Febelfin

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Implementation Guidelines on the Revised Large Exposures Regime, CP 26, unofficial Febelfin comment

Brussels, 11/09/2009,

Dear Sir,

Febelfin, i.e. the Federation which regroups four trade associations from the Belgian financial industry[1], welcomes the opportunity to express its views on the consultation document mentioned above. We send you our comments in an unofficial way, as they still have to be evaluated by the Febelfin Board.

We observe that the new notion of « connected clients » potentially differs from the current internal definitions within the banks, especially concerning the criterion of "connection through a common main and not easily replaceable source of funding". This brings a fundamental problem of compatibility with the definitions currently calibrating the notation systems in the IRBA framework. We kindly ask regulators to investigate this issue.

We acknowledge that underlying assets should ideally be taken into account when calculating large exposures, but ask for realistic expectations: many banks are currently unable to apply a look-through approach, and probably no one is able to implement it within a short time-frame.

The availability of information about individual underlying assets is currently insufficient in banks, notably for externally managed schemes. We don't argue the necessity of this improvement, but additional resources must be put in place. Taking into account these difficulties, we wish a grandfathering clause allowing to apply the new rules only for the new investments. If impossible, a reasonable delay would be welcome. In all cases, our member banks are ready to discuss bilaterally with the regulators to establish how this item can be managed and reported in a transitory period.

While we approve the principle of a progressive approach with incentives to migrate to a full look-through calculation, we would like to bring two points to the attention:

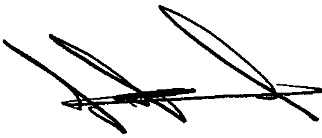
[1] The following trade associations are part of Febelfin: the Belgian Bankers' and Stockbroking Firms' Association (ABB/BVB); the Professional Union of Credit Providers (UPC/BVK); the Belgian Asset Management Association (BEAMA); the Belgian Leasing Association (BLA).

a) The rules to take the risk mitigation into account in the treatment of tranched products are extremely complicated; we fear that they are very difficult to implement and that they take away all intelligibility of the system. Low complex rules would be very welcome in this area.

b) Regarding all unknown exposures as one specific group of connected clients can have unmanageable consequences, and we are afraid that this residual category would be higher than expected.

We hope these remarks will be taken into account. Please do not hesitate to contact our services and our working group, should you want any further information.

Yours sincerely,



Michel Vermaerke
Chief Executive Officer

Daniel Mareels
Director Taxation & Prudential, Legal & Compliance

Enc.

cc. Mr Jean-Paul Servais, Chairman, Banking, Finance and Insurance Commission.

Implementation Guidelines on the Revised Large Exposures Regime, CP 26, unofficial Febelfin comment, annex

Introductory remark: we have mentioned only these questions for which we have specific comments.

Connected clients

1. Are the guidelines in relation to the Interpretation of control sufficiently clear or are there issues which need to be elaborated further or which are missing? Please provide concrete proposals on how the text should be amended.

Following §§ 41-44 we wonder how to calculate the exposure for companies controlled on an equal basis by several parties (50/50; 33/33/33;...). In this context additional guidance would be appreciated on how we need to interprete § 44: '*The entire exposure to a connected client must be included in the calculation of the exposure to a group of connected clients, it is not limited to, nor proportional to, the formal percentage of ownership.*'

2. Are the guidelines in relation to the Exemption from the requirement to group clients in relation to control sufficiently clear or are there issues which need to be elaborated further or which are missing? Please provide concrete proposals on how the text should be amended.

In § 46 the following is mentioned: For subsidiaries where the majority of the shares are owned by the central government, and exposures to the central government receive a 0% risk weight under the Directive 2006/48/EC, *there is no requirement to group the subsidiaries as connected clients.*

We wonder if we should read this sentence as:

a) Banks should not group the subsidiaries as connected clients;
b) Banks have a discretion to group the subsidiaries as connected clients.

Supplementary, additional examples on how to group clients or not would be welcomed.

3. Are the guidelines in relation to the Interpretation of economic interconnectedness (single risk) sufficiently clear or are there issues which need to be elaborated further or which are missing? Please provide concrete proposals on how the text should be amended.

We would appreciate additional guidance to distinguish between economic dependencies which are either mutual or only one way.

We note also that economic interconnectedness is varying over time and consequently it will be very challenging for banks to adjust their capital to the ever changing interconnectedness of their clients. Referring to the example given in paragraph 49, a client may be able to overcome dependencies at a certain moment in time, but this may not be the case later on.

The concept of "economic interconnectedness", though meaningful, is likely to be difficult to implement in practice. First, because the information about such dependence is not always at hand (and involves some subjective judgments, as there are many grey areas) and, second, because applying that concept in full might mean that certain exposures would be counted twice, or more

often, as there would be potential overlaps between groups (for example when a guarantor provides guarantees to two different institutions). In banks' systems, groups of clients are mainly determined by control aspects. Such groupings are used for our internal processes, as well as for large exposure purposes. It would be unnecessarily costly to be forced to build a different grouping system only for large exposure purposes, because there might be some possible economic relations that the current system does not take into account.

While we agree with the statement in paragraph 47 that 'an institution is obliged to determine whether there exists a relationship of economic dependence between clients', however in doing so, an institution should be able to base its analysis on the available information (public, or communicated bilaterally). Economic dependences, most notably when they concern interbank guarantees, are confidential and generally not disclosed to the credit provider. Therefore, the institution will not be in a position to determine all existing relevant dependencies.

4. Are the guidelines in relation to the Interpretation of connection through the main source of funding being common sufficiently clear or are there issues which need to be elaborated further or which are missing? Please provide concrete proposals on how the text should be amended.

The new notion of « connected clients » potentially differs from the current internal definitions within the banks, especially concerning the criterion of "connection through a common main and not easily replaceable source of funding". It brings a fundamental problem of compatibility with the definitions currently calibrating the notation systems in the IRBA framework. These systems are based and calibrated on documented definitions of counterparts and it is not helpful to let the credit analysts apply two different definitions for PD or LE calculation purposes.

We propose to investigate this problem. The existing definition of counterpart and group in the internal models are not identical across the banks and it would be possible to investigate on a bilateral basis with the regulators whether the existing internal definitions are compliant and, if not, how they could be enhanced for LE purposes.

About the definition itself, if the two first criteria (direct or indirect control / economic interconnectedness) seem to be largely unambiguous, the third one (connection through a common source of funding) can be interpreted differently and should be clarified at European level. Some standards given in the CEBS document also are difficult to understand: by example, commitment of the bank to support conduits under similar conditions absolutely does not always mean that an economic or financial link exists between these counterparts.

5. What do you think about the proposed 1% threshold as proposed above?

We propose that the process to identify the connected clients should not be implemented for exposures that individually and before any interconnection, do not exceed 1% (a higher limit would be welcome) of own funds. Hence the materiality limit should be calculated before analysis of the economic interconnection.

6. Are the guidelines in relation to the Control and management procedures in order to identify connected clients sufficiently clear or are there issues which need to be elaborated further or which are missing? Please provide concrete proposals on how the text should be amended.

Paragraph 64 seems to indicate that credit institutions need to identify also whether **clients of their clients** are connected or not. We do not find this relevant for the calculation of LE exposures. May we ask explicit confirmation that such an identification is not necessary?

7. Are there remaining areas of interpretation of the definition in Article 4(45) of Directive 2006/48/EC that need to be covered in CEBS's guidelines?

See our comments under question 4.

Treatment of exposures to schemes with underlying assets according to Article 106 (3) of the CRD

8. Does the proposal provide sufficient flexibility for institutions to deal with different types of schemes? If you believe additional flexibility is necessary, how should the proposal be amended?

Feasibility

We acknowledge that underlying assets should ideally be taken into account when calculating large exposures, but we must be realistic : many banks are currently unable to apply a look-through approach, and probably no one is able to implement it within the foreseen deadline of a few months, due to the necessary upgrading of data processing systems and to availability of information.

Deeply upgrading or modifying the global framework of the Basel II data systems is a heavy IT process which needs to be analyzed, customized and tested. There is no light fall back solution : treatment of underlying assets must be totally integrated in the existing identification models, due to the constraint of connecting them with all the other direct or indirect exposures worldwide.
IT planning is not extensible and must be reasonably anticipated, taking into account the other regulatory constraints.

The availability of information about individual underlying assets is currently insufficient in the banks, notably for externally managed schemes. We don't argue the necessity of this improvement, but additional resources must be put in place, especially for the first census of the information and for the future follow-up on a day to day basis. Note that the credit reviews are organized on an annual basis, due to regulatory constraints of re-notation; it is not possible to neglect this process, and the detailed analysis of schemes with underlying assets should better be organized on the same basis.

Taking into account these difficulties, we wish a grandfathering clause allowing to apply the new rules only for the new investments. If impossible, a reasonable delay (end 2010) is absolutely necessary. In all cases, we are ready to discuss bilaterally with the regulators to establish how this item can me managed and reported in the best and realistic way in a transitory period.

Rules to calculate the exposures

We approve the principle of a progressive approach with incentives to migrate to a full look-through calculation, but we would like to bring two points to the attention :

a) The rules to take the risk mitigation into account in the treatment of tranched products are extremely complicated; we fear that they are very difficult to implement and that they take away all intelligibility of the system. We fear that the complexity and as well the logic of calculation rules removes any intelligibility. For example, the system ignores the difference in seniority between the first loss tranches, which is hardly defensible. More generally, it does not seem at all suited to underlying consisting in retail exposures. For these reasons we advocate a simpler calculation method.

b) Regarding all unknown exposures as one specific group of connected clients can have unmanageable consequences, and we are afraid that this residual category would be higher than expected.

We feel it is necessary to exempt the look-through approach to positions in the trading book as these are only held for a short period of time.

9. Do the fall-back solutions (approaches b) to d)) appropriately take into account the uncertainty arising from unknown exposures and schemes?

We wonder whether our interpretation is correct that all unknown exposures in all investment funds and structured products a bank has invested in need to be added together? We do not support such an approach, if confirmed.

We are of the opinion that all unknown exposures of a bank are unlikely to be fully concentrated. We propose to introduce a weighting (e.g. 50%) to reflect the likely concentration of banks' portfolios for which look-through cannot reasonably be applied.

Reporting requirements

We welcome that definitions and coherency of COREP would be the basis of this new reporting (under the new and unified COREP). The reporting requirements don't seem to be excessive or unreasonable.

17. Do you agree that the net exposure should be calculated as proposed above?

An important difficulty in relation to the implementation of the proposed reporting framework is that banks will have to report both before and after credit risk mitigation. For most IRB banks, the risk mitigation mechanism is inbuilt into the credit models and thus not available in the financial data warehouse for reporting purposes.

Furthermore, the treatment of value adjustments and provisions follows the standardized approach as large exposures should be reported net of these adjustments. This treatment would not seem compatible with the approach of IRB banks.

20. Please express your preference for one of the two alternatives outlined for the identification of a client or group of connected clients (2-Templates-Approach vs. 1-Template-Approach).

We prefer the 2-Template approach as it seems easier to implement.

21. Do you agree with the proposed reporting of CRM, in particular to differentiate only between "unfunded", "funded" and "real estate"?

See our comments under question 17.

22. Would it be possible to include more detailed information into the large exposure reporting, like total amount of collateral and guarantees available vs. the eligible part, types of securities and issuers provided as collateral or would this be too burdensome?

Information about the total amount of collateral and guarantees available is easy to provide for. However, reporting other information such as the eligible part, types of securities and issuers provided is very burdensome to implement.

If the total value of collateral is included, it should be clear what this encompasses: the market value or the collateral value? The value of the collateral available or used? And would this include only eligible or also non-eligible collateral?

24. Do you think the identification system of the counterparty as proposed and based on national practices is practical? Does an identification system based on national practices generate problems for cross-border banks? If yes, please describe the problems and propose how they can be solved.

We feel that an identification system based on national practices is difficult to align with the internal systems of each bank.

All counterparties are not identified by a national codifying system, and the codifying systems in the different countries are fundamentally different (except VAT numbers, limited to commercial bodies). The only solution is to use the internal identifying systems of the banks, subject to previous validation by the supervisors. Note that internal systems for identifying actors, which constitute the basis of the data systems developed for Basel II, are well known to regulators, who have audited them under the IRBA approval procedures.