European Association of Co-operative Banks
Groupement Européen des Banques Coopératives
Europäische Vereinigung der Genossenschaftsbanken

***Committee of European Banking* Supervisors**

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Consultation Paper (CP 14) on the First Part of its advice to the European Commission on large exposures.

Ladies, Gentlemen,

The European Association of Cooperative Banks (EACB)[1] welcomes opportunity to comment on CEBS's orientations on key concepts for a future large exposures regime.

This matter is of crucial importance for many of our member organisations. Accordingly we are available at any time for more detailed comments on the matter in question.

Yours sincerely

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Secretary General

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Head of Legal Department

1 The European Association of Co-operative Banks (EACB) is the voice of co-operative banks in Europe. It represents, promotes and defends the common interests of its 28 members and co-operative banks in general. With 60,000 outlets and 4,500 banks, co-operative banks – which are privately owned entities- are widely represented throughout the enlarged European Union and play a major role in the financial and economic system. In Europe, one out of two banks is a co-operative. Co-operative banks have a long tradition in serving 130 million customers, mainly consumers, retailers and SMEs. Quantitatively, co-operative banks in Europe represent 45 millions members, 700,000 employees with a total average market share of about 20%.
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I. GENERAL REMARKS:

The members of the EACB appreciate CEBS's work on the revision of the large exposure regime. An early industry consultation, the publication of orientations on key concepts for a future large exposures regime and a hearing on those concepts indicate a high level on openness.

It is probably due to the very conceptual character of the document that we would like to make some preliminary comments to explain our understanding of the proposal and our vision of the suggested concept. It is from that angle we would want our responses to your questions be understood:

- The new regime, as described under III, VIII. and IX., with the 10%, 25% and 800% limits should be considered as **a backstop regime for complex banks**; an additional "test" for unforeseen event risk as a specific element of concentration risk; This regime should fit, as much as possible into other concepts of the CRD and avoid "extra procedures" to a maximum extent;

- For non-complex banks, proportionality aspects need to be taken into consideration. As CEBS points out in the summary of the hearing on July 11, the aforementioned system is the one on which most of them rely to manage their large exposures risk. In fact that regime is the one which many non-complex banks use to manage their single address risk. Accordingly the proposed regime has to be considered as a **basic indicator approach to LE-risk.**

- Therefore, in particular with regard to the management of the single address risk by less complex institutions and the proportionality principle, the relationship between the suggested LE new regime and the requirements of the *"CEBS Guidelines on the Technical aspects of the management of concentration risk under the supervisory review process",* in particular "Concentration 2" has to be clarified. The new regime must not lead to an over-regulation for less complex institutions, which will not be able to implement more sophisticated systems on top of the LE regime.

- We would also like to point out that the reporting aspect, in particular for more complex institutions has to be solved. A more extensive review of the LE regime should lead to an alignment of the reporting requirements with institutions´ actual internal risk management. As the review of industry practices carried out by CEBS during 2006 has shown, the mismatch that especially but not only larger/ more sophisticated institutions experience between their own practices and the supervisory requirements is reflected in a reporting burden that is little or not at all related to their internal risk management and limit systems.

- Any new LE regime should avoid to a maximum extent the creation of "extra processes", which imply the deviation from other concepts of the CRD for the generation of certain data.

- We welcome the proposed differentiated approach related to the calculation of exposure values. The proposed way forward should in any case be designed as an open concept, meaning that institutions can choose which specific approach to use.

II. RESPONSES TO THE QUESTIONS RAISED IN CP 14

1. Do you agree with our analysis of the prudential objectives of a large exposures regime?

The analysis identifies unforeseen event risk as a major prudential objective for a large exposure regime. This conclusion leads to the parameters as described under XIII. and IX. As the analysis rightly points out, unforeseen event risk is an element of concentration risk, an element of single- address-risk, to be distinguished from sectoral and geographical risk.

For complex banks, there are certainly merits to identify unforeseen event risk as a category of single-address-risk, requiring a specific backstop regime to limit the risk appetite of an institution. Such limits, however, should not preclude more sophisticated internal approaches, developed under pillar 2 for concentration risk.

We are not convinced, however, that for non-complex institutions unforeseen event risk can so easily be distinguished from other elements of single address risk. In fact, the tools for the management of such risk by non-complex banks can not be distinguished from different types of single-address risk.

Even if unforeseen event risk is considered as a prudential rationale for an LE regime, such risk is generally managed by processes to identify “single addresses” and limits to exposures and accordingly not in a different way than single address risk under pillar 2.

2. With regard to the market failure analysis set out in Section IV. Do you agree with the analysis that there remains a material degree of market failure in respect of unforeseen event risk?

What the analysis seems to provide is that the current regime of large exposures, but probably even more the current risk management practices of banks have helped to avoid significant failures of European banks due to large exposures. In particular, the example given for the Norwegian savings banks seems to be an excellent example for the positive development of the European banking sector in this respect.

Beyond this, we do not see that the market failure analysis delivers any solid evidence for a need for tighter rules or for intervention by regulators. Most of the given examples stand for bad governance, but not for market failure.

3. Do you have any further evidence that you consider useful for deepening the market failure analysis?

For the time being, we do not dispose of any additional evidence. We would like to underline, however, that with regard to a global level playing-field CEBS should continue to collect evidence on this matter in order to avoid any over-regulation of the European banking sector.

4. Do you agree with our perception that there are broad consistencies between the EU LE regime and those in other jurisdictions such that there is no systematic competitive disadvantage for EU institutions? If not, could you please provide us with a detailed explanation of where you consider that competitive distortions arise?

The LE regime is not applied on a global scale. While this may not create a systematic competitive disadvantage for EU institutions, we would nevertheless like to point out that

- US banks seem not obliged to consider all assets in their LE reports (eg. Guarantees, off-balance sheet items)
- LE limits may require the syndication of loans in the context of M&A transactions, what can create disadvantages in that business.

We suggest that CEBS should further explore these aspects in order to ensure a global level playing-field.

5. What are your views in respect of the analysis of the recognition of credit quality in large exposure limits and our orientation not to reflect further the credit quality of highly rated counterparties in large exposure limits?

The response to this question is closely linked to the prudential objectives. If the purpose really is to cover unforeseen event risk, then a higher risk-sensitivity of this “backstop systems” does not seem to make much sense.

This does not exclude, however, that certain exposures to certain counterparties, in particular to other regulated entities (banks) or to sovereigns should be given a lower weighting.

As regards collateralized exposures, we suggest to consider “net exposures” only. In particular in the case of highly liquid collateral, it would seem inappropriate to consider full exposure.

6. What do you consider to be the risks addressed by the 800% aggregate limit? What are your views as to the benefits of the 800% limit?

We take the view that the 800% is fully adequate as a backstop limit for complex institutions and certainly as a kind of basic indicator approach for less complex institutions. There are no other, more objective indicators. Reducing this limit could have an important impact on the market and also lead to reduced competitiveness of European banks.

7. What principles or criteria might be applied for an institution to demonstrate its ability to measure and manage the relevant risks?

As we have pointed out before, the approach may vary depending on whether the bank is large and complex or non-complex and small. For the latter, the suggested limits, together with a careful monitoring of all large exposures, will be sufficient for a proper management of all single address risk.

But also regarding larger and more complex institutions the situation is not so different: In fact, the recitals of the CRD rightly point out that the rules are "to limit the maximum loss that a credit institution may incur through any single client or group of connected clients". In so far, the suggested regime indicates some fixed maximum criteria, a backstop. This approach facilitates the development of banks' own models, which then have to respect the quantitative limits of that regime. This solution will probably be the easiest and allow banks to implement this regime into their models for the management of concentration risk. For validation purposes banks should be given the opportunity to prove that there is robust evidence that their systems consider the limits imposed.

8. Do you consider that the principles outlined with respect to offbalance sheet items would be suitable to govern the calculation of exposure values by institutions using the Advanced IRB Approach for Corporate exposures and/or the Internal Models Method (EPE) for financial derivatives and/or securities financing transactions?

As a general rule, we think that the procedures to calculate exposure values should not deviate from the calculation of exposure values for the purposes of the solvency regime in the CRD.

Complex banks should be given the opportunity to rely on their internal models for the calculation of off-balance sheet items. We therefore strongly support the use of solvency compliant EADs, whether they are internally defined or based on the regulatory assumptions, to report and verify the L.E. limit compliance.

We are then in favour of the two-tier approach to the LE regulatory framework, whereby most sophisticated banks would be allowed to use their own EADs to assess their large exposures, as long as the exposure amount can be expected with a high degree of confidence to be no more than the value used.

Accordingly, banks who use the formula "marked to market + add-on" must be permitted to report these EADs in the L.E. regime. For banks, who use Internal Models Method (EPE), we believe that the principles should define the time horizon over which to consider potential future exposures, as well as the statistical measure to use.

In terms of time horizon, a one-year horizon seems to be the most appropriate, since this is consistent with the regulatory and economic capital process.

9. Do you support harmonization of the conversion factors applied to the offbalance sheet items set out in Section IX.II? How important are these national discretions?

A harmonization of convergence factors would be a right step. However, any new regime should not lead to over-regulation.

In particular, as described in Nr. 200 of CP 14 most member states use conversion factors in their large exposure regimes for low and medium risks. These CCFs have proved their merits and should be maintained.

10. How are these facilities, transactions etc regarded for internal limitssetting purposes? What conversion factors do you consider appropriate?

Generally speaking, we think that the existing CCFs of Art. 113 of the directive 2006/48 are appropriate.

With respect to the question set out in paragraph 206, on whether there are unconditionally cancellable facilities existing that are of a size to give rise to potential conflict with the large exposure limits, we would like to mention liquidity facilities provided to structured finance transaction. The ABCP programs of European style typically do not include strictly separated purchaser SPVs in comparison to the US programs. Accordingly you have legally separated individual receivable portfolios as related underlying for such a facility but the identical commitment counterparty within several contracts. CRD contains a differentiated system of conversion factors to be applied for determining the relevant exposure value for own funds calculation purposes of facilities in general and those used in securitization transactions in particular. The implementation and the capital consequences of this methodology represented and still represent a large challenge for the banking industry. There should be no need to introduce another conversion factor system if the one of the CRD can be regarded as reliable.

11. In the above analysis we have not given consideration to the appropriate treatment of either (a) liquidity facilities provided to structured finance transactions or (b) nthtodefault products. How do you calculate exposure values for such products for internal purposes?

Some Structured credit products bare a risk linked to the underlyings, some products bare a risk which is not directly linked to the default of the client (such as securitizations of a set of receivables) and is thus extremely granular. Due to the large variety of products, the treatment should be left to the bank, on a case by case basis, based on the way banks follow such risk.

Liquidity facility on bankruptcy remote vehicles bares a very small credit risk. Their main risk is a liquidity risk which is monitored under pillar 2 with Contingency Funding Plans. Therefore, such liquidity facilities should be included in the Large Exposure regulation with a 20% risk weight.

Liquidity facilities are committed to the relevant entities and as such we are calculating the externally committed line as exposure. The conversion factor applied to protection seller positions in nth to default baskets is 100 %. Nth to default baskets are regarded according to the repayment status of the underlying portfolio: protection will be taken into consideration on default of the (n-1)th title in the portfolio.

12. Do you consider the suggested principles set out in Section IX.III appropriate for application to institutions' exposures to collective investment schemes and/or structured finance transactions?

The members of the EACB disagree with the suggested approach. In our opinion, uniformly applying a "look-through"-approach does not reflect actual credit risk measurement techniques and could in many cases exaggerate the credit risk. Taking this as a general principle is inadequate given the variety of financial instruments, from our point of view. Transparency of the composition of the underlying portfolio is desirable, but not always practicable due to a fundamental insufficiency of data supply in the market (e.g. on private placements of mezzanine tranches).

From a reporting point of view, a look-through regime for single name concentration evaluation purposes would be difficult if not impossible to implement. Information at such a deep level of detail, such as names of legal entities composing the underlying assets is normally not available (funds, securitization structures where the bank is a mere investor, etc.). Exceptions can only be imagined where an institution is taking investments in an individually designed collective investment scheme which it is governing itself and where it is determining the investment strategy a sufficient data supply can be assumed. Considering the potential burden of implementing a look-through approach, we have strong reservations against the proposals made, which would even be of no use or relevance under other prudential aspects.

Depending on the position of the institution's own exposure within the ranking order of the transaction, information on the current volume of more junior exposures is often not available. In addition, the treatment of positions that rank higher than the senior tranches (e.g. market risk hedges) is not yet clear. If the "look-through-approach" should serve as a general principle for structured finance transactions, its scope of application should be defined adequately and precisely.

In order to avoid the problem of adequately defining the scope of application and since structured transactions in general have an individual character, we would prefer an open and flexible approach. The proposed distinction between highly diversified and less diversified portfolios seems appropriate, as well as to abstain from a decomposition of a highly diversified portfolio. Institutions should be given discretion to define their own criteria for an adequate degree of diversification and other risk factors like homogeneity and quality of the portfolio or correlation between the portfolio and the banks overall portfolio. They should be able to choose the adequate treatment of structured transactions.