D0425F-2012
26 March 2012

Joint Response to EBA consultation Paper (CP 51) –

Draft ITS on Supervisory Reporting Requirements for large Exposures

Key Points

- The first time adoption of the ITS should be, at the earliest, January 1st, 2014.
- More clarity will be needed with the application of the NACE sector codes and counterparty identification codes. In particular, we are concerned that the latter would proceed independently from the FSB work on common legal entity identifiers.
- The EBF and AFME understand that the Large Exposure reporting requirements as well as the COREP reporting will not be affected by current accounting regimes as Article 94 would have an impact on the timeframe of implementation of the new LE and COREP reporting requirements by two to three years. COREP reports and Large Exposure reports use the same data base because they are interconnected. Therefore, the period between the reporting reference date and the date institutions will have to submit the set of data related to this reference date should be the same as the period established in COREP framework.
- As noted by the EBA, the geographical and sector information is already covered under Pillar 2 framework and therefore we consider this to be a duplication.
- We call for an alignment between the reporting required under European regimes (for COREP, FINREP, and Large Exposures) with the FSB's data template for G-SIBs (see the FSB's Consultative Document Understanding Financial Linkages: A Common Data Template for Global Systemically Important Banks, 6 October 2011). These reporting initiatives will conceivably require overlapping data that will be duplicative and unnecessary. To the greatest extent possible definitions and data fields should be aligned.

Overarching Comments in relation to CP 50 and CP51

We note that CP 51 is meant as an addendum to the ITS COREP & FINREP consultation (i.e. CP 50). Large Exposure reporting will be implemented together with COREP and FINREP and maybe even other reporting streams, such as recovery and resolution plans, which will need to be coordinated and analysed to avoid unintended consequences, duplications and where possible to exploit any synergies in data mining and management.

The EBF and AFME would, therefore, like to refer to the comments that they have jointly submitted to respond to CP50 as several of those comments are also relevant within the context of CP 51.

- As we strongly support the European Commission's aim to achieve a Single rulebook, we welcome the proposals made in CP51 for aiming at introducing uniform requirements.
- As firms will implement the proposals made in CP50 and CP 51 together, the comments made as to the magnitude of the proposed new framework are also

EBF a.i.s.b.l
ETI Registration number: 4722660838-23
10, rue Montoyer B-1000 Brussels
+32 (0)2 508 37 11 Phone
+32 (0)2 511 23 28 Fax
www.ebf-fbe.eu

relevant within the context of CP 51: from a practical point of view, the timing which is being proposed in CP50 and CP51 is unrealistic. Even if firms would have unlimited resources to try and make the proposed overhaul happen, this cannot possibly be implemented as planned by the Authorities as introducing the required changes inevitably takes time. It is a strong possibility that data quality could suffer if such ambitious timelines are adhered to.

- As a consequence, the date of the first-time application of the Framework which is being proposed in CP50 and CP51 needs to be postponed until 1 January 2014, at the very least. Our comments below provide additional arguments explaining in particular why implementing the proposed Large Exposure framework prior to 1 January 2014 cannot possibly be envisaged (see our answers to Question 1).
- Large Exposure remittance dates need to be extended to 50 working days as well.
- EU Authorities are legally required to explain why they envisage imposing reporting requirements. They are, therefore, expected to explain, amongst others:
  - (i) why and how Large Exposures reporting would be suitable for macro-prudential analysis (see also the critical comments that we make in this regard below);
  - (ii) why precisely Article 11, Paragraph 2 b, of CP51 proposes introducing an additional reporting threshold of EUR 150 million (see also the critical comments that we make in this regard below);
  - (iii) why, in particular, it proposes to implement the Principle of Proportionality referred to in Article 95 of the Proposal for a Regulation on prudential requirements for credit institutions and investment firms by authorising competent authorities to lower the 150 million threshold;
- The proposal made in Article 9 of CP50 is highly questionable from a Single rulebook perspective: reports based on national GAAP should not be required if an institution prepares consolidated financial statements based on IFRS.
- The option whether to use XBRL for reporting purposes should rest with the firms and, therefore, not with their competent supervisor. Furthermore, a uniform solution should be elaborated in the area of electronic signatures.

<u>**General remarks on CP 51**</u>

1). <u>LE Reporting and Systemic Risk Monitoring</u>

In our view, the large exposures regime is not suitable for macro-prudential analysis. It focuses on limiting credit risk; being designed as a backstop regime, very conservative assumptions are made, so that the actual risk (taking into account risk weights and conversion factors) in relation to a customer is not captured. Information on geographic and sector risk can also be generated from other reporting streams, e.g. via statistical reports or COREP and FINREP. Analysis of contagion effects can, for example, be carried out better via the much more granular credit registers in place in many countries. Use of the LE regime for macro-analysis is unnecessary and leads to duplication of reported information. On top of this, the LE reporting regime may result in over-statement of risk since, for example, double counting due to multiple allocations of borrowers, consolidation and guarantees cannot be filtered out cleanly. The meaningfulness of macro-analysis based on LE reporting appears questionable also because the volume of large exposures that is reported depends to a very great extent on the structure of the banking market in a country. Thus, a country with a highly fragmented banking market, i.e. with a large number of small banks, will generally report more large exposures than, for example, a country with few big banks.

2) The EUR 150 Million Threshold

The introduction of an additional reporting threshold of EUR 150 million represents a dramatic, disproportionate and sudden increase in reporting requirements for many banks. The EBF and AFME further submit that it is not covered by the EBA's mandate and must therefore be rejected. Article 381 of the CRR defines a relative threshold of 10% of the eligible capital for a large exposure. Article 383 (3) CRR merely empowers the EBA to specify the details of reporting as such, i.e. formats, frequencies, IT solutions.

3) Concentration Risk

No reporting requirement, in our view, can be inferred from the obligation under the CRR/CRD to monitor concentration risk. It is true that Article 79 requires concentration risk to be addressed and controlled. These requirements are addressed to the institution's risk management function, however, not to its supervisors. What is more, the European Commission did not give any mandate to EBA to come up with regulatory standards on concentration risk.In that regard, the Large Exposures reporting should not, and cannot, be used for monitoring the concentration risk set out by Article 79 of the CRD.

4) Consolidation

For reports on a consolidated basis, institutions will have to aggregate the exposures of all members of the group to identify large exposures to a client or group of connected clients. This will be an onerous undertaking, especially for banking groups with a large number of subsidiaries. We would therefore welcome the adoption of a pragmatic approach which nevertheless ensured that large exposure requirements were satisfied at all times at group level. Our proposal is as follows: To identify whether or not there is a large exposure at group level to one client or group of connected clients only exposures of subsidiaries exceeding 5 % of their eligible capital after consideration of risk mitigation techniques and exemptions should be considered.

Responses to Consultation Questions:

1. What would be the minimum implementation period to adjust IT and reporting systems to meet the new ITS reporting requirements? Please elaborate on the challenges which could arise.

We, firstly, refer to the detailed comments that we have made in this regard in our submission to the CP 50 consultation.

One year in any event is required as a minimum to implement the new large exposure reporting requirements. Therefore the ITS should not become effective earlier than 1 January 2014, if there is no need to change to the current accounting regime according to Article 94 CRR, otherwise a transition period of three years is needed. Particular challenges which the industry will face specifically in respect of Large Exposures Reporting can be summarised as follows:

- Reporting the counterparties identification codes (column 020) and the NACE codes (column 060): Banks will need some time to link such codes in the counterparties' databases with the individual counterparts and to feed them into the software producing the Large Exposures reporting;
- There is no justification for project planning based on a standard that has still to be adopted. It is unlikely that the standard – even if it is sent to the Commission on schedule at the end of June – will enter into force unchanged. Finalisation is therefore not expected before the end of Q3.
- Institutions using standard software can only test it after delivery of the required release. This will cause further delays.
- With regard to the look-through approach there is uncertainty whether to use the existing CEBS guidelines or to wait for new EBA guidelines
- Uncertainty whether to use national standards or overseas standards for foreign counterparty characteristics;

According to Article 383 (3) of the CRR, the Commission is requested to submit the ITS by 1 January 2013 at the latest. In this light, it does not appear necessary to set such a tight implementation deadline taking into account that reporting could be carried out on the basis of existing reporting structures and implementation of the harmonised reporting requirements postponed by a reasonable period of at least twelve months.

2. What would be the minimum implementation period required for institutions NOT subject to large exposures reporting at the moment to implement the large exposures reporting described in this consultation paper?

See response to question 1.

3. Would the required implementation period be the same for reporting requirements on an individual basis and on a consolidated basis?

EBF and AFME Members indicated that this would be more or less the same. However, this will be dependent on specific circumstances, geographic locations and language differences within a banking group.

4. Compared to previous versions of the large exposures templates are there additional reporting requirements which, cause disproportionate costs?

The issues mentioned above as challenges to implementation will likely lead to higher cost of implementation. Furthermore, where Large Exposure Reporting is concerned, the following issues are to affect the cost of implementation:

- The new requirements to report IFRS data and to report every exposure equal or larger than EUR 150 million will cause disproportionate costs. The absolute threshold of EUR 150 million would penalise institutions, whose eligible capital exceeds EUR 1.5 bn by increasing the reporting burden in some cases by a factor of hundreds of times. We therefore strongly resist the introduction of a new reporting threshold, which in any case, would not be in line with CRR.

5. Are the templates, related instructions and validation rules included in Annex VIII and Annex IX sufficiently clear? Please provide concrete examples where the implementation instructions are not clear to you.

EBF and AFME Members have identified several areas where the templates and related validation instructions should be clearer:

In particular, guidance is needed for the LE2 template on how to apportion derivatives under a netting agreement or multi-option facilities, which are often made to a number of counterparties within the same group. In the absence of such guidance, variations in banks' approaches will make comparisons between banks and macroprudential analysis very difficult.

Banks would require the EBA to clarify its intentions regarding the reporting of breaches. It is true that Article 385 states "if exposures exceed the limit set out in Article 384(1), the institution shall report the value of the exposure without delay to the competent authorities". This suggests that a continuous monitoring system is needed. However, these requirements are addressed to the institution's risk management function, however, not to its supervisors. In addition to this, since the institutions shall report any breaches without delay, this column does not provide any additional information.

<u>Annex IX, Part II, 1. General Remarks</u>
As large exposures reporting is a part of regulatory reporting (COREP) the breakdown of exposures (columns 90-140, 150-190, 260-300) should be according to COREP (on-balance, off-balance, counterparty credit risk) instead of referring to FINREP. This does not generally rule out a more detailed breakdown regarding equity exposures and undrawn credit lines, but still the same criteria like in COREP reporting should apply.

Since the exposure of civil-law-associations shall be added to each partner, shall also the exposure of a borrower group with joint liability be added to each partner?

<u>Annex IX, Part II, 2. LE Limits</u>
Row 030 / Institutions in %
In the specification it is missing that the applicable limit for institutions has to be put in relation to the eligible capital. It would be clear if the first sentence would read: The applicable limit for institutions based on Article 384 (1) of CRR has to be reported as percentage of the eligible capital.

<u>Annex IX, Part II, 3. LE 1 Template and 4. LE 2 Template</u>

<u>*Columns 010-060 / Counterparty Identification and counterparty characteristics*</u>
The EBA should ensure that any development of counterparty identifiers should link into the FSB work in this area. Meanwhile, in many countries a fully developed system for the identification and characterisation of counterparties is in place. Institutions are reporting these master data already to the national authorities for the coding process. Therefore, we suggest that in countries where the competent authorities consider the current master data system sufficient, the authority may allow to report only the code of the counterparty and the code of the connected client belonging to the group.

If this suggestion cannot be accepted please consider the points raised below for columns 010 – 060.

Column 010 / Name
The name should not be requested because the code is already sufficient to identify the individual clients and the group of connected clients. If the reason for reporting the name is the idea to identify the client on EU level by its name, because the code is only a national code, one has to object that the identification of a client by its name only will produce misleading results.

Column 020 / Code of the group
Annex IX states:
"The actual composition of the code depends on the national reporting system …" and "For a group of connected clients, the entity's code to be reported is the code of the parent company …"

These two rules contradict each other. There are national reporting systems that have already a certain composition of group codes, but these group codes do not necessarily consist of the parent company's code.

Furthermore, in some cases when reading a code, one will not know whether it is the code of the individual client or the code of the group of connected clients. Only together with the value "1" (for individual) or "2" (for groups) of column 030 one will know whether the code belongs to the individual or to the group.

These issues need to be considered further and so we recommend that the national codes currently used, without a new prefix, should stay in place until a uniform codification is available.

Column 050 / Sector
Since the NACE code indicates also the sector to which the client belongs, we suggest to report the NACE code for all the clients, but not to report the Sector.

If this suggestion is not accepted, please clarify the following points:

- Are "General governments" the central governments and the regional governments, or only central governments?
- To which sector belong local authorities, public sector entities, multilateral development banks and international organisations?

Further, the counterparties' sectors defined in column 050 should be mapped with the existing exposure classes of the CRR.

Column 060 / NACE code
It is unclear what is to be entered in this field: the codes or the names of the NACE code?

We suggest to report the NACE code for all the clients, but not to report the Sector.
The link in Annex IX leads to a page that is no longer updated since 26 March 2010, please include an up to date link. Please give also examples of the format to be reported for one level detail and for two level detail.

Column 070 – 200 / Original exposures

Reference made to Annex IX, page 5, block 070-200 to Article 106 seems partially wrong because the para. 1 of this article refers to the exposure value after specific credit risk adjustment.

Further, paragraph 5 in Annex IX, Part II: Template related instructions, 3.1. Instructions concerning specific columns, page 6 says: "Exposures deducted from own funds, which are not exposures according to Article 379 (6) point (e), are included in these columns. These exposures are deducted in the columns 220."

As the instructions rightly point out, the items mentioned in Article 379(6) of the CRR are not exposures within the meaning of large exposure requirements. They are therefore ignored when calculating exposure amounts and, as a result, are already excluded from column 070. The EBA does not, in our view, have a mandate to extend the scope of the definition of exposure set out in the CRR. Column 220 should therefore be deleted.

Column 100 / Equity instruments

The explanation refers to Articles 150 and 163 which describe the Internal Ratings Based Approach. Why is here referred to the Internal Ratings Based Approach while the explanation of the columns 070-200 Original Exposures refers to Article 106 i.e. Standardised Approach?

Column 220 / (-) Exposures deducted from own funds

CRR Article 379 (6) Point (e) is stated as legal reference. But according to CRR Article 379 the exposures mentioned in Paragraph (6) Point (e) shall not be included in the exposures at all, therefore they cannot be deducted in column 220. In order to be in line with the CRR we suggest deleting this column.

Columns 230-250 (Exposure Value before application of exemptions and CRM)

Institutions must report the exposure value before taking into account the effect of the Credit Risk Mitigation. We would welcome EBA to clarify where, if applicable, the following information should be reported (For institutions applying the Financial Collateral Comprehensive Method):

- E*, the fully-adjusted exposure value
- Eva, the volatility-adjusted exposure value
- Cva, the volatility-adjusted exposure value of the financial collateral
- Cvam, the value of Cva adjusted for any maturity mismatch

We assume that exposures from netting agreements and collateralised derivatives are already included as net positions in column 070 and that no breakdown is required in columns 230 to 250.

Some concrete examples would be helpful to illustrate these points.

Column 260-320 / (-) eligible credit risk mitigation (CRM) techniques

The column numbers in the last paragraph are wrong (it should read columns 260-300 instead of 270-310, 310 instead of 320 and 320 instead of 330).

- "Substituion effects" are reported in columns 260 (not 270) to 300 (not 310).

- “Funded credit protection other than substitution effect” are reported in column 310 (not 320).
- “Real Estate” is reported in column 320 (not 330).

We assume the consideration of collateral is optional and that these cells should only be completed if the substitution approach is used. We would appreciate clarification of this point.

Column 310 : Funded credit protection other than substitution effect
The reference here needs to be modified:

“Funded credit protection” is defined in article 4 (33) and not 4 (3).

6. What are the cost implications of introducing a breakdown by residence of the counterparties?

As we have highlighted in our response to CP50, it will be a huge challenge to implement in firms’ IT-systems the new geographical breakdowns which are being proposed as the information which is being requested in this respect is not available today.

7. What are the cost implications of introducing a breakdown by sector of the counterparties?

Cost implications would be manageable. However, to report the sector as well as the NACE code would be double reporting of the same information, see our comments to columns 050 and 060.

8. What are the cost implications of introducing a breakdown by economic sector by using NACE codes?

Cost implications would be manageable. However, to report the sector as well as the NACE code would be double reporting of the same information, see our comments to columns 050 and 060.

9. Would other classifications be more suitable or cost efficient?

We suggest to report the NACE code for all the clients, but not to report the sector as described in our comments to columns 050 and 060.

Further Comments to CP 51

CHAPTER 5, Article 11 (3) on page 9
According to Article 383 (1) CRR the exposures on a consolidated basis, excluding those exempted from the application of Article 384(1) has to be used to determine the 20 largest exposures. In the ITS should be clearly stated which column has to be used to determine the 20 largest exposures. In Annex VIII this value is in column 340.

Please note that the CEBS Guidelines on reporting requirements for the revised large exposure regime of December 2009, in paragraph 47 – on the contrary - stipulate that the determination of the 20 largest exposures has to be based on the exposure value before credit risk mitigation and exemptions. This is not in line with the CRR.

V. Accompanying documents

a. Validation rules 1.a on page 11:

The legal references are included in Annex IX, not in Annex VIII as stated in point a.1.a.

Validation rules 1.e on page 11:

Validation rules that sum up the components of a counterparty in LE 2 and compare this sum with the value of the counterparty in LE 1 should allow for rounding differences of +/- 1.