



Frankfurt, November 2016

**KfW Research**

Papers and Proceedings on Economics

# »» Regulation of Promotional Banks and potential impacts

Bank aus Verantwortung

**KFW**

## **Imprint**

Published by  
KfW Bankengruppe  
Palmengartenstraße 5-9  
60325 Frankfurt am Main  
[www.kfw.de](http://www.kfw.de)

Authors:  
Dr Harald Lob  
Julia Schneider-May  
David Kauffmann

Picture credits  
Source: Getty Images / Photographer: Marcel ter Bekke

Frankfurt am Main, November 2016

# Regulation of Promotional Banks and potential impacts

## 1. Introduction

Roughly eight years since the start of the great financial crises and seven years after the collapse of a big investment bank in the USA the consequences are not limited to the financial sector: the recession that followed was both deep and prolonged and was in line with other recessions after financial turmoils.<sup>1</sup>

The post-crisis regulatory agenda was and still is set by the heads of governments and states and all in all the standard setters delivered in time.<sup>2</sup> The new regulation comprises higher and better capital, liquidity requirements, changes to rules on corporate governance, including remuneration and a standardized regulatory reporting. The new regulation is addressing liquidity risk, constraining leverage and excessive concentration and is headed by a macro-prudential chapter and some new institutions acting as a supervisor or a resolution agency. The Basel Committee is enhancing supervision and promoting consistent global implementation of its framework.<sup>3</sup>

It is too early to conclude that the new prudential regulation is completely designed: the Basel Committee still continues its work. With its press release of January 11, 2016 the Basel Committee endorsed the new market risk framework as a result of the fundamental review of the trading book and announced to complete its work regarding the excessive variability in risk-weighted assets including the strengthening of standard approaches and reducing the meaning of internal models.<sup>4</sup> More generally the use of models, the quality of data and disclosure requirements are discussed. The aim is to strike an appropriate balance between simplicity, comparability and risk sensitivity.<sup>5</sup>

Most enlightened people know that all the reforms will almost certainly not prevent future financial crises. But the aim of the reform should be to make the whole financial system, including banks, insurance companies, stock exchanges and other participants, more resilient in the face of shocks without restricting competition and innovation. We “do not want the stability of the graveyard”.<sup>6</sup>

In this article we will focus on the prudential treatment of regional, national and multilateral promotional/development banks in Europe. This group is hard to be designed<sup>7</sup>: Entities are quite different in size, scope, ownership and the respective business models. But these entities play an important role in long term financ-

ing of the real economy, the support of public policy and have an anticyclical and stabilizing role.<sup>8</sup>

Since 2015 the prudential regulation of public development banks differs. We look for some central arguments to find the key elements for an appropriate regulation. So we will only focus on some aspects and leave others outside: We will not deal with statistical requirements (AnaCredit), macroprudential issues, Pillar III of Basel and all aspects of consumer protection, given the clear role of the public sector entities. Instead we will focus on the development of regulatory framework in Pillar I and II and the regulation and impacts for development banks and the real economy.

To ensure the goals, set by the heads of governments and states, development banks may and should play an appropriate role which requires an appropriate regulation, dealt with in section 4.

## 2. Development of a regulatory framework

As a result of the financial crisis the regulatory framework has been reformed comprehensively. Not only the regulatory requirements itself were extended with the implementation of Basel III but also the regulatory environment was changed with the foundation of the European Banking Union and the adoption of the responsibility for the banking supervision by the ECB. The target was to reassure a maximal harmonization of regulation and shall support a more prudential and preventive supervision for all banks clustered into different groups. Such groups are for instance global systemic relevant banks, national systemic banks and less-significant banks.<sup>9</sup> The reform package of Basel III included a single rule book which is composed of a binding regulation and a directive which has to be transformed into national law.<sup>10</sup>

Although some of them still have a special regulatory regime, development banks are part of these clusters and regulation increasingly impairs on these banks and their business model. In order to understand the regulatory changes and to get an overview on the most recent discussions, the following section will introduce the major regulatory amendments according to Basel III and the Banking Union. In addition it covers the most recent reforms regarding risk modelling of banks which from a regulator's perspective are still to be interpreted as post-crisis measures.

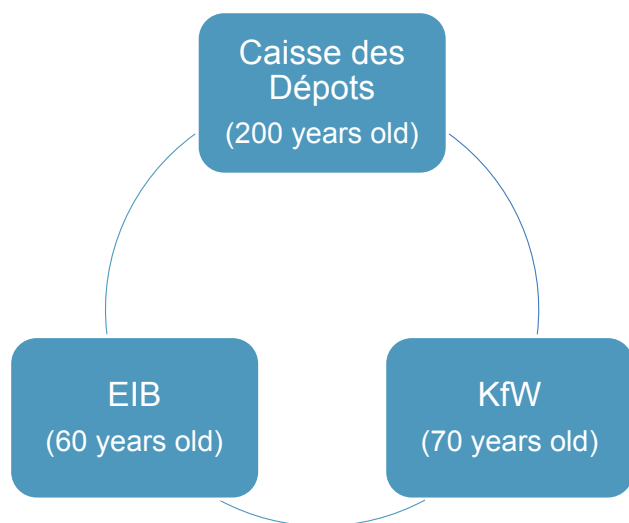
Prior to this, to give a concise interpretation of the ac-

tual prudential regulation for national and multinational promotional banks we need an accepted framework. This framework can be designed in different ways.

One approach is to start with the overwhelming goals of prudential regulation: depositor protection, to de-risk the financial system by avoiding concentration risks, improving resilience and taming the business and the financial cycle. Other goals are consumer protection by approving different products and the control of remuneration in the banking sector to avoid systems of moral hazards. These different goals can be summarized by micro- and macroprudential policies. The very few mentioned contributions show that this approach is still “under construction” to create a feasible concept.

The approach used in this article is different. We take the political normative decisions as a given choice to guarantee the goals above. We use a regulatory triangle with

**Figure 1: Regulatory Triangle**



Source: Diagram by author.

as points of reference. Indeed, CDC shows a unique business model, but has served as role model for some of its activities for institutions in Italy, Morocco and Canada. European Investment Bank shows – for our purposes – the same features as CEB in Paris and EBRD in London. As to KfW: After 1989 KfW was a role model for new institutions in the former COMECON member states: for example in Hungary and Poland. Some new entrants in the EU also set up a national development bank, and last not least: KfW gave advice to Portugal, Ireland, the UK and Malta.

To design the framework we start with the self-assessment of the institutions: CDC, EIB and KfW.

CDC sees its special role defined by the role as a state agency, set up by a special legislation. The unique governance model was created to allow CDC to serve the general interest and the economic development in France. A special focus is put on the idea that CDC is a long term investor. External ratings follow exactly the rating of France, the risk weighting according to the Basel Accord and the European Capital Requirements Directive (CRD IV)/Capital Requirements Regulation (CRR) is 0. The LCR is confirmed and CDC has access to the purchase programmes from ECB.

Taken these key words we find similar ideas in EIB-documents:

- ownership,
- role as an instrument of public policies,
- clearly defined and limited tasks,
- the idea of long term orientation,
- the 0-Risk Weighting in the Basel Accord and CRD/CRR and
- special relations to the ECB.

As EIB was set up on the business model of KfW the same applies to KfW.

Regarding these 3 institutions from a conceptual point of view and looking at the rules, the procedures and the institutions implied, we can roughly say:

None of these institutions have to apply in depth special rules of investor, borrower and consumer protection. None is obliged to set up recovery and resolution plans and pillar 3 of Basel is not mandatory.

With regard to institutions, none has a direct contact to the ECB as a banking supervisory agency. And as no resolution plans are required, the SRB is not part of the prudential supervision of these entities.

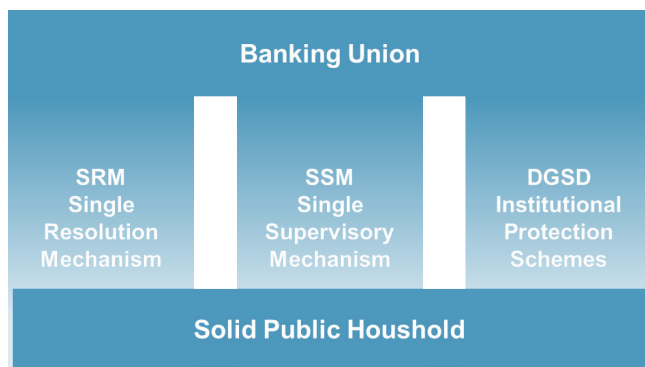
To sum up: A special role places these institutions in another relevant market than that of commercial banks. Taken the normative choice, we can focus on Pillar 1 and 2 and we can compare the practices to define best solutions.

## 2.1 Single Supervisory Mechanism

The banking union contains three pillars, the Single Supervisory Mechanism (SSM) as central pillar of the banking union reassures a banking supervision under

the responsibility of the ECB. It stands for transparency and cross-border activity. This new macroprudential supervision shall guarantee a preventive and proactive supervision which applies same rules and standards.<sup>11</sup> The second pillar, the Single Resolution Mechanism (SRM) was established to reassure an orderly resolution with a prevalence of liability of the owners and creditors of banks in order to protect the taxpayers. Lastly, the third pillar addressing the Deposit Guarantee Schemes Directive (DGSD) has been further harmonized in 2014, negotiations are in progress.

**Figure 2: Banking Union**



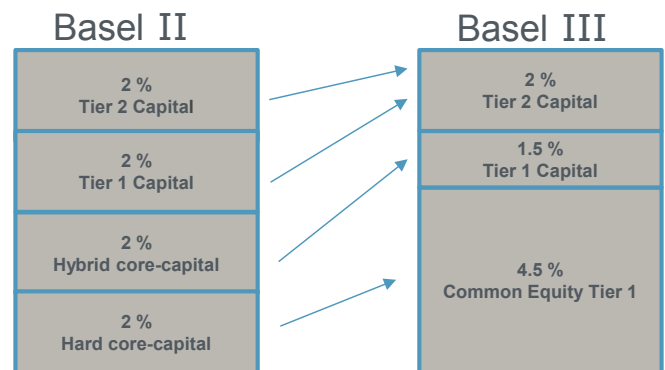
Source: German Ministry of Finance, 2014 Monatsbericht June 20, 2014.

The harmonization within the Single Supervisory Mechanism is realized by centralizing the responsibility for the banking supervision within the ECB for banks which have been classified as significant. The ECB now directly supervises 129 banks in cooperation with the national authorities by means of establishing so-called Joint Supervisory Teams. Furthermore, the single rule book serves as uniform regulatory framework and includes, inter alia, the CRD IV and the CRR.<sup>12</sup> The common approach due to centralization and the application of the single rule book shall assure unified supervision and corrective measures. Therefore, the SSM shall guarantee a consequent application of regulations and prudential policies.

## 2.2 Capital requirements

A core element of Basel III was the requirement for capital with greater quality and size and the strengthening of the liquidity position. With regard to capital the focus is laid on Common equity tier 1 which includes mostly paid-in capital, retained earnings and other reserves as a crucial ratio. The quality of capital has been increased by inter alia abolishing hybrid instruments as regulatory capital and by increasing the minimum requirements.

**Figure 3: Evolution of capital requirements**



Source: Deutsche Bundesbank, 2013, Monthly Report June 2013.

Apart from that CRD IV introduced several capital buffers in order to increase the loss absorption capacity, risks coming from counter-cyclical developments on the capital market and the economy, systemic or macroprudential risks or risks which occur due to failures of systemic banks. The following table shows the possible size of buffers which have to be contained out of Common Equity Tier 1 capital.

**Table 1: Combined capital requirements**

Buffer	Size (CET 1)
Capital conservation buffer Art. 129 CRD IV	2.5 %
Counter cyclical buffer Art. 130, 135 ff. CRD IV	0–2.5 %
Systemic risk buffer Art. 133 ff. CRD IV	0–5 %
Buffer for global systemic relevant banks Art. 131 CRD IV	1–3.5 %
Buffer for national systemic banks Art. 131 CRD IV	0–2 %
Possible Sum	10 % <sup>13</sup>

Together with the minimum requirement the total capital requirements can easily sum up to 18 %. Apart from the capital conservation buffer, all other buffers are subject to supervisory discretion or depend on the composition of the bank's portfolio, respectively. This does not yet include TLAC<sup>14</sup> or MREL<sup>15</sup> or the SREP<sup>16</sup> buffer. The supervisory authorities perform a yearly supervisory review and evaluation process. The framework for the SREP has been modified and extended by the EBA in 2014 and by the ECB since it took over the responsibility. Within this process quantitative and qualitative deficiencies as well as not covered risks will be addressed with an additional, bank-specific SREP-buffer. As a consequence of Basel III and continuing supervisory amendments the capital requirements for banks have more than doubled. Moreover, the implementation of the leverage ratio puts



pressure on the banks - some more than others according to the business model - to deleverage their balance sheet.

In addition to the increase of requirements for capital ratios, Basel III requires banks to take certain deduction from capital. Therefore, under Basel III the capital base is additionally strained by for instance deduction of capital held in non-consolidated participations, deferred tax assets, losses of the current year, value adjustment deficits and certain benefits from pension plans.<sup>17</sup>

### 2.3 Major reforms on RWA side

Having primarily addressed the requirement for capital ratios and the numerator within Basel III the Basel Committee recently focuses on the denominator and consults continuously new requirements on the modeling of risks which again will most likely result in more need for capital. According to the statement of Mr. Dombret to the *Börsenzeitung* the ongoing reforms are still linked to post-crisis measures and are not to be interpreted as Basel IV.<sup>18</sup> The aim of the Basel Committee is to reduce RWA variability in the banking industry. While Basel II promoted the confrontation of banks with their own individual risk situation and therefore supported the development of internal models the Basel Committee now goes into the opposite direction and partly forbids the use of internal models or makes it more unattractive, increasing the importance of standardized approaches again. This means for banks that they have spent huge sums of money to develop internal models for example for operational risks in times where low interest margins burdened the profit situation with the consequence to return to the standardized approach again.

Since 2014 the Basel Committee published inter alia a new framework for market risk, a revision of the standard approach for operational risk and a revision of the standardized approach for credit risk. The fundamental review of the trading book includes a revised boundary between the trading book and banking book, a revision of the internal models approach for market risk and the standardized approach for market risk, a shift from value-at-risk to an expected shortfall measure of risk under stress and an incorporation of the risk of market illiquidity.<sup>19</sup> A first quantitative impact study of the Basel Committee itself identified an increase in capital need for market risk of in average 22 %.<sup>20</sup>

The amendments for operational risk modelling include the replacement of the current non-model-based approaches, which comprise the Basic Indicator Approach (BIA) and the Standardized Approach (TSA)

with a modified Alternative Standardized Approach (ASA). Furthermore, it shall remediate weaknesses identified in the existing approach. The own funds requirements depend on the total size of the business and historical loss data. Especially for large institutions the modified OpRisk will lead to higher capital need due to higher risk sensitivity.

Next to OpRisk and Market Risk the Basel Committee has revised the standardized approach for credit risk. The second revision includes proposals for exposures to multilateral development banks, retail and defaulted exposures, and off-balance sheet items. Moreover, the Basel Committee also plans to publish a revision of the credit risk framework, i.e. this also covers the internal rating based approach (IRBA). The target of the Basel Committee is to balance simplicity and risk sensitivity, and to promote comparability by reducing variability in risk-weighted assets. Furthermore, also the EBA has published a discussion paper on possible changes for IRBA which includes for instance the exclusion of non-default exposures. For banks, the ongoing changes especially for the most important risk, credit risk, mean high costs for changing processes and adapting IT systems and for sure higher capital requirements which may result in less lending activity. The Basel Committee further plans to revise the credit risk standardized approach treatment for sovereigns, central banks and public sector entities.<sup>21</sup>

Having revised these approaches, the Basel Committee wants to introduce a capital floor based on standardized approaches which reassures that banks always stick to a certain minimum requirements calculated with the standardized approaches while having in place an internal model. The attractiveness for internal models shrinks therefore continuously only 10 years after internal models have highly been promoted. To be certain, the Basel Committee will continue to publish papers on setting additional constraints on the use of internal model approaches in 2016.<sup>22</sup>

### 2.4 SREP

Having strengthened the requirements for banks especially with regard to the minimum requirements for capital and for modelling risks, regulators extended the possibility of sanctions and their own evaluation process. The target of the SREP process, known as Pillar 2 processes according to Basel II, is to enhance the link between an institution's risk profile, its risk management and risk mitigation systems as well as its capital planning<sup>23</sup>. Pillar 2 therefore is composed of the establishment of sound, effective and complete strategies and processes to assess and maintain the amounts, types and distribution of internal capital in

relation to their risk profiles (ICAAP) and the governance and internal control. Additionally, Pillar 2 includes the SREP process in which the supervisor assesses whether the institution has adequate arrangements, strategies, processes and mechanisms as well as capital and liquidity in place.<sup>24</sup>

The key purpose of SREP is to ensure that institutions have adequate arrangements, strategies, processes and mechanisms as well as capital and liquidity in place.<sup>25</sup> In case of nonconformity or less capital to cover risks, the supervisors impose additional SREP buffers. In detail and according to the EBA methodology supervisors compare the calculation of Pillar I and Pillar II and require the higher amount as a surcharge in Pillar I.

All together one can observe that in the landscape of normal banks regulatory costs in times of low interest rate margins force the redesign of business models, dramatic deleveraging or mergers between banks. It is hard to earn the regulatory costs and this development puts also pressure on promotional banks although promotional banks as a rule act countercyclical to normal banks.

### **3. Regulation of Promotional Banks**

#### **3.1 Role of Promotional Banks**

As commonly known, the basic role of a bank acting as a financial intermediary is to transfer short-term into long-term money, which is widely recognized as maturity transformation. Funds with short-term maturities such as deposits or bonds are typically offered as a longer-dated loan in this process. As this service could be provided by each and every financial institution, i.e. banks, where do development banks come into play? There must be some kind of niche where ordinary banks are not present.

In principle, the theoretic concept for the activity of development banks is the abolishment of market failures.<sup>26</sup> There are business areas where no bank is active due to an unfavourable risk-return-ratio in general, or for several other reasons. It might be hard to identify ex ante whether a sector suffers from market failure. However, in the case of KfW it is quite simple to define its business activities, as all of its offerings are mandated by the law, based on an understanding with the EU Commission.

The business model being a result of the assignment of tasks by legislative act is characteristic for a development bank. We will talk about the effect of regulation on this relationship later on when we elaborate on the limitation of exposures due to regulatory requirements.

The support of SME business is one of the most important missions of a development bank, as this backbone of the economy in many countries often experiences a restricted access to finance which is particularly true for micro enterprises.<sup>27</sup>

KfW, for example, needs to conduct its business in a manner which is neutral towards the competitors of the banking market. A typical loan is therefore passed on to the ultimate lender via a financing partner which can be a private bank, a savings bank or a co-operative bank (or their respective central institution) as well as an insurance company.

#### **3.2 Peer Groups of Promotional Banks**

A representative peer group of development banks in Europe would, in its major traits, be composed of the entities which the EBA shows in its report to the EU Commission on the perimeter of credit institutions.<sup>28</sup>

These are either development banks comparable to KfW (e.g. CDC, CDP), banks which are exempted due to historical reasons or oddities which do not fit into the regular setup of banking regulation. Another focus lies on banks promoting export financing.

As of today, five major patterns can be identified to classify development banks, characterized by scope of activity and applicable type of regulation.

Firstly, there are monoliners, i.e. banks with only one business area, which are subject to normal supervision. One example for this group is Landwirtschaftliche Rentenbank in Germany, which is solely supporting agricultural clients. Secondly, we can observe monoliners which fall under supervision by the government, e.g. The Crown Corporations in Canada. A third group acts as multiliners in a regime of special supervision. Banking regulation is to some extent tailored to the particularities of these normally out-of-scope entities, which are providing a wider range of activities. Lastly, the majority of development banks belongs to a group of multiliners where normal banking supervision either by the ECB and/or the relevant national competent authority applies. Actually, multilateral development banks form a fifth group of development banks, not being supervised.

#### **3.3 Regimes of Regulation**

The dimension of the financial crisis of 2008 was unprecedented and so was the reaction of the supervisory authorities. They as well were accused for having failed. Understandably, as a reaction, existing rules were tightened heavily and new restrictions were implemented to prevent the appearance of the next bank-

ing crisis – of this nature at least.

Focus also shifted towards those credit institutions which were so far not in the spotlight of regulation, such as development banks. Albeit being exempt from the CRD IV as mentioned before, KfW, for example, cannot elude from this megatrend.

From a national perspective, KfW is exempt from CRD IV. Furthermore, institutions such as credit unions, export financing funds and regional as well as sectoral development banks are not being subjected to the CRD either. The underlying motives differ. For KfW, this is the case due to the following factors: the institution is being supervised by designated state authorities and closely cooperates with the latter. Moreover, it is obliged to perform particular financing transactions that are of public interest. In addition, KfW is not allowed to conduct deposit business.

#### **4. Regulation and Impacts for Promotional Banks**

##### **4.1 Impact on structure and business model**

With regard to promotional banks, the challenge for standard setters is to provide an adequate regulatory framework. On the one hand, development banks are often too big and too important for an economy to be left to their own devices without the establishment of comprehensive minimum requirements to which the institutions in question need to adhere to. On the other hand, conventional banking regulation methodologies usually do not match the governance structure and promotional activities of development banks. As these institutions are not eligible for deposit business, otherwise necessary measures for the protection of the banks' respective counterparties are e.g. not an issue. Furthermore, a multitude of tasks bestowed upon development banks by legislative institutions would cause an infringement of banking supervision requirements if there were no exemptions from implemented European directives and/or national regulations<sup>29</sup>:

- Promotional banks increase their volume of granted loans – especially in times of economic or financial crises – in line with market cycles by offering corresponding programmes. If these entities had to adhere to regulatory requirements, the fulfilment of this intrinsic duty might be compromised in case their leverage or relevant capital ratios would hence fall below the calibrated minimum standards. Assuming a lack of excess capital, the state as the owner of the development bank can alternatively assign the development bank as its vehicle to perform certain assigned operations for which the state provides the funds.
- Some characteristics of development banks cannot

be compensated even by a comfortable level of capitalisation.

- Development banks are typically state owned and do not bear the same default risks or systemic risks as other banks.
- With regard to the requirements for credit risk modelling development banks such as KfW are disadvantaged in case the standardized approach will replace the IRBA or a floor is implemented due to the fact that the standardized approach does not allow for any recognition of collaterals, notwithstanding it is inherent to the on-lending business which has to be obeyed by the law.
- Liquidity key risk indicators as imposed by the regulatory framework of Basel III do not bear justice to the long-term orientation of the business model of development banks.<sup>30</sup>

As a result, the corresponding guidelines are not only heterogeneous throughout Europe, but also undergoing constant changes and amendments.

In this context, neither EBRD, CEB nor EIB depend on any guidance implemented by a comprehensive European or national banking supervisory authority in connection with their function as multilateral development banks.

As far as KfW is concerned, a binding legal decree (hereafter: KfW-V), which became fully effective as of January 1, 2016, has been published in October 2013. Overall, KfW's legal status has not undergone any changes following the release of KfW-V: as a public sector entity, it is still neither a credit institution nor a financial services provider according to Article 2 (1) Note 2 in connection with Article 2 (6) Sentence 1 Note 2 of the German Banking Act, and it is moreover continuously exempt from banking supervision laws of the European Union.

The major novelty is that from January 2016 onwards the competent supervisory authorities have pertinent access and information rights as well as possible sanctions at their disposal.

Although it kept its particularities and exemptions, regulation has a noticeable impact on KfW's way how to conduct its promotional activities. Within the scope of the KfW-V and the rules therein KfW must adhere to, the supervisory authorities apply the same rigorously as they do with regard to other banks subject to the same rules.



In 2014, when the first provisions of KfW-V regarding governance became effective, KfW had to adapt the structure of the committees of the supervisory board. Since 2016 the remaining parts of KfW-V came into force determining the bank supervisory laws and regulations to be applied to KfW.

#### 4.2 Major challenges

Apart from the possible infringements mentioned earlier, development banks face several obstacles they need to overcome.

Traditionally, state-owned development banks such as KfW are considered by investors as utmost reliable debtor. The external rating published by rating agencies is by far the most important criterion to conclude on the creditworthiness of a bank when providing funds. Having the backing of the state behind them, investors are very confident about this aspect.

Now that regulators tend to include credit institutions which were so far excluded from the ordinary regulatory sphere, development banks amongst others also need to fulfil capital requirements even if investors still solely focus on the rating. Even for the rating agencies, in these cases capital ratios are immaterial to the rating decision. So even if for the participants of the capital markets everything is fine, the capital regime might impose restrictive effects on a bank's business activities.

This is especially true for the leverage ratio. By nature, a state-owned development bank is bearing a lot of low-default sovereign exposure. We do not need to stress once again the punishing effects of the leverage ratio on such portfolios – literature on this aspect is quite exhaustive – leading by tendency to a riskier banking business in order to achieve sufficient revenues. The question is whether it is expected from development banks to practice a search-for-yield. If so, it is contradictory to the long-term business model of a development bank. If not, it limits business volume and thereby the development bank's ability to perform its major task.

Apart from that, regulation imposes some practical burdens on newly regulated banks. Let it be workshops with the supervisory authority which might be necessary to explain the bank's business model in all of its details. Or, when fully rolled out specific regulations come into effect, such as the KfW-V in case of KfW, the authority's regular and ad hoc information requests, let alone the conduct of examinations, e.g. for the approval of an internal model. Alongside, new regulatory propositions need to be monitored and implemented.

#### 4.3 Harmony between regulation and politically intended business model

Obviously, the business activities of a development bank are not always congruent with the aims of banking regulation. Even trade-offs can be identified, as it is the case for the leverage ratio as explained in chapter 4.2. The question arises how to tune in to regulation without overly impacting development financing. Development banks are to some extent in dire straits to find a balance between their promotional mission as their *raison d'être* and the appropriate application of prudential provisions.

The regulation of a development bank is a particularity. Outweighing the benefits and burdens of applying regulatory provisions will stay a constant challenge. Thus, a quite individual form of regulation could emerge in order to consider all of the indisputably particular characteristics inherent to promotional banks, making them a unique segment within the banking sector.

#### 5. Outlook and alternatives for an appropriate regulation

If it is commonly accepted that development banks shall be regulated to a certain extent, in any case, an adapted regulation is necessary to safeguard the promotional duties of these banks.<sup>31</sup> In fact, neither this idea nor the different components are entirely new.<sup>32</sup> What's new is a quite complex set-up and combination of rules, procedures and institutions. If we want to protect the promotional duties and design an appropriate regulation for that we have to keep in mind that the prudential regulation of public sector entities is closely linked to competition and state aid policy and an efficiency control by the Court(s) of Auditors. Thus, we have to bring in line several systems obeying to their own rules.

We have shown the key elements of this type of regulation. If we want to follow this road of regulation and promotional tasks models and if we want to keep our promises the following conditions should be respected:

1. As financial crises are more like tsunamis than dominos<sup>33</sup> promotional banks should have enough capacity to act quick and hard.<sup>34</sup> This shall be granted by a regulation that takes into account their duties and there are other measures one can think of.
2. A still unsolved problem is the choice of an appropriate supervisory institution and the autonomy granted to this institution(s). A certain division of labour may be appropriate. Given the close link of the public sector entities and the multilateral development banks to the respective sovereigns a carve out from resolution sys-

tems shall be appropriate.

However, as observed in the past, times of intense regulation are in general followed by times of deregulation which take into account overly ambitious rule set-

ting. A trigger might be that several banks will not be able to stand high costs of regulation combined with a low profitability. At least the latter seems to be a prevalent condition from now on. ■

## Literature

**Ayadi, R., Arbak, E. and W. P. de Groen**, 2012, Regulation of European Banks and Business Models: Towards a New Paradigm?.

**Basel Committee for Banking Supervision**, 2016, press release, Revised market risk framework and work programme for Basel Committee is endorsed by its governing body, <https://www.bis.org/press/p160111.htm>, accessed 13.02.2016.

**Basel Committee for Banking Supervision**, 2016, Minimum capital requirements for market risk, <https://www.bis.org/bcbs/publ/d352.pdf>, accessed 26.01.2016.

**Basel Committee for Banking Supervision**, 2015, Finalising post-crisis reforms: an update - A report to G20 Leaders, <http://www.bis.org/bcbs/publ/d344.htm>, accessed 27.01.2016.

**Börsenzeitung**, 2016, Bankenaufsicht – Ein überfälliger Schritt, Frankfurt.

**Borio, M.**, 2015, presentation at Deutsche Bundesbank Regional Office Frankfurt.

**Deutsche Bank Research**, 2015, Promoting investment and growth: The role of development banks in Europe, [http://www.dbresearch.com/PROD/DBR\\_INTERNET\\_EN-PROD/PROD0000000000380779/Promoting\\_investment\\_and\\_growth%3A\\_The\\_role\\_of\\_devel.pdf;RWSESSID=F479E6478AC760666FA6E01D687C80B5.srv-tc1-dbr-com](http://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD0000000000380779/Promoting_investment_and_growth%3A_The_role_of_devel.pdf;RWSESSID=F479E6478AC760666FA6E01D687C80B5.srv-tc1-dbr-com), accessed 29.02.2016.

**Deutsche Bundesbank**, 2013, Monatsbericht Juni 2013, [https://www.bundesbank.de/Redaktion/DE/Downloads/Veroeffentlichungen/Monatsberichte/2013/2013\\_06\\_monatsbericht.pdf?\\_\\_blob=publicationFile](https://www.bundesbank.de/Redaktion/DE/Downloads/Veroeffentlichungen/Monatsberichte/2013/2013_06_monatsbericht.pdf?__blob=publicationFile), accessed 17.04.2016.

**Deutsche Bundesbank**, n.d., Service Glossary, [https://www.bundesbank.de/Navigation/DE/Service/Glossar/\\_functions/glossar.html?lv2=32052&lv3=329434](https://www.bundesbank.de/Navigation/DE/Service/Glossar/_functions/glossar.html?lv2=32052&lv3=329434), accessed 17.04.2016.

**European Banking Authority**, 2014, Report to the European Commission on the perimeter of credit institutions established in the Member States Background and introduction, <http://www.eba.europa.eu/documents/10180/534414/2014+11+27+-+EBA+Report+-+Credit+institutions.pdf>, accessed 12.01.2016.

**European Banking Authority**, n.d., Supervisory Review and Evaluation Process (SREP) and Pillar 2, <https://www.eba.europa.eu/regulation-and-policy/supervisory-review-and-evaluation-srep-and-pillar-2>, accessed 04.02.2016.

**European Central Bank**, 2015, Survey on the access to finance of enterprises in the euro area, <https://www.ecb.europa.eu/pub/pdf/other/accesstofinance-small-medium-sized-enterprises201512.en.pdf?2c146594df6fe424c7adb001e1306c73>, accessed 17.12.2015.

**European Commission**, 2015, Working together for jobs and growth: The role of National Promotional Banks (NPBs) in supporting the Investment Plan for Europe, <http://europa.eu/rapid/attachment/IP-15-5420/en/The%20role%20of%20National%20Promotional%20Banks.pdf>, accessed 05.03.2016.

**Fisher, P.**, 2015, The Financial Regulation reform agenda – what has been achieved and how much is left to do, <http://www.bis.org/review/r151009b.pdf>, accessed 05.03.2016.

**German Ministry of Finance**, 2014, Monatsbericht des BMF, Juni 2014, [https://www.bundesfinanzministerium.de/Content/DE/Monatsberichte/2014/06/Downloads/monatsbericht\\_2014\\_06\\_deutsch.pdf;jsessionid=DAC907DA590D9E16FA9F5A328CE83AAC?\\_\\_blob=publicationFile&v=3](https://www.bundesfinanzministerium.de/Content/DE/Monatsberichte/2014/06/Downloads/monatsbericht_2014_06_deutsch.pdf;jsessionid=DAC907DA590D9E16FA9F5A328CE83AAC?__blob=publicationFile&v=3), accessed 06.03.2016.

**Ingves, S.**, 2015, Speech by Stefan Ingves at the IIF Annual Membership Meeting, Lima, <http://www.bis.org/speeches/sp151010.htm>, accessed 05.03.2016.

**Kuhn, T. S.**, 1981, Die Struktur wissenschaftlicher Revolutionen, Frankfurt.

<sup>1</sup> Cf. Borio, M., 2015, Presentation at Deutsche Bundesbank, Regional Office Frankfurt.

<sup>2</sup> Cf. Basel Committee for Banking Supervision, 2015, "Finalising post-crisis reforms: an update - A report to G20 Leaders".

<sup>3</sup> Cf. *ibid.*

<sup>4</sup> See Basel Committee for Banking Supervision, 2016, "Revised market risk framework and work programme for Basel Committee is endorsed by its governing body".

<sup>5</sup> Cf. Ingves, S., 2015, Speech at the 2015 IIF Annual Membership Meeting.

<sup>6</sup> Fisher, P., 2015, "The Financial Regulation reform agenda – what has been achieved and how much is left to do".

<sup>7</sup> For a first idea see European Banking Authority, 2014, "Report to the European Commission on the perimeter of credit institutions established in the Member States".

<sup>8</sup> Cf. European Commission, 2015, "Communication from the Commission to the European Parliament and the Council – Working together for jobs and growth: The role of National Promotional Banks (NPBs) in supporting the Investment Plan for Europe".

<sup>9</sup> Cf. Deutsche Bundesbank, 2013, "Monthly Report June 2013".

<sup>10</sup> Cf. Deutsche Bundesbank, 2013, "Monthly Report June 2013".

<sup>11</sup> Cf. German Ministry of Finance, 2014 Monatsbericht 20. Juni 2014, "Die Europäische Bankenunion – Wie weit sind wir schon?"

<sup>12</sup> Cf. Deutsche Bundesbank, Service, Glossar "Single Rule Book".

<sup>13</sup> The buffer for systemic risks and systemic banks are not added up (only in special circumstances) but the higher one counts. Additionally, a bank can only be systemically relevant either on a global or a national level.

<sup>14</sup> Recommendation of the Financial Stability Board to introduce a further loss absorbing capacity ratio for global systemically relevant institutions. It addresses the "big-to-fail" problem and requires banks to hold additional capital of 18 % of the risk weighted assets and 6.75 % of the unweighted assets.

<sup>15</sup> The Banking Recovery and Resolution Directive (BRRD) which determines the recovery and resolution of credit institutions and security firms requires a minimum requirement for eligible liabilities in order to ensure that enough capital is available for a bail-in.

<sup>16</sup> Supervisory Review and Evaluation Process.

<sup>17</sup> Cf. Deutsche Bundesbank, 2013, "Monthly Report June 2013".

<sup>18</sup> Cf. Börsenzeitung, 2016, "Bankenaufsicht – Ein überfälliger Schritt".

<sup>19</sup> Cf. Basel Committee for Banking Supervision, 2016, "Minimum capital requirements for market risk".

<sup>20</sup> Cf. Börsenzeitung, 2016, "Bankenaufsicht – Ein überfälliger Schritt".

<sup>21</sup> Cf. Basel Committee for Banking Supervision, 2016, "Revised market risk framework and work programme for Basel Committee is endorsed by its governing body".

<sup>22</sup> Cf. Basel Committee for Banking Supervision, 2016, "Revised market risk framework and work programme for Basel Committee is endorsed by its governing body".

<sup>23</sup> Cf. European Banking Authority, no date, "Supervisory Review and Evaluation Process (SREP) and Pillar 2".

<sup>24</sup> Pillar 2 can be divided into two major components: (i) aimed at institutions, where those are expected to establish sound, effective and complete strategies and processes to assess and maintain, on an ongoing basis, the amounts, types and distribution of internal capital commensurate to their risk profiles (ICAAP), as well as robust governance and internal control arrangements, and (ii) supervisory review and evaluation process.

<sup>25</sup> Cf. European Banking Authority, no date, "Supervisory Review and Evaluation Process (SREP) and Pillar 2".

<sup>26</sup> Cf. e.g. Deutsche Bank Research, 2015, "Promoting investment and growth: The role of development banks in Europe".

<sup>27</sup> Cf. European Central Bank, 2015, "Survey on the access to finance of

enterprises in the euro area".

<sup>28</sup> Cf. European Banking Authority, 2014, "Report to the European Commission on the perimeter of credit institutions established in the Member States".

<sup>29</sup> It is important to stress that Directive 2013/36/EU does apply to the major part of development banks in Europe, with only a few entities operating out of its scope as a consequence of their specific business purpose.

<sup>30</sup> For KfW, e.g. a guarantee structure provided by the German Federation which facilitates stable refinancing opportunities in times of crises is not being taken into account by the requirements implemented to safeguard an adequate solvency position.

<sup>31</sup> Cf. Ayadi, R., Arbak, E. and W. P. de Groen, 2012, "Regulation of European Banks and Business Models: Towards a New Paradigm?".

<sup>32</sup> For the discussion of a new paradigm see T. S. Kuhn, 1981, "Die Struktur wissenschaftlicher Revolutionen".

<sup>33</sup> We owe this argument to M. Borio.

<sup>34</sup> The action of KfW in the current crisis may be a pattern.