



## **COMMENTS OF IRISH BANKERS FEDERATION TO CEBS' QUESTIONNAIRE ON THE SURVEY OF MARKET PRACTICES**

### **INTRODUCTION**

1.0 Irish Bankers Federation welcomes the opportunity to respond to the CEBS' Questionnaire on the Large Exposure Rules in the EU and we welcome CEBS' involvement in the exercise currently being conducted by the European Commission. The rules concerning large exposures were originally set out in 1992 in the EC Directive EC/92/121, effective from 1 January 1994. These rules were subsequently contained in the Consolidated Banking Directive 2000/12/EC and are now incorporated into the Capital Requirements Directive (CRD). The CRD makes some minor changes to the rules to bring the requirements into line with the new approach to credit risk as set out in the CRD. The same fundamental rules have however applied for over twelve years and a thorough review of the rules is in our view, warranted. However, the scope of this task, combined with the limited timeframe permitted does not allow for a comprehensive review of the large exposure rules. A comprehensive review of the large exposures framework should instead be pursued as part of a longer-term project. However, there are a number of specific issues that can be addressed within the timeframe permitted, notably, a move to achieve greater commonality in the application of the rules and reporting practices in place across Europe.

### **CEBS' QUESTIONNAIRE: REGULATORY ENVIRONMENT**

- 2.0 The Large Exposures Directive provides for a minimum standard and member states are free to impose more stringent limits. As ascertained by the European Commission in their review of the national large exposure rules, there are various national discretions exercised across Europe. In some cases, these national discretions are putting the institutions operating within that jurisdiction at a competitive disadvantage to their European counterparts, thus compromising the principle of a level playing field.
- 2.1 To support our call for greater consistency, we would like to highlight one of the major differences between the Irish Large Exposures Framework and the EU Large Exposures



Framework. As noted, member states are free to impose more stringent limits to those set out in the Directive. An additional limit imposed by the Irish Financial Regulator relates to sectoral exposures, whereby a credit institution “*shall not have risk assets amounting to more than 200% of own funds concentrated in any one sector or business or economic activity which is subject to a predominant risk factor; where a common risk could be considered to apply to two or more separate sectors ... not more than 250% of own funds shall be employed with such sectors in aggregate*<sup>1</sup>.”

- 2.2 The nature of the Irish banking industry is such that the majority of institutions operating in the Irish market are in some way specialised, with many institutions focusing on a particular niche of the market. Despite this tendency towards specialisation, diversification within these niches is attainable. While Irish Bankers Federation recognises the need to monitor and control sectoral exposures, we are of the view that recognition of institutions’ internal approaches to managing sectoral exposures should be relied upon. We question the merits of the current approach to sectoral analysis, whereby exposures are allocated to sectors based on a coding system. This approach takes no account of the underlying risk characteristics of the exposure and in our view fails to adequately capture real sectoral concentrations.
- 2.3 Irish Bankers Federation also questions the use of the term ‘predominant risk factor’. The Regulatory interpretation of the term ‘predominant risk factor’ is in our view arbitrary and has not evolved to take account of changing market conditions and risk management techniques. For example, the activities of an institution operating in the funds industry would predominately relate to the Financial Intermediation Section<sup>2</sup> of the Sectoral Return in place in Ireland. However, the very nature of this lending means that these types of exposures are not subject to a predominant risk factor and should not therefore be subject to the 200% restriction.

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<sup>1</sup> “Licensing and Supervision Requirements and Standards for Credit Institutions” (1995)

<sup>2</sup> There are 22 categories defined by the Irish Financial Regulator, ranging from exposures to Agriculture & Forestry to Hotels & Restaurants.



- 2.4 To our knowledge, no other EU jurisdiction has imposed similar restrictions relative to sectoral exposures. Institutions in Ireland are therefore operating at a competitive disadvantage to their European counterparts. This limitation is significantly restricting the lending capacity of institutions operating in Ireland. The extent to which an institution may be prudently exposed to a particular industry sector or geographical region will vary depending upon the characteristics of the individual institution and the sector or region concerned. A 'one-rule-fits-all' approach is not appropriate.
- 3.0 As stated above, we are of the view that a thorough review of the Large Exposure Rules cannot be achieved within the timeframe permitted. However, we are of the view that the outcome of the European Commission's review should result in a move to ensure that the same generic rules are applied consistently across Europe. In this spirit, we are also of the view that harmonisation of large exposure reporting across Europe is an achievable short-term objective.
- 3.1 The EU Directive allows member states to apply one of two approaches to large exposures reporting. The first method requires reporting of all large exposures at least once a year, combined with reporting during the year, of all new large exposures and any increases in existing large exposures of at least 20% with respect to the previous communication. The second method available requires reporting of all large exposures at least four times a year.
- 3.2 The Irish Financial Regulator applies the second approach and requires reporting of all large exposures on a quarterly basis. In addition to the Directive requirements, the Financial Regulator requires institutions to report their 20 largest exposures to credit institutions and 30 largest corporate exposures, despite the fact that these exposures may not be determined as a large exposure as per the Directive. It is our view that this requirement should be removed and only exposures that are deemed to be large exposures as per the EU Directive should be reported to the Financial Regulator.
- 3.3 The Irish Financial Regulator also requires that institutions report where the value of an exposure exceeded its current value since the last reporting date. This supersedes the rules as set forth by the Large Exposures Directive and requires that institutions' systems retain daily balances. We are aware that at least one other Financial Regulator requires reporting



of exposures which exceed the report date exposures, referred to as the intra-period. However, it is our understanding that this is not a common requirement across Europe. In line with the objective of harmonised reporting across Europe, it is our view that this national discretion should be removed from the Irish Large Exposure Framework.

## **CONCLUSION**

- 4.0 The rules in place in Ireland concerning sectoral exposures, as described above, are causing major problems for a number of Irish institutions. These rules place Irish institutions at a competitive disadvantage to their international counterparts and are a clear example of the misalignment between regulatory rules and market practice. We ask that the Commission consider the possibility of eliminating the discrepancies found to exist across Europe in terms of Large Exposure Rules. This may as already noted, require a longer-term horizon. There are however a number of discrepancies such as the treatment of sectoral exposures in Ireland, as well as the varying reporting requirements in place across Europe that should be reviewed as part of the exercise currently underway by the Commission.