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Committee of European  
Banking Supervisors

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## Response to CEBS Questionnaire on Market Practices with regard to Large Exposures

Dear Sir, Madam,

May we first thank you for the giving us the opportunity to reply to the CEBS questionnaire on market practices with regard to large exposures.

We are firmly in favour of the involvement of the banking industry in work on improving European supervisory law. At the same time, we should like to make some constructively critical comments on the form of such involvement as well as the timing of and the timeframe for the CEBS survey. The exchange of views between the banking industry and supervisors/CEBS should take place by way of a real dialogue. Sending and completing questionnaires can only be a first step in this direction. In addition to that, there should also be the opportunity for a direct, verbal exchange of views by way of expert meetings, bilateral talks, etc. Precisely because of the complex nature of the subject in question, once-only, unilateral, written contact in the form of a questionnaire is not enough. Concise but meaningful replies are only possible if the thinking behind various questions is explained. At present, the exact purpose of parts of the questionnaire is not clear enough. We believe that a detailed and balanced evaluation of the written responses to the questionnaire should therefore form the basis for further discussion.

We welcome it that CEBS has extended the consultation period by one month at the request of the European banking industry and has indicated that further rounds of consultations could be arranged. However, due to the enormous workload that implementation of Basel II, particularly supervisory recognition of IRBA and AMA models, currently imposes on us and our member banks, it is not possible for us to answer the questionnaire in detail even by the

new deadline. We have therefore concentrated for the time being on answering questions 16 and 17, which deal with the regulatory environment for large exposures. As regards questions 1-15, covering internal management of concentration risk, it was not possible for us to collect and evaluate the large number of replies from our member banks within the short consultation period that has been set. We shall therefore be following up the present comments with a detailed response to these questions in the near future. Because the implementation of Basel II will continue to impose a heavy workload until the end of the year, a comprehensive dialogue on the subject in question is only possible in our opinion from early 2007 onwards.

As regards questions 16 and 17, may we comment as follows:

Generally speaking, we believe that the current large exposures regulatory regime is able to effectively capture and limit the risks inherent in large exposures. We therefore feel that there is no need for a general review of the current large exposures regulatory regime at least in the short term, particularly as such a review would in any case require preliminary work over a period of several years.

The guiding principle in any improvement of the existing large exposures regulatory regime should be to avoid extending the overall body of supervisory rules and reporting requirements beyond existing standards so as to protect banks as far as possible against any additional workload imposed by the need to implement new supervisory rules. New rules should definitely only be introduced where existing regulation has been unable to prevent cases of market failure.

Also, with a general review of the large exposures regulatory regime in the future in mind, we are firmly in favour of greater recognition of internal risk measurement and risk control models in the area of large exposures in order to give banks more scope in designing their risk management systems. A question that will therefore have to be asked is whether and, if so, to what extent credit weightings may be used in capturing and measuring large exposures.

Even if we do not believe that a general review of the current large exposures regulatory regime is necessary at present, we should nevertheless like to stress that the existing structures should be added to and improved on some points in order to develop more risk-sensitive rules and create a level playing field in lines of business that are not yet covered by

the current regime. Some additions to the current regime are also urgently required from the angle of legal certainty, for example. It should be remembered in this connection that, alongside capital requirements, the rules on monitoring large exposures are one of the pillars of banking supervision today. Banks believe that they need an adequate degree of legal certainty in this respect so that they do not have to constantly check whether they comply with the rules and requirements set by supervisors.

We feel that, in the short term, the treatment of derivatives and other modern financial instruments under the large exposures regulatory regime needs to be addressed in particular. The existing large exposures regulatory framework was mainly established before modern financial instruments had been developed. As a result, the existing regime does not reflect these instruments in an appropriate way and lacks the flexibility needed to cover them properly. In many areas, such as the add-on calculation for derivative exposures and particularly the ability to net down fully collateralised add-on exposures, the large exposure rules deviate considerably from internal risk management practices. Therefore, the large exposures regulatory framework should adapt the prudential treatment of such instruments, as it has evolved to a highly sophisticated level as part of today's banks' risk management. In our view, it is imperative that uniform rules are recommended to national supervisors in order to achieve a uniform approach and thus more certainty of application and a leveller playing field in this important line of business.

With regard to intra-group exposures, we feel that the current limits for large exposures cause some disproportionate constraints. For example, the 20% limit on exposures to affiliated companies which are not subject to consolidation at group level is out of proportion to the general 25% limit for exposures to non-associated companies (see Art. 111 para. 1 and 2 EU/2000/12). As, in terms of the risk involved, there is no difference between such an affiliated company and a non-associated borrower, the general limit should be consistently applied. Also, as a general remark, we would question the prudential need for limits with respect to intra-group exposures if central risk management is carried out at group level.

Clarification is also needed on temporary overshooting of existing large exposure limits. It would therefore have been helpful if the stocktaking carried out by CEBS had taken into account whether supervisors have a different administrative practice in regard to overshooting of existing limits. To maintain a level playing field, we feel that further harmonisation is desirable in this area, too.

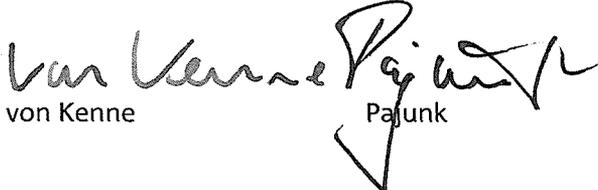
From a German supervisory standpoint, we also believe that the decision-making requirements for large exposures need to be harmonised internationally. The unanimous decision by *all executive directors* called for in Germany goes too far in our opinion.

Finally, with the envisaged harmonisation of the large exposures regulatory regime in mind, we wish to stress that this harmonisation should not be confined to the EU member states. At least the Basel Committee on Banking Supervision should be involved in work on improving the rules on large exposures in order to encourage harmonisation among its members as well.

Specifically with regard to question 17, we wish to point once again that, in addition to the stocktaking it has carried out so far, CEBS should not only look at the legal basis for monitoring large exposures in the individual member states. The existing differences can in fact only be captured fully if it is examined how national supervisors interpret and apply the different rules. We have the strong impression that there are, for example, considerable differences within the EU in how overshooting of the existing large exposure limits is tolerated.

We shall of course be pleased to answer any questions you may have and to discuss this subject further with you on request.

Yours sincerely,

  
von Kenne  
Pajunk