Consultation response

Draft Regulatory Technical Standards

on the identification of a group of connected clients (GCC)

September 2022

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on the EBA's consultation on draft RTS on the identification of a group of connected clients (GCC). AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financialmarkets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, andthe Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.

AFME is registered on the EU Transparency Register, registration number 65110063986-76.

Consultation Questions

We provide responses to individual questions from the consultation below. Where a question has not been referenced, we have no additional comments.

Question 1. Could you please indicate, if the approach of sections 4, 6 and 7 of the existing EBA guidelines, now transposed in the Articles of the draft RTS, remains sound and is implementable with no major challenge or unduly high costs. Please elaborate.

Dependency

We believe the identification of economic interconnectedness between two or more entities is important and relevant in terms of clients monitoring and preventive management. As part of this monitoring, it is important to retain the flexibility that allows banks to assess economic relationships and distinguish between those relationships that constitute a dependency and therefore give rise to a connection, versus those that are not dependent and are therefore not classified as connected. As such, we are supportive that this element has been retained in the RTS.

Proportionality

Economic dependency relationships, different from control relationships, require quite granular information, which may not be obtainable. In the case of economic dependencies such as supply chain links or dependence on large customers, it is a commercially sensitive inside information.

Experience dictates that when applying the current guidelines, centralized databases are not available, thereby requiring very extensive and granular procedures. The process is operationally complex and very burdensome, and manual routines are required with higher workload in the form of a more detailed analysis and more subjectivity. Therefore, it entails high costs and time regarding

managing changeable information. Moreover, it is possible that different institutions will arrive at different results when analysing the same entities.

As such, the RTS should clearly define the principle of proportionality for identifying economic dependencies. In the cases where the sum of all exposures to one individual client do not exceed 5% of Tier 1 capital, we consider that banks should just use readily available information with a proportionate approach, as it is stated in the current guidelines.

Double Counting (of Single Risk)

We would also like to highlight the issue of double counting that impacts on a bank's management limits. Including the same entity in multiple connected client groups artificially increases aggregate exposures, thereby limiting bank capacity to support the real economy.

Connectedness of Central Governments

We welcome the feedback provided during the public hearing that the ECB and EU central banks are independent of their respective governments and that for third countries a review of dependence must be performed on a case-by-case basis.

Question 2. Have you identified any additional aspect(s) that would require clarification? In this vein, would you see the need for further illustrative examples (and if yes, on which precise situation or specific case)? Please elaborate.

It is imperative for institutions to give due emphasis to the clause (cannot be replaced in a timely manner without excessively increased costs) – as, it could still be possible for the entity to easily (i.e., in a timely manner without excessively increased costs) find a replacement or to compensate for any losses (or foregone profits) inflicted by the party in financial difficulties without experiencing own repayment difficulties; in which case the institution does not need to consider these companies / persons as a single risk.

Question 4. Is the additional Scenario C 0 related to the determination of a group of connected clients by means of control, listed in Section 3.4.1 (Groups of connected clients based on a control relationship), sufficiently clear? Would you see need for further illustrative examples of a control relationship?

We believe additional illustrative examples are needed as there are structures other than SPVs where the risk is segregated and there is no risk of contagion even though the control relationship exits.

Therefore, we would welcome the inclusion of illustrative examples for those structures where risk is segregated (in addition to SPVs) and clarity as to the cases where it can be refuted that these exposures be considered a single risk.

Question 6. In point (c) of Article 2(1), would you prefer following a quantitative approach by replacing the term "significant part" with a threshold of "50% or more" as envisaged in point 1 of LEX 10.16? What would be the advantages or disadvantages? Please elaborate.

As indicated by a number of respondents to the GL in 2017, a "significant part" depends on the specific situation and might involve different percentages. For example, a 50% threshold may be appropriate when assessing customer dependencies, but it may be relatively easy to substitute a supplier of a product / service that is homogonous.

A single threshold therefore is too rigid and likely capture some relations that are not meaningful in terms of economic dependency.

The benefit of a single threshold however, is that it ensures consistency of application and reduces the operational intensity with identifying relations.

Therefore, a possible approach would be to define a "significant part" as being presumed to occur if a 50% threshold is exceeded, which can be rebutted if a lack of dependency is deemed evident through an internal assessment. This will bring consistency whilst allowing banks to adjust for clear exceptions.

Question 7. What is your view on the wording "that cannot be replaced in a timely manner without excessively increased costs" compared to the wording used in the GL "that cannot be easily replaced"? What do you think about this change, is it more comprehensible? Please elaborate.

It is a better wording, because the relevant criterion is the cost to replace a supplier or a customer, in terms of different volume and price, irrespective if it is easy or uneasy from a management perspective. This could be further enhanced by specifying that 'timely' means sufficient time to avoid bankruptcy of the industry.

Question 8. Is the additional Scenario E 8 related to the determination of a group of connected clients by means of economic dependencies, listed in Section 3.4.2 (Establishing interconnectedness based on economic dependency), sufficiently clear? Would you see need for further illustrative examples of an economic dependency relationship? Please elaborate.

As raised during the public hearing, we would welcome more clarity on Scenario E8 – case of horizontal group by means of economic dependencies. In particular, we would like specific examples of when such a scenario could arise, and how any resultant single risk must be reported. In terms of the reporting, it is not clear in which group the single risk should be allocated as there are no control relationship between A, B or C.

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