Committee of European Banking Supervisors
CEBS

3 April 2008

Feedback statement on the consultation paper (CP16) on CEBS' Advice to the European Commission on large exposures

1. On 7 December 2007, as part of its response to the second part of the European Commission's Call for Advice,[1] CEBS published a consultation paper (CP16)[2] on a number of technical aspects of the large exposures (LE) regime. The consultation period ended on 22 February 2008. Thirty-eight responses were received. The responses have been published on the CEBS' website: http://www.c-ebs.org/Consultation_papers/LE_Part2_responses.htm, except for those that the respondents asked to be treated as confidential.

2. This paper presents a summary of the key points arising from the consultation and the changes made to address them. The Annex to this paper is a feedback table which provides CEBS' detailed views on the comments received.

General comments

3. The respondents expressed broad agreement with the proposals contained in CP16. They agreed that an amended limit-based backstop regime would be the most appropriate regulatory tool for dealing with 'unforeseen event risk'. Most of the respondents stressed that this amended regime should be aligned with solvency rules. Indeed, a majority of the specific comments discussed below reflect the general view that large exposures rules should be aligned more closely with CRD solvency rules, and national discretions reduced where appropriate.

4. Respondents remarked on the need to distinguish between the objectives of the large exposures limits for idiosyncratic risk and the management of concentration risk under the Pillar 2 of the new capital framework.

Specific comments

5. In general, respondents called for further clarification on the **definition of interconnectedness,** with a number of the respondents calling for the criterion of interconnectedness to be dropped altogether. Respondents also expressed the view that expanding the concept of financial dependency from mutual dependency to one-way dependency would be unworkable, since one-way dependency is not easily identified in practice. Most of the respondents invited CEBS to include measurable criteria in its proposals.

[1] http://www.c-ebs.org/documents/LE_CfA2.pdf
[2] CP16: http://www.c-ebs.org/press/documents/LE_Part%202_07122007.pdf

6. Most of the respondents agreed that exposure values should be calculated **net of accounting provisions and value adjustments**, with some respondents asking for clarification as to which value adjustments should be included. Respondents also stressed the need for consistency between the items that are included to calculate exposure values in the large exposures regime and those that have an impact on the calculation of own funds. Some respondents invited CEBS to propose a common formula for calculating exposures values for large exposures and for own funds.

7. Respondents felt strongly that a **100% conversion factor for off-balance sheet items** is excessively conservative, and that low-risk items should receive a 0% conversion factor. However, some respondents also pointed out that it does not make sense for banks to provide credit facilities that put them at risk of breaching large exposures limits. Some respondents would welcome a detailed set of definitions of items qualifying for a 0% conversion factor. In any case, respondents stressed that the conversion factors used for large exposure purposes should be the same as those used for solvency purposes.

8. Respondents – mainly from large/sophisticated institutions – welcomed CEBS' proposal to allow them to use **the same conversion factors for large exposures rules as for solvency rules**. However, they stressed that exposure values should be based only on EAD, and not on other RWA components, as the latter would make the regime far more complex.

9. Regarding **credit risk mitigation techniques**, respondents once again stressed the importance of aligning the large exposures and solvency regimes, arguing that any other solution would impose disproportionate costs on institutions.

10. In general, respondents favoured the recognition of a broader range of **physical collateral** in the large exposures regime. They believe that CEBS underestimated the existence of sufficiently liquid markets and mischaracterized specific products (such as leased assets). Some respondents argued that what should be considered is the value of the collateral after the application of the appropriate haircut, rather than the institution's ability to obtain the corresponding liquidity immediately. For unfunded credit protection, some respondents argued that the large exposures regime should take double default into account.

11. Respondents expressed the view that **indirect exposures** should not be subject to large exposures limits, but should instead be treated under Pillar 2 with a requirement for regular stress tests.

12. The respondents were in favour of continuing to differentiate between **trading book** and **banking book** exposures, on the grounds that trading book exposures are less subject to unforeseen events, and are monitored more actively (stress testing, mark to market method). They felt that any other proposal would have a significant impact on costs and on the provision of services, especially at investment firms.

13. Regarding the **scope of application**, respondents argued that, in countries that have standards that are equivalent to the CRD, the large exposures

regime should apply only on a consolidated basis. Respondents also welcomed the exemption of investment management firms from the large exposures regime.

14. Respondents objected strongly to regulatory limits on **intra-group exposures**. They felt that as long as there are no practical impediments to the prompt transfer of own funds, banking groups should have the flexibility to manage intra-group transfers of capital, which are generally less costly to the group than other forms of funding. Respondents believed that the same rule should apply to exposures to group entities in all countries with equivalent supervisory standards, both within and outside the EEA.

15. Some respondents argued that the **national discretion** provided in Article 113.2 of the CRD (exemption of intra-group exposures from the large exposures regime) should be maintained. Others suggested that intra-group exposures should not be limited when there is common risk management and capital transferability, or when the parent has communicated to the concerned supervisory authorities its commitment to provide support to its subsidiaries in case of need.

16. Some respondents commented that they saw no justification for the CRD's **20% limit on exposures to subsidiaries** which, although not consolidated, are controlled by the parent institution, when the large exposures limit for unconnected third parties is 25%. They favoured applying the same 25% limit to both cases.

17. Most of the respondents agreed with CEBS' proposal to exempt exposures under article 113.3 (a) to (f) of the CRD: i.e. claims on **sovereigns, international organizations, and some regional governments and local authorities**.

18. Respondents were opposed to the introduction of a hard 25% limit on **interbank exposures,** and more specifically to the removal of the current national discretion that allows the exemption of interbank exposures with maturities of less than one year. Their concerns focused mainly, but not exclusively, on the impact on smaller banks; they argued that counterparty diversification would become more difficult, riskier, and more costly for small banks, and also for banks active in small markets outside the Euro-zone. These banks would be forced to move to riskier counterparties, ultimately driving up their capital requirements.

19. Respondents at smaller institutions stressed the problems that such a rule would create in everyday liquidity management, specifically for exposures of less than one year maturity. It would leave many small institutions with few attractive options for managing their excess liquidity, disrupting their operations and ultimately driving up the risks assumed by the institutions and the costs passed on to their customers.

20. Respondents at large institutions proposed that any limits imposed on interbank exposures should take the **maturity of the exposures** into account, in order to distinguish between funding liquidity and credit allocation.

21. Respondents considered that the best supervisory response to a **breach of limits** would be for the institution and its supervisor to agree on an adjustment period for returning to compliance, during which time the excess exposure would be deducted from the institution's own funds. Some respondents argued that, since the focus of the large exposures regime should be on consolidated exposures, some flexibility should be allowed in cases where the large exposures limits are breached on a solo or sub-consolidated basis, but not on a consolidated basis.

22. Most of the respondents agreed with CEBS' proposal that **reporting** should be based on a harmonized reporting framework defined by supervisors, in order to decrease reporting burdens on institutions. However, a few respondents (mainly large institutions) favoured the use of their internal reports.

23. Respondents did not express any strong views on CEBS' proposals on the issue of **credit risk management**.

Feedback table on CP16: analysis of public responses and suggested amendments

CP16	Summary of comments received	CEBS' response	Amendments N/R : change not required
Chapter 1: Summary of CEBS' key findings in Part 1 of its Advice			
	Respondents agreed that an amended limit-based backstop regime is the best tool for addressing the market failures related to Large Exposures (LE). One respondent argued that an amended limit-based back stop regime is not sufficient, and that an internal limits-based approach would be the most suitable approach. In general, all respondents stressed the need to align the large exposures and solvency regimes and to eliminate national discretions. A few respondents considered large exposures rules not to be an appropriate solution to liquidity crisis situations. A few respondents argued that large exposures are closely linked with concentration risk and that the amended	Agreed. CEBS agrees that national discretions result in uneven application of the large exposures regime across Member States, and is proposing to eliminate many of the national discretions in order to align the large exposures regime as closely as possible with the solvency rules. Nevertheless, some national discretions (e.g. for intra-group exposures) may be retained as appropriate mechanisms for addressing differences in cost/benefit analysis across Members States	N/R

	large exposures regime should not duplicate the concentration risk regime. They called for a clear distinction between large exposures limits for idiosyncratic risk and the management of concentration risk under Pillar 2. One respondent proposed an approach that would differentiate between small/less complex and large/AIRB institutions.	The objective of a large exposures regime is to capture negative externalities arising from single name large exposures that give rise to the risk of traumatic losses due to 'unforeseen events'. This market failure is not fully addressed by any of Basel II's three pillars. In particular, CEBS believes that a Pillar 2 approach is not sufficient to address the identified market failure, and that other regulatory tools are necessary to meet the objectives of an effective large exposures regime. CEBS believes that differentiating supervisory treatment according to the size of the institution would not be an appropriate solution, as it would cause problems in the definition of the instructions and would introduce competitive distortions in the market.	
Chapter 2: Definition of Large Exposures (connected clients)			
	Respondents agreed with the proposed definition of 'control'. However, most respondents strongly opposed the proposed definition of 'interconnectedness' and recommended deleting this criterion from Art. 4 (45) of the CRD. Respondents considered the current definition to be impractical and imprecise. They judged that the examples provided in paragraph 92 CP16 expanded the scope of financial dependency without associating	CEBS believes that there is a need to clarify the definition of connected clients. In order to capture all dimensions of connectedness, CEBS proposes to amend Article 4 (45) of the CRD. This broadening in the scope of the rule was considered necessary in orders to include the element of a common source of funding in the definition. Recent events in financial markets	Please see Chapter 3 of the Advice.

	them with measurable criteria. They felt that 'interconnectedness' should be limited to mutual financial dependency. The criterion of one-way dependency would lead to very large groups of clients, thus mapping sectoral or regional risks which are outside the scope of the large exposures regime. Some respondents argued that 'interconnectedness' should not be defined in the large exposures regime, but should instead be determined on the basis of an institution-driven case-by-case credit analysis. Some respondents did not agree that the supervisor should have the final decision on whether a client should be regarded as part of a group of connected clients, noting that supervisors may not have all the detailed information possessed by the institutions. Some respondents also raised concerns about the practical feasibility of the proposal to include an entity in more than one group of connected clients in some cases. Respondents called for the definition of connected clients in large exposures rules to be aligned with CRD solvency rules in order to avoid separate grouping of clients and double counting of risk (and consequently capital) between the two regimes.	have shown that two or more undertakings can be financially dependent because they are funded in the same vehicle. CEBS agrees with the comments received on the proposed definition of 'interconnectedness', and is proposing a non-exhaustive list of examples. The list provides an illustration of a relationship of possible financial dependency for which institutions would normally need to group clients. CEBS also believes that Level-3 guidelines on the concept of connected clients should be issued in order to ensure a common interpretation of the definition in all Member States. CEBS believes that, in addition to the issue of control of one client over another, institutions should be required to consider whether there is a relationship of dependency or correlation between clients. If it is likely that the financial problems of one client would cause repayment difficulties for the other, there is a financial dependency that needs to be addressed. A dependency connection between the clients may be mutual or one-way. It is implicit in the CRD provisions that when the opinions of the institution and the supervisor diverge, the supervisory authority makes the	

		final decision. This rule applies to the decision as to whether a client must be regarded as part of a group of connected clients.	
Chapter 3: Definition of exposure values			
	A number of respondents argued that CEBS' proposal should include a formula for calculating the exposure amount to be compared with own funds. One respondent proposed one possible formula. A few respondents from specialized institutions argued that, in order to capture single name unforeseen event risk properly, the large exposures regime should take double default into account: that is, it should consider both the underlying exposure and the credit protection. One respondent believes that the appropriate treatment of guaranteed and guaranteeing exposures is to recognise neither the guarantor nor the guaranteed, because both the guaranteed and guarantor parties have to fail in order for a firm to suffer financial difficulties.	CEBS does not intend to propose a specific formula. Instead, CEBS has clarified the definition of exposure value to indicate that the proposed backstop regime is applied to the most accurate exposure value for which the firm has regulatory permission under the CRD. CEBS's view is that institutions should be allowed to use the 'substitution' approach for unfunded credit protection. The substitution approach implies that the institution can choose to assign the exposure to the direct creditor, without taking into account the guarantee for large exposures purposes, or to assign the exposure to the guarantor, assuming the default of the direct creditor. Both choices are in line with the purposes of the large exposures regime. CEBS's view is that the recognition of double default in the large exposures regime is not consistent with the principle of non-recognition of creditworthiness for large exposures purposes.	Please see Chapter 5 of the Advice

On-balance sheet items	Most respondents considered that on-balance sheet items should be calculated net of accounting provisions and value adjustments. One respondent argued that the above rule should not apply to gains in value of AFS securities, andthat the items included in the calculation of the large exposures value should be aligned with those that are included in the calculation for own funds purposes. Another respondent believes that the term 'value adjustments' relates only to specific charge-offs (such as LLPs) and not to general value adjustments. A few respondents proposed that the calculation of exposure values for on-balance sheet items should be consistent with the CRD, meaning that exposure values for SA institutions should be net of specific provisions, while for IRB institutions they should be gross of specific provisions. A few respondents proposed that the exposure value should be gross of accounting provisions and adjustments; otherwise banks would bear the cost of making two separate exposure calculations under the two regimes.	Agreed. CEBS believes that exposure values for on-balance sheet items should be based on relevant accounting standards. This means that exposures will be calculated net of accounting-specific provisions and value adjustments (not general value adjustments). The proposed rule is consistent with the general principle that items that are deducted from own funds should not be recognised for large exposure purposes. This rule should apply to both standardised and IRB institutions. A provision has been included to ensure that specific provisions and value adjustments are not considered twice, once for the calculation of exposure value for large exposures purposes and once for the calculation of own funds.	Please see Section 5.1. of the Advice.
Off-balance sheet items	Respondents would prefer to be able to apply the same approach in both the large exposures and solvency regimes. They considered a 0% CCF to be adequate and	The proposed large exposures regime is a 'backstop' and not a risk-sensitive regime. Even if market participants believe that it is very unlikely that an exposure will be drawn, it is still	Please see Section 5.2. of the Advice.

	justified for low-risk items. Most respondents considered the 100% CCF to be unnecessarily conservative. They argued that items having the same risk should have the same weight for solvency and large exposures purposes, which would not be the case if different CCFs were applied to the same items under the solvency and the large exposures regimes. One respondent argued that if credit lines are included in the large exposures regime, there should be a clear distinction between committed and uncommitted facilities. Respondents believe that AIRB institutions should be permitted to use the same CCF for large exposures purposes as in their internal methods that have been approved by supervisors for solvency purposes. These respondents felt that the main objective should be for institutions to harmonize and streamline calculations and monitor exposures for both solvency and large exposures purposes, as this would reduce IT and reporting costs. Any other proposal would reduce incentives for institutions to move to the advanced approaches. One respondent considered some of the principles to be redundant, since supervisory approval of the models used for solvency purposes is a prerequisite.	imprudent to enter into an exposure of more than 25% of own funds. CEBS concludes that it is prudent to apply a 100% CCF to all off-balance sheet items. Recent events in financial markets have shown that a conversion factor of 0% for undrawn credit facilities that may be cancelled unconditionally at any time may underestimate the risk involved. A credit institution may not be able to exercise this right, for reputational or operational reasons. As stated above a 100% conversion factor was considered appropriate for all off-balance sheet items and for all types of institutions. That means that AIRB institutions are not permitted to use their own exposure calculations and therefore the principles initially proposed in CP16 are not included in CEBS's Advice.	
Financial derivatives and	Respondents from large institutions stressed	Agreed. CEBS proposes that institutions be allowed to use for the	Please see Section

securities financial transactions	that institutions which are permitted to use the IMM should not also be asked to calculate the PFE for large exposures purposes. They should instead use only their EPE, while continuing to use PFE internally to satisfy the use test.	large exposures regime the same exposure values that they use in the capital requirements framework. This includes those institutions that have obtained permission to use the Internal Model Method (IMM) set out in Annex III, Part 6 of the CRD to calculate exposure values for certain transactions.	5.3. of the Advice.
CIU's, structured transactions and other arrangements where there is exposure to underlying assets.	Respondents agreed with CEBS' proposal for schemes with underlying assets, and with the proposed principles. One respondent stated that it should be left to the institution to determine whether the exposure stems from the scheme, the underlying asset, or both. One respondent suggested guidance as a starting point for the development of such principles (e.g. the notion that firms could ignore structures in which the underlying assets were known not have an impact on large exposures).	CEBS proposes to develop further guidance on the appropriate treatment of various structured instruments. The elements proposed by some respondents will be taken into consideration.	Please see Section 5.4. of the Advice.
Chapter 4: Credit Risk Mitigation Techniques and Indirect Exposures			
	Respondents were strongly in favour of full alignment between the large exposures and solvency regimes, judging that the CRD's minimum requirements are already conservative and satisfy the needs of the large exposures regime. They felt that recognizing CRM techniques in a way that differs from their recognition for solvency purposes would lead to higher implementation costs for institutions, without any added value for the industry. In	CEBS has again considered the option of full alignment of the large exposures and the solvency regimes and has concluded that full alignment does not ensure that the prudential concerns will be kept at an acceptable level. CEBS therefore confirms its previous conclusion that the solution strikes the best balance between prudential	Please see Chapter 7 of the Advice.

	their opinion, any other alternative would make calculations more complex, since it would require separate calculations of PDs and LGDs for the borrower and the guarantor of the protection. They thought that the large exposures regime should rely only on the EAD calculation for collateralized exposures. Respondents considered that the conditions of Annex VIII of the CRD relating to minimum requirements and eligibility for the recognition of funded and unfunded protection are sufficient for both solvency and large exposures rules. One respondent shared CEBS' concerns about the liquidity of some collateral, and agreed that only those CRM instruments that are considered sufficiently liquid should be accepted. Most respondents agreed that institutions that use the simple method should use the substitution approach for large exposures purposes. Some respondents suggested that institutions should have the flexibility to choose between the substitution approach and the approach used in the comprehensive approach.	concerns and the cost/benefit arguments is to accept the same treatment of credit risk mitigation techniques for large exposures purposes as for solvency purposes, but only for those CRM instruments considered sufficiently liquid. Once an element becomes eligible as credit protection for large exposures purposes, it is subject to the minimum requirements set out in annex VIII of the CRD. Thus, for these instruments, there is full alignment of the large exposures and solvency regimes. In order to be consistent with the treatment provided for solvency purposes, CEBS agrees that for institutions that use the simple method under the CRD, the substitution approach under Article 117.1.b should also be recommended in the large exposures regime.	
Physical collateral	Most respondents thought that physical collateral should be eligible for CRM purposes under the large exposures regime if it is eligible under the solvency regime. One respondent argued that the large	In view of the great uncertainty surrounding the valuation of other physical collateral due to the low liquidity of these markets, CEBS' view is that physical collateral other than	Please see Section 7.1 of the Advice

	exposures regime should recognize physical collateral to an even wider extent than under the solvency rules. Respondents argued that CEBS ignores the fact that there is an efficient market for retail and SME defaulted loans in several countries. They considered the issue to be the collateral's value after the appropriate haircuts, rather than the institution's ability to obtain the corresponding liquidity. Respondents stressed the need for alignment with solvency rules, and for a uniform definition of 'timely' between the two regimes. Respondents noted that different approaches in the two regimes would increase IT costs. For leasing transactions, respondents argued that physical collateral other than real estate can meet the criteria of timely and certain recovery, due to the nature of the contracts. Respondents felt that CEBS' proposal does not recognize the timely and relatively certain recovery of leased assets, and that such recognition would give institutions incentives to hold high-quality protection and to practice sound management, thus resulting in a better regime.	real estate collateral should not be recognised for large exposures purposes, whatever approach the institution is using. CEBS has not identified any market as being sufficiently liquid for the purposes of the large exposures regime, apart from the residential and commercial property markets. In CEBS' view, when institutions experience solvency/liquidity stress as a consequence of the default of a large exposure, it is crucial that the recovery of these amounts should be certain and timely. The need to obtain liquidity – by realising the collateral – can be more acute in a large exposures scenario than in other circumstances, since it can be more difficult for the bank to obtain external funds. Thus the relevant exposure value for large exposures purposes is not necessarily the same as for minimum capital purposes, because the time horizon for the assessment is not the same in both cases, particularly for the most illiquid mitigation instruments.	
Indirect exposures	Respondents considered the appropriate treatment of indirect exposures to be a stress testing framework rather than a limit-based regime.	Agreed. CEBS's view is that there are good reasons to require institutions to	Please see Section 7.2 of the Advice

		mitigate the idiosyncratic unforeseen event risk inherent in indirect exposures. However, an approach to indirect risk based on quantitative rules may not be a practical. CEBS believes that a requirement for appropriate stress tests, combined with suitable information requirements, is preferable to designing a system of limits.	
Chapter 5: Trading Book issues			
	Respondents agreed with CEBS' proposal to maintain the differentiation in approaches between the banking and trading books. They felt that the problem of regulatory arbitrage between the banking and trading books is outside of the scope of the large exposures regime. They noted that unforeseen event risk is lower for trading book exposures, since they have a shorter time horizon and are effectively managed with mark-to-market and regular stress testing. One respondent suggested differentiating between small and larger institutions, since larger institutions are in a position to apply the same rules to both banking and trading book exposures. One respondent believed that CEBS' opinion that an alignment of the two regimes would have adverse effects on investment firms is contradicted to some extent by the work currently being conducted on incremental default risk. This respondent considered that	Agreed. Based on the supporting responses of the banking and investment sectors CEBS confirms its view that an alignment of the banking and the trading book regime should not be pursued and that the current regime is appropriate.	Please see Section 6.4 of the Advice

	the inclusion of an incremental default risk charge in the trading book will reduce the differences between banking and trading book risks, and thus that no blurring between trading and banking book exposures will occur. Following this argument, another respondent thought that the current level of own funds for investment firms should not be changed, since it is in line with the UCITS framework Some respondents felt that all products belonging to the trading book – including credit-related products – should be treated the same, but that institutions should pay attention to the features involved in each product when classifying them in the trading book. Regarding the deduction of excess trading book exposures, respondents stated that the current regime works well and that a change from the current regime would overstate the risk of these exposures and result in additional costs for the industry.		
Chapter 6: Intragroup exposures (Scope of application; Specialized institutions)			
Scope of application	In general, respondents believed that the large exposures regime should apply only at the consolidated level. Some respondents raised concerns regarding the unlevel playing field of the CRD regime for the leasing industry.	CEBS believes that no changes are needed in the current scope of application. The large exposures rules should apply at the consolidated, sub-consolidated, and solo level (in this case, with the option for supervisors to waive this requirement).	Please see Chapter 4 of the Advice.

Intra-group exposures	Respondents from large institutions and associations argued that no limit should be applied to intra-group exposures between entities subject to the same consolidated supervision, whatever the location of the entity (within or outside the EEA), provided there is supervisory equivalence. They felt that CEBS proposal does not recognize the lower risk profile of intra-group funding, and that the large exposures regime is not the appropriate tool for regulating intra-group exposures in the absence of an insolvency regime. Most respondents considered the fungibility of capital to be an important consideration, and that it should be taken into account in exempting intra-group exposures from the large exposures regime. Respondents believe that limits would prevent institutions from managing and allocating liquidity efficiently across group entities, and would interfere with the capital allocation policy of banking groups. They felt that limits would also create additional barriers to the free movement of capital across the EU, thus increasing the liquidity risk for subsidiaries; increase funding costs (due to more expensive and less stable sources of funding) and operating expenses; and place institutions in smaller Member States at a competitive disadvantage. Respondents generally agreed that the large exposures treatment of intra-group	The approach proposed by CEBS reflects the fact that the market failure associated with the treatment of intra-group exposures in the large exposures regime is present to varying degrees in the different EU Member States. The cost/benefit analysis presented in the Advice indicates that removing the national discretion to exempt intra-group exposures from large exposures limits would not be appropriate, because of significant differences in the impact of limiting intra-group exposures on the functioning of Member States' banking systems. CEBS's advice is to retain the national discretion set out in Article 113.2, which provides that intra-group exposures may be fully or partially exempted from large exposures limits when counterparties are covered by the same or equivalent supervision on a consolidated basis. CEBS also proposes to extend the current national discretion to exposures that satisfy the conditions of Article 80.8 of the CRD. This would allow Member States to exempt from Large Exposure rules exposures to entities that are members of the same institutional protection scheme.	Please see Section 6.5 of the Advice

	exposures should be aligned with their treatment for solvency purposes, except with respect to Article 80.7(d) of the CRD. They recommended exempting all intra-group lending from large exposures limits: not only exposures to subsidiaries established in the same Member State, but also exposures to subsidiaries established in any country, provided either that the parent company has committed to support the subsidiary if needed or that institutions can demonstrate that they have common risk management of all entities and capital transferability within the group. Respondents asked for clarification as to which conditions (Art. 69 or Art. 80.7 of the CRD) should be satisfied in order for intra-group exposures to be exempted. One respondent proposed a number of eligibility criteria that could be applied. Some respondents proposed that any change in the current rule should allow institutions some flexibility in managing their intra-group exposures.	CEBS considers that the costs of imposing limits on large exposures are likely to exceed the benefits where the supervisor of the creditor entity judges that capital is fungible, that groups can credibly commit in advance to support a particular entity, and that all counterparties in the group share the same risk characteristics. Alternatively, when exposures are not within the same legal jurisdiction, but there are robust loss-sharing and other arrangements for dealing with a troubled or failed cross-border banking group.	
	The few respondents who addressed the 20% limit on exposures to group entities (Article 111.2 of the CRD) were opposed to it, and recommend that this article be deleted. They argue that there is no rationale for applying a stricter limit to group entities, for which institutions have more detailed information. One respondent recommended that the	CEBS agrees that the 20% limit is not justified, and therefore recommends that Article 111.2 be deleted and replaced with qualitative principles designed to ensure that firms are managing their exposures to entities outside of their consolidated group on an arm's length basis. CEBS recommends that Article 113.3(n) also be deleted. CEBS notes	

	exemption provided for in article 113.3 (n) be maintained, because the bundling of deposits in a central entity is often essential for remaining competitive.	that the proposed treatment of interbank exposures will allow small banks that are members of a network to continue to bundle deposits with a central or regional entity for cash-clearing purposes.	
Specialized institutions	Most respondents agreed with the exemption from large exposures limits for investment managers and other financial institutions that are not credit institutions, since they are not exposed to the risks associated with large exposures (they are not authorized to lend money or to hold deposits), and they have relatively low capital requirements.	Agreed.	Please see Section 4.2 and 4.3 of the Advice.
Chapter 7: Sovereigns, international organizations, multilateral developments banks and public sector entities			
	Most respondents agreed with CEBS' proposal to exempt exposures under Article 113.3 (a) to (f) and to eliminate the corresponding national discretions. A few respondents proposed that institutions should have the discretion to apply large exposures limits if they consider that the risk assessment justifies such treatment. One respondent opposed CEBS' proposal, which it considered politically motivated and not in line with the default experience for sub-sovereigns.	On reflection, CEBS believes that exposures under Article 113(3), item (e), can be exempted if a number of conditions – based on annex VI, part 1, paragraph 5 of the CRD - are met.	Please see section 6.1 of the Advice.
Chapter 8: Interbank exposures			
	Respondents were generally opposed to any extension of the regime to interbank exposures, as this would severely restrict	CEBS has concluded that the basic market failure analysis applies to interbank exposures: large interbank	Please see Section 6.2 of the Advice.

	the activities of smaller banks. It could also impose significant restrictions on market liquidity and affect banks' liquidity management more broadly. Respondents felt that the implications of this proposal at the micro level have not been fully considered. The responses from small institutions stressed that this rule would damage their business model (particularly for banks with excess liquidity to invest) and could put them out of business. They argued that imposing a 25% limit on interbank lending would actually increase the portfolio credit risk for many smaller banks: since it would be very difficult for them to find enough creditworthy banks to place their funds, they would have to turn to a broader set of counterparties in which to invest, most of which would be of lower credit quality. Respondents argued that reduced opportunities to place fund in the interbank market would result in reduced returns and profitability. This would have a negative effect on the pricing (interest rates) offered to their depositors. Respondents also argued that administrative costs would increase, due to a larger number of transactions, resulting in an increase on operational risk. Large institutions (as well as building societies) urged CEBS to consider the impact of this proposal on IRB institutions that will operate with reduced capital levels due to	exposures give rise to systemic risk that must be addressed. However, the costs and benefits of imposing limits on unsecured exposures varies significantly across banks and across Member States. CEBS considers that the risk-weighting of exposures would not be conducive to achieving the stated objectives of the large exposures regime. It is important to ensure that the ex-ante measure meets the objectives of the regime: for a backstop to be effective, it must be calibrated to insulate the lending bank from the unforeseen failure of its counterparty. Risk weights of 20% or 50% weights do not capture the impact of unforeseen event risk: they would allow banks that have between 100% and 250% of Tier 1 capital exposed to a single counterparty, and thus, if that counterparty were to default, would almost certainly lead to the failure of bank unless it received external support. CEBS acknowledges that exposures with longer maturities are associated with greater unforeseen event risk than exposures with shorter maturities. However, in order to protect against failures that arise with little or no warning, CEBS considers it generally inappropriate to make blanket exemptions for short maturity exposures in a backstop regime.	

	the implementation of the CRD. They also argued that this proposal would confer a significant competitive advantage on U.S. banks, with major repercussions for large European banks that compete in the interbank derivatives market. Respondents representing small institutions and associations provided estimates of the quantitative impact that this limit would have on their business. One investment firm argued that CEBS' moral hazard argument under the MFA does not apply to investment firms, as there is no moral hazard associated with OTC derivatives or securities financing transactions. Many respondents questioned CEBS' argument that institutions can collateralize these exposures without additional costs. They suggested that interbank markets are not as deep and liquid as CEBS assumes, and it can be difficult in practice to collateralise derivatives exposures. They also suggested that CEBS' argument does not apply to banks with a small capital base. Some respondents suggested that recent market events arose not from the level of capital but rather from poor credit judgement regarding the risks associated with opaque products. In their view, the resulting liquidity concerns should not be addressed by a regime that is focused on capturing losses from unforeseen event risk.	There is a trade-off between exempting exposures of progressively longer maturities and achieving resilience against a wider range of unforeseen events affecting banks. Moreover, imposing meaningful limits on smaller banks could impose high costs on them: it would probably cause some of them to go out of business. Therefore CEBS considers it appropriate to make some provision for smaller banks. CEBS has reviewed this section and redrafted the proposal. The current proposal addresses the supervisory concerns derived from the MFA and provides a balanced approach for institutions of all sizes.	

	Most respondents agreed with CEBS' analysis of market failure in interbank exposures. However, they considered defaults to be very unlikely when very low maturities and highly rated counterparties are involved: since institutions are regulated entities they are unlikely to default in the short term. Respondents felt that if CEBS intends to propose limits on interbank exposures, those limits should take the maturity of the exposures into account, in order to distinguish between funding liquidity and credit allocation. Most of the respondents recommended that exposures of maturity less than one year be excluded. One respondent proposed as an alternative approach to eliminate the national discretions under Article 113 of the CRD and harmonize the risk weightings. One respondent recommended applying a 25% limit to interbank exposures without taking maturity into account, because this would protect against systemic risk. Some respondents indicated that they do take implied government support into account when assessing their counterparties. Some indicated that they would invest more resources in counterparty credit risk evaluation if the limits were tightened. A number of respondents stated that they welcomed reporting and peer review of		

	interbank exposures.		
Chapter 9: Breach of limits			
	Some respondent considered that limits should never be breached at a consolidated level (since the scope of application for large exposures should be the consolidated basis), but that less stringent rules should apply at the sub-consolidated or solo level (e.g. the breach may be maintained for a longer period and no deduction of the excess from own funds should be applied). They also thought that breaches of limits should be considered acceptable in few exceptional cases. Overall respondents agreed with CEBS' proposal for a supervisory response to breaches of limits that would be implemented consistently across Member States: i.e. deduction of the excess exposure from own funds.	CEBS believes that the breach of limits rules should be the same regardless of the level of application of the large exposures regime. CEBS believes that the most appropriate solution is to allow a temporary breach, only when specific and extraordinary circumstances occur, provided the excess is deducted from own funds. This will provide the institution an adjustment period in which to return to compliance.	Please see Chapter 8 of the Advice
Chapter 10: Reporting			
	Many of the respondents who provided comments on reporting were in favour of harmonized quarterly reporting requirements based on framework defined by supervisors, although the use of institutions' internal reports was widely supported as well. Respondents categorically rejected reporting under pillar 3. Respondents in favour of reporting defined by supervisors stressed the importance of a simple harmonised reporting format with harmonised reporting frequency and due	CEBS' opinion is that the best way to meet the objectives laid down for reporting to supervisors is for those reports to be defined by the supervisors. This would ensure that the definitions and risk metrics used in the reports from different institutions would be identical, in line with CEBS' views regarding exposure values for the purposes of the large exposures regime.	Please see Chapter 9 of the Advice

	dates. They felt that attention should be given to ensuring that reporting would not lead to additional administrative burdens on institutions. Some respondents thought that CEBS' proposal is not the best solution. They argued that 'one size fits all' reporting is not feasible for large exposures purposes and would overlap with the institutions' internal reports. They thought that reporting should be based on these internal reports, which in their view are more granular and more accurate and would provide the supervisor with a better understanding of the institution's own risk management processes. Respondents called for further consultation with industry regarding the elements to be reported. According to some respondents, exposure values to be reported should be calculated along the same lines as in the COREP templates, in order to ensure the inter-operability with COREP reporting. Many of the respondents were opposed to the reporting of exposures that are exempted from Large Exposure limits. Reporting of the composition of the group of clients was also regarded as excessively burdensome.	CEBS' intends to highlight to the Commission the need for further CEBS' guidelines regarding reporting requirements and format. The development of such guidelines will involve further consultation with the industry. CEBS is still of the opinion that exposures exempted from the large exposures limits should be reported. CEBS believes that it is important for supervisors to be fully informed of all large exposures incurred by institutions The aggregate exposure to all counterparties belonging to the same group (group of connected clients) is relevant for triggering the reporting obligation as well as for enforcing the large exposure limit. In this respect, the composition of a group of connected clients is crucial for the scope of institutions' lending. In order to allow supervisors to verify that institutions comply with such rules, the institutions should indicate the composition of the group in their reports.	