)
14. Ibid, para. 109. [↑](#footnote-ref-15)
15. Ibid, paras. 115, 119. [↑](#footnote-ref-16)
16. Ibid, para. 117. [↑](#footnote-ref-17)
17. Ibid, para. 121. [↑](#footnote-ref-18)
18. Cases T‑150/18 and T‑345/18 *BNP Paribas v ECB* [2022] ECLI:EU:T:2020:394, paras. 81-82. [↑](#footnote-ref-19)
19. Case T-351/18 *Ukrselhosprom PCF and Versobank v ECB* [2021] ECLI:EU:T:2021:669, paras. 307-308. [↑](#footnote-ref-20)
20. Ibid, para. 319. [↑](#footnote-ref-21)
21. Ibid, paras. 317-321. [↑](#footnote-ref-22)
22. Ibid, para. 323. [↑](#footnote-ref-23)
23. Ibid, para. 324. [↑](#footnote-ref-24)
24. Ibid, para. 311. [↑](#footnote-ref-25)
25. Ibid. [↑](#footnote-ref-26)
26. Ibid, para. 323. [↑](#footnote-ref-27)
27. Ibid, para. 327. [↑](#footnote-ref-28)
28. Ibid, para. 311. [↑](#footnote-ref-29)
29. Ibid, para. 334. [↑](#footnote-ref-30)
30. Ibid, para. 328. [↑](#footnote-ref-31)
31. Ibid, para. 328. [↑](#footnote-ref-32)
32. Ibid, para. 327. [↑](#footnote-ref-33)
33. Case T‑667/21 *BAWAG PSK v ECB* [2024] ECLI:EU:T:2024:131, para. 68. [↑](#footnote-ref-34)
34. Ibid, para.67. [↑](#footnote-ref-35)
35. Ibid, paras.72-73. [↑](#footnote-ref-36)
36. Ibid, para.74. [↑](#footnote-ref-37)
37. Ibid, para.78. [↑](#footnote-ref-38)
38. Ibid, para. 71. [↑](#footnote-ref-39)
39. Ibid, para. 79. [↑](#footnote-ref-40)
40. Ibid, para. 81. [↑](#footnote-ref-41)
41. Ibid, para. 83. [↑](#footnote-ref-42)
42. Diane Fromage, ‘The ECB’s guide on pecuniary penalties in banking supervision: Increased transparency on its (still) limited powers’ [2021] 60 EU Law Live Weekend Edition, 3. [↑](#footnote-ref-43)
43. CRD VI [↑](#footnote-ref-44)
44. Ivanna Chaikovska, ‘Enforcement actions of banking supervision authorities in European Union : non-compliance with post-crisis banking regulations’ [2020] International Journal of Arts and Sciences 111. [↑](#footnote-ref-45)
45. Diane Fromage, ‘The ECB’s guide on pecuniary penalties in banking supervision: Increased transparency on its (still) limited powers’ [2021] 60 EU Law Live Weekend Edition, 5. [↑](#footnote-ref-46)
46. Elizabeth Howell, 'The Evolution of ESMA and Direct Supervision: Are There Implications for EU Supervisory Governance' [2017] 54(4) Common Market Law Review, 1056. [↑](#footnote-ref-47)
47. Silvia Allegrezza and Giulia Lasagni, ‘The enforcement of ECB sanctions in light of the proportionality principle: Is there a need for a guide to define a solid legal framework’ [2024] 61 Common Market Law Review, 682. [↑](#footnote-ref-48)
48. Ibid. [↑](#footnote-ref-49)
49. Ibid, 685. [↑](#footnote-ref-50)
50. Ibid, 684. [↑](#footnote-ref-51)
51. Ibid. [↑](#footnote-ref-52)
52. Silvia Allegrezza and Olivier Voordeckers, ‘Investigative and Sanctioning Powers of the ECB in the Framework of the Single Supervisory Mechanism: Mapping the Complexity of a New Enforcement Model’ [2015] Eucrim, 157. [↑](#footnote-ref-53)
53. Juliette J.W. Pfaeltzer, ‘Naming and Shaming in Financial Market Regulations: A Violation of the Presumption of Innocence?’ [2014] 10(1) Utrecht Law Review, 143. [↑](#footnote-ref-54)
54. Helene Hayden, ‘Enforcement of Fines and Other Pecuniary Obligations Imposed by the ECB (Part I): European Level’ [2021] 18(6) European Company and Financial Law Review, 1011-1050. [↑](#footnote-ref-55)
55. Ibid 1042. [↑](#footnote-ref-56)
56. Giulia Lasagni, ‘The enforcement of ECB sanctions in light of the proportionality principle: Is there a need for a guide to define a solid legal framework’ [2024] 61 Common Market Law Review, 690. [↑](#footnote-ref-57)
57. CRD IV, Art 97(4). [↑](#footnote-ref-58)
58. ECB, ‘Supervisory approach and methodologies’ (*European Central Bank – Banking supervision* 2024) <<https://www.bankingsupervision.europa.eu/banking/lsi/approach/html/index.en.html#snci>> accessed 10 July 2024. [↑](#footnote-ref-59)
59. Mario P. Chiti, Marco Macchia and Andrea Magliari, ‘The Principle of Proportionality and the European Central Bank’ [2020] 26(3) European Public Law, 672. [↑](#footnote-ref-60)
60. ECB, *ECB Annual Report on Supervisory activities* [2021], 51. [↑](#footnote-ref-61)
61. ECB, *LSI supervision report 2022* [2022] 8. [↑](#footnote-ref-62)
62. [↑](#footnote-ref-63)
63. Bart Joosen and Matthias Lehmann, ‘Proportionality in the Single Rule Book’ in Mario P. Chiti and Vittorio Santoro (eds) *The Palgrave Handbook of European Banking Union Law* [Palgrave Macmillan 2019]. [↑](#footnote-ref-64)
64. ECB, *Guidance to banks on Non-Performing Loans* [2017], 23. [↑](#footnote-ref-65)
65. CBI, Non-Performing Loans: The Irish perspective on a European problem - Deputy Governor Ed Sibley’ (*CBI,* 22 September 2017) < <https://www.centralbank.ie/news/article/non-performing-loans-dg-ed-sibley21Sept2017>> accessed 10 July 2024. [↑](#footnote-ref-66)
66. ECB, *Guidance to banks on Non-Performing Loans* [2017], 4. [↑](#footnote-ref-67)
67. Ibid, 5. [↑](#footnote-ref-68)
68. Ibid, 17. [↑](#footnote-ref-69)
69. Commission, ‘Report on the Single Supervisory Mechanism established pursuant to Regulation (EU) No 1024/2013’ [2023] COM(2023) 212 final, 5. [↑](#footnote-ref-70)
70. Ibid, 6. [↑](#footnote-ref-71)
71. Enrica Bolognesi and others, ‘Non-performing loans and the cost of deleveraging: The Italian experience’ [2020] 39(6) Journal of Accounting and Public Policy, 4. [↑](#footnote-ref-72)
72. Ibid. [↑](#footnote-ref-73)
73. CBI, Non-Performing Loans: The Irish perspective on a European problem - Deputy Governor Ed Sibley’ (*CBI,* 22 September 2017) < <https://www.centralbank.ie/news/article/non-performing-loans-dg-ed-sibley21Sept2017>> accessed 10 July 2024. [↑](#footnote-ref-74)