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The voice of banking
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Joint Trade Associations' Response

CEBS CP 26: Consultation paper on CEBS's draft implementation guidelines on the revised large exposures regime

Introduction

The London Investment Banking Association (LIBA), the International Swaps and Derivatives Association (ISDA) and the British Bankers' Association (BBA) welcome this opportunity to comment on CEBS CP 26: Consultation on CEBS draft implementation guidelines on the revised large exposures regime. Our combined membership represents a diverse group of financial institutions incorporated in a number of states both within and outside the EU and operating across the broad spectrum of European and international capital markets. As with our previous responses, this submission mainly represents the views of a sub-section of our members made up of large internationally active financial institutions. However, in some areas we have also included the views of smaller banks.

This response is structured in two sections – key messages and answers to the consultation questions

Key Messages

Members have identified the following key issues from this consultation:

- Definition of connectedness – ABCP conduits
- Definition of connectedness – economic interconnectedness
- Reporting
- CEBS guidance on Article 106 (2)(c) and (d)

Definition of connectedness – ABCP conduits

We support the acknowledgement by CEBS that the connectedness of ABCP conduits should be assessed on a case-by-case basis. However we are concerned by the direction of guidance in this area, as it appears to suggest that the IKB/Rhineland funding example is typical of well run conduits. We do not believe that this is the case and that connectedness should not be the general presumption.

We think that the factors that distinguish well managed conduits, where connectedness should not be regarded as an issue are as follows:

- a) Diverse nature of the underlying assets in the majority of conduits
- b) Disclosure of the underlying assets

- c) Staggered CP rollover
- d) Appropriate sizing of transaction-specific and programme-wide credit enhancement combined with disclosure
- e) Robust, explicit (i.e. contractual) provisions for addressing specific asset deterioration at an early stage exist in all major multi-seller programmes
- f) Restructuring contractual provisions underlying transactions
- g) Limited maturity transformation

We strongly suggest that these factors should be incorporated into the CEBS guidance. For further detail please see question 4.

Definition of connectedness – economic interconnectedness

Members have significant concerns regarding the interpretation of economic interconnectedness. We do not believe it is always possible to deliver the assessment of connectedness that the guidelines appear to require. Even with a significant increase in the resources allocated to making this assessment, the information, in many cases will simply not be available and it will be very burdensome to undertake this analysis on an ongoing basis.

The potential implication of an overzealous interpretation of inter-connectedness is likely to be a withdrawal by firms from lending to those entities on which such information is not readily available. CEBS guidance therefore needs to reflect the balance required between the authorities' dual objectives of enhancing the soundness of the banking system and for firms to continue to lend to corporates, SMEs and consumers

For further detail see question 3.

Reporting

We think that further consideration needs to be given to the exposure values that should be used, in particular what is meant by pre and post CRM exposure values.

As regards the reporting of connected clients, we question whether the level of detail requested is really necessary and would seek clarity on what supervisors propose to do with this information. If this information is reported at each reporting date, it will be very onerous for firms to prepare. We also think that the requirement for a single national coding system is unnecessary and that resources could be better deployed elsewhere.

CEBS guidance on Article 106 (2)(c) and (d)

We note that the consultation does not include guidance in relation to paragraphs 106(2)(c) and (d), regarding certain exemptions from the large exposures regime. As the CRD indicates that guidance will be provided, we would like to know when CEBS proposes to consult in this area.

Consultation questions

III Connected clients

A Definition of a group of connected clients in Article 4(45) of Directive 2006/48/EC

- 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.**

In general the guidelines are clear.

The indicators of control are not significantly different to those in CP 16 or to current requirements. Therefore in line with our response to that consultation, Members generally agree with the principles outlined. Members think that the guidance relating to the use of accounting indicators is particularly helpful, as is the material in paragraphs 43 and 45.

However in relation to private equity, Members believe that the wording of the Article 4(45) Directive 'unless it is shown otherwise' is relevant and consider that it should be possible to demonstrate that there is not a relationship of control where there is a single general partner. We would appreciate further clarification on this issue.

- 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.**

Yes the guidelines are clear.

- 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.**

No the guidelines are not clear.

Members have significant concerns regarding the interpretation of economic interconnectedness. Firms will simply not be able to deliver the certainty on capturing connections between counterparties that CEBS seems to be expecting. Even if they were to initiate an enormous increase in the amount of resource currently directed toward credit analysis, it would not be possible to obtain and maintain this information in a systematic manner for all counterparties. As CEBS notes in paragraph 60 it will rarely be possible to implement automated procedures to comply with the guideline, therefore a significant increase in manual resource would be necessary to undertake the analysis, but in many cases the exercise will be fruitless as the information will simply not be available. While we note that CEBS focuses on the initial granting of credit to a client in paragraph 62, the relationships that CEBS identifies in the bullets in paragraph 50 are unlikely to remain static over time.

The potential implication of an overzealous interpretation of inter-connectedness is likely to be a withdrawal by firms from lending to entities on which such information is not readily available. CEBS guidance therefore needs to reflect the balance required between the authorities' dual objectives of enhancing the soundness of the banking system and for firms to continue to lend to corporates, SMEs and consumers.

In risk management terms, firms will assess the risks facing the customer, which may impact on their ability to meet their obligations (including where possible an assessment of dependency on suppliers or customers) and will seek to mitigate that risk either by reducing the amount it is prepared to lend or obtaining some credit risk mitigation. Therefore we think that the approach being suggested is confusing aggregation with risk management. Any dependencies require assessment and mitigation rather than aggregating.

We acknowledge that CEBS has sought to clarify that economic interconnectedness is not intended to pick up mere sectoral or geographical concentrations, but instead focus on interdependencies that relate to bilateral relationships, but we think that the guidance to be

clarified as to the extent of work required, i.e. a recognition that 'all reasonable efforts should be made'.

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.

No the guidelines are not clear and we think that there are serious issues that require further consideration.

The funding criterion raises two serious issues for our members as follows:

- o ABCP Conduits;
- o Application to other exposure classes

ABCP Conduits

As you will recall from our response to CP 16 and in our comments on the Commission's consultation for CRD II, we do not believe that the large exposures regime is a relevant tool for dealing with the issues posed by the drawing of liquidity facilities to special purpose vehicles. However we acknowledge that the funding criterion has been included in the text adopted in May and that therefore CEBS is looking to provide guidance to ensure convergence on the application of the provision.

However, in developing that guidance we believe that there are certain factors, not apparent in the consultation paper that CEBS should take into account to ensure an appropriate outcome is achieved. We concur with the acknowledgement in the CP that the concept of interconnectedness should be assessed on a case by case basis.

There is a need to balance the Authorities' policy objectives of enhancing the soundness of the banking system with the desire to ensure that funding continues to be available, particularly in the current fragile climate. The EU ABCP conduit market provides a significant source of reasonably priced funding to a variety of sectors of the market including SMEs, corporates, and consumers. At the end of 2008, \$252.2 bn of EU sponsored commercial paper was outstanding. Although the CP market has obviously declined in size, the reduction has related mainly to the funding of ABS through the SIV market and credit arbitrage conduits. The multi-seller conduit market, however, has remained quite resilient. In light of the increased cost, or simple disappearance of other sources of funding such as syndicated lending and term ABS markets, it is vital to continued economic recovery that ABCP conduit financing is not discouraged. There is a significant risk that if the connectedness criterion is applied too restrictively (i.e. aggregation applied to broadly), as indicated by the current consultation text, that this market ceases to operate at a sufficient level to address financing needs.

That said, it would be clearly inappropriate for CEBS to advocate imprudent activity, which is why it we think it is appropriate that the guidance should distinguish between the IKB/Rhineland example, which was an extreme outlier in the way that it was managed, and the majority of well-managed conduits where there are objective legal and operational mitigants that promote the adoption of a non-aggregative approach..

In the case of IKB/Rhineland funding there was a clear absence of information regarding the underlying asset pools and the sufficiency of transaction-specific credit enhancement supporting them. The vehicle was also used to invest in long term assets exclusively in a concentrated asset-class, and was backed primarily by liquidity banks who were not affiliated with the programme sponsor and therefore whose interests were not aligned. As a result, the problems in one pool quickly translated to others causing investor confidence to

evaporate and a draw on the liquidity facilities that IKB was not able to meet. This transmission mechanism is considered to be absent in the case of multi-seller conduits by virtue of a robust suite of contractually-documented programme mitigants and market-standard sponsor behaviours and policies. This should inform the case by case analysis of interconnectedness.

The primary factors that we believe distinguish the majority of well-managed conduits from the situation illustrated by IKB/Rhineland are as follows:

- h) Nature of the underlying assets in the majority of conduits: the assets tend to be diverse, being spread across multiple purchasing companies, originators and asset classes. As a result a programme-wide, or cross-programme funding problem is unlikely to arise at the same time as the result of multiple asset deterioration.
- i) Disclosure of the underlying assets: in a properly managed programme, the ABCP sponsor provides detailed disclosure to investors on the nature and performance of the underlying assets. Such disclosure provides investors with a full understanding of the risks that they are buying into and as a result means that investors are not concerned about possible contamination between pools, thus reducing the risk of loss of investor confidence due to information asymmetry.
- j) Staggering of CP rollover: ABCP sponsors and liquidity providers are keenly aware of the need to manage their liquidity profile and will stagger the CP rollover dates to ensure that potential liquidity draws can be covered. Thus it is unlikely that all facilities would be drawn at the same time. We would note that these potential draws on liquidity are factored into firms' liquidity risk management and are subject to supervisory review.
- k) Appropriate sizing of transaction-specific and programme-wide credit enhancement combined with disclosure: in well managed conduits there will be considerable dialogue with originators regarding the appropriate sizing of the credit enhancement and disclosure to investors on how this is done. Appropriate sizing of pool-specific credit enhancement upfront ensures that the risks of drawing on programme-wide credit enhancement and possible contamination between pools are minimised. Appropriate disclosure ensures that investor confidence in the diversified, ringfenced nature of the pools is maintained.
- l) Robust, explicit (i.e. contractual) provisions for addressing specific asset deterioration at an early stage exist in all major multiseller programmes: standard contractually-stipulated conduit/programme-level features such as (i) the posting of programme-wide credit enhancement to collateralise deteriorating assets and (ii) conditions precedent that must be met for the issuance of CP, in the absence of which, sponsor banks must draw liquidity where certain transaction-specific performance tests have been breached, each ensure that the deterioration of individual asset portfolios is addressed at an early stage as and when specific circumstances require, as opposed to "at the same time." Such features are typically policed by the rating agencies and well-understood by the investor community, increasing market confidence. Such provisions will already be taken account in a firm's assessment of significant risk transfer.
- m) Opportunity to restructure underlying transactions: the multi-seller market has evolved to provide annually-renewable client financing, affording sponsors a regular opportunity to revisit, on a contractual basis, the levels of transaction-specific credit enhancement provided within a transaction in response to portfolio performance (there being no equivalent avenue available to term ABS investors). There is considerable evidence of sponsor-driven transaction-specific restructuring during the current dislocation, thereby increasing investor confidence and reducing the likelihood of asset deterioration.
- n) Limited maturity transformation: As distinct from more narrow Structured Investment Vehicles (SIVs) or the IKB context, the majority of multi-seller conduits fund a very significant proportion of assets (such as trade receivables) with relatively short maturity,

which therefore are considered self-liquidating in line with the maturity of the CP issued. As a result the, reliance on the drawing of a liquidity facility is reduced because the assets repay and the CP holders can be redeemed from the proceeds. Where maturity mismatches exist between the maturity profile of the programme's assets and liabilities, they will be factored in to the credit enhancement and the staggering of the CP rollover.

We think that the above criteria should be built into the CEBS guidance in determining whether conduit financing should be aggregated under the connectedness requirements.

In addition we would also note that the changes to the regulatory framework also play a mitigating part in relation to conduit financing. The 0% conversion factor for 364 day facilities was removed with the introduction of the CRD. And because of the stringent nature of the requirements for eligible liquidity facilities, the majority of them now attract a 100% conversion factor. Additionally, such facilities are now covered by specific regulatory reporting requirements. Therefore these facilities are much more visible to supervisors and in firms' capital management. In addition the work that has been undertaken in both Basel and the EU in relation to liquidity has made it very clear that such contingent liquidity draws should be taken into consideration in firms' liquidity management.

Application to other exposure classes

In paragraph 56 CEBS indicates that the funding criterion was not designed to be applied solely to conduits – 'it should be noted that the requirement to connect clients due to a common source of funding is not dependent on either the type of entity being funded nor the form of the funding used, but rather it is dependent on entities receiving all or the majority of their funding from a common source, which can not be easily replaced.' The application of the funding criterion for connectedness, in our view, goes further than that required by the Directive, which indicates that funding is only a factor where counterparties are likely to experience simultaneous financial distress and should therefore be viewed as a single risk. This is only likely when counterparties are reliant on a single type of funding and can not absorb temporarily higher costs of switching to alternatives.

In addition, CEBS provides no guidance on how the criterion should be applied in other circumstances and whether it applies to entities that are funded by the firm or other entities that are funded solely by someone else. In the case of the former (entities funded by the firm), if taken to extreme, firms would end up aggregating all their exposures to small businesses in the same sector (we note that geographic location of itself should not trigger the connectedness of clients). Such entities will usually rely quite heavily on bank funding and may find it difficult to obtain a replacement particularly in times of general financial stress, such as the current climate. This would quickly lead to breaches of limits and would only serve to pick up sectoral concentrations that should already be addressed under Pillar 2. This is presumably not intended by the CEBS guidance.

As regards entities who may be connected by virtue of funding by others, there are practical problems regarding the availability of information, which would not be solved by the proposed 1% materiality threshold (on which we comment in question 5). As noted in our response to CP 16 the resources that would be required to pick up this information systematically would be significant as it would require manual intervention, particularly as it relates to the ability of the counterparty to obtain alternative funding.

In addition the funding criterion highlights the potential procyclicality that is being introduced by the large exposures requirements. In more benign periods of the economic cycle, it is easier for bank counterparties to find alternative sources of funding than in times of financial stress. Therefore the application of the requirements could lead to large exposures breaches resulting from aggregation of clients as connected because of financial conditions.

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

Since we have serious concerns about the practicality of the requirements to assess interconnectedness, especially in relation to paragraph 50, a concept of materiality is helpful. However, we think that 1% is far too low if it is to be applied at the solo and consolidated level (it would not be practical), therefore we would strongly recommend a higher percentage should be applied.

It is unclear in the draft guidelines whether firms would be required to do further analysis if an individual exposure itself were greater than the materiality threshold, or if aggregate exposures to client are over the materiality threshold. Discussion at the hearing indicated that it was the former rather than the latter, which will partially reduce the burden by reducing the need to reassess all counterparties. However, even if this is the case, the application of the control criterion will mean that there would have to be a reassessment of a large number of groups and the possible inter-dependencies between them. A few Members have provided information on the numbers of groups that would fall above the 1% threshold as follows:

Threshold	1%	3%	5%
No of groups captured (approximate range)	500 – 700	140 – 150	60 – 70

While at the 5% level this may not sound like a significant number, the amount of work required would still be significant as it would result in a reassessment of each group against each of the others, and each group is comprised of a number of entities, which will result in a multiple of the numbers illustrated above. We would therefore recommend a threshold of [3% -GIVEN NUMBERS SUPPLIED I AM NOT SURE THAT THIS 5% GOING TO BE PERSUASIVE PLEASE COULD MEMBERS INDICATE WHETHER THEY WOULD NOT ACCEPT 3% - SILENCE WILL BE REGARDED AS CONSENT]

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.

No the guidelines are not clear.

Members still do not have a clear sense of how much they will be expected to do to ensure that they have identified and aggregated connected clients, because of the issues identified in question 3 above. Members are concerned that the level of detail is such that vast amounts of resource will have to be deployed to prove that clients are not connected, particularly given the supervisory override in paragraph 33 (see question 7 below).

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?

As noted in our response to CP16, Members remain concerned about the proposal to include a supervisory override in paragraph 33 in relation to individual decisions on connectedness. We do not believe that this is a practical proposition and will likely result in firms referring all decisions on connectedness to the supervisor for guidance. It also potentially constitutes shadow management. We think that a more appropriate way forward would be for supervisors to focus their attention on whether firms have an appropriate policy/procedure in place for determining connectedness. Obviously such an approach would not preclude the option for firms to approach their supervisor for guidance in relation to individual cases where there is ambiguity.

Given that the determination of interconnectedness (particularly regarding economic factors) will include a level of subjectivity, we were also concerned that the supervisory override could be invoked when firms have come to different conclusions about certain counterparties. We were pleased to note from the Hearing that this was not CEBS intention.

In the context of control, we also seek further clarification on the treatment of participating interests.

IV 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?

As noted in our response to CP14, we question the principle, in paragraph 74, that look through is always a superior approach. This is because of the variety of structures present in the market. Given the principle in paragraph 74 we found the messages in paragraph 75 to 77 confusing. We think that a more appropriate approach would be to allocate exposures according to the source of risk.

Firms tend to take a case-by-case approach to the determination of approach, because there is not a one size fits all answer. As noted in our response to CP 14 (as amended by our response to CP 16) we suggest that the following factors should be taken account of in determining where the risk lies and therefore how the exposure should be recorded:

Institutions should identify whether the risk of incurring a loss relates predominantly to the default of the underlying assets or the scheme itself, or both. In determining this assessment, firms must evaluate the economic substance of the transaction. Examples of factors that firms might take into account in determining this assessment include:

Sources of repayment, including recourse provisions; size, nature, quality and granularity of the underlying credit exposures; tenor; and the sustainability of the cashflows, position in the waterfall.

While we recognise that the recent market turmoil has highlighted issues with certain structured products, we still believe that the starting point should be to determine an appropriate allocation of the exposure that reflects the true source of the risk (which may be to the vehicle, the assets or to both) and that these factors should be incorporated into paragraph 75 and the principle of appropriate risk allocation into paragraph 74.

Recording exposures to both the underlying assets and the scheme itself potentially represents double counting where this is not justified. Such an approach is likely to disproportionately impact smaller institutions.

We object to the suggestion in paragraph 77 that institutions will automatically seek to arbitrage the requirements. A focus in the guidelines on how the firms record the exposures for risk purposes and reporting to management would not only address this issue but more closely align the regulation with risk management, thereby facilitating an appropriate dialogue between firm and supervisor. In other words rather than starting from the premise of look through and justifying a different treatment, the guidance should look to firms to explain their risk management approach and query why there are divergences from that for large exposures purposes.

As regards the guidance, we would suggest that the first decision should be whether to record the exposures to the underlying assets, to the scheme or to both according to the factors that we have outlined above.

Once that is established and the firm is looking to the underlying assets it is appropriate to have a range of approaches: full look through, partial look through, mandate based approach and unknown. As regards the full look through approach, we would highlight that there are a number of practical problems that should be borne in mind. In particular firms will not be able to influence the content of information provided on such transactions where they are not the lead managers and that scheme reporting tends to be periodic and therefore it would not be possible to conduct a daily analysis. For tranching products, although industry initiatives are underway to enhance disclosure, there are likely to be difficulties in obtaining the necessary information in respect of existing transactions. Furthermore the full look through approach would not be practical for trading book positions, which are only held for a short period. In addition please see our comments in question 3 regarding the problems associated with connectedness.

Perhaps this is an area where a de-minimus threshold could be considered in relation to the need to look through. Practicalities would suggest a percentage of around 5%.

If looking to the scheme itself, it is appropriate to consider whether that scheme is connected to others. However, such analysis should take account of our comments in relation to question 4.

B Treatment of schemes with underlying assets

- 9. Do the fall-back solutions (approaches b) to d)) appropriately take into account the uncertainty arising from unknown exposures and schemes?**
- 10. Do you think the partial look-through approach provides additional flexibility or would an institution in practice rather apply either a full look-through or not look through at all?**
- 11. Do you think the mandate-based approach is feasible? If not, how could an approach based on the mandate work for large exposure purposes?**
- 12. Do you believe that considering all unknown exposures and schemes as belonging to one group of connected clients is too conservative (approach d)? What alternative treatment would you propose (please note that, as explained above, an approach which allows the treatment of unknown exposures and schemes as separate independent counterparties is not considered to be prudentially appropriate)?**

Members have expressed no particular concerns with regard to approaches b) and c). However, Members strongly believe that it is inappropriate to aggregate all unknown exposures as a single connected group. To do so, would not be reflective of the risk and will have a very significant impact on the market, as it could take very few transactions for a firm to hit 25%. It would not be justified by the risk, as it is statistically unlikely that all such transactions would be connected. Aggregation of 'unknowns' will be a particular problem for existing transactions where it will not be possible to retrospectively change the amount of information available. Even with the improvements in disclosure that will result from both industry and regulatory initiatives it is by no means clear that there will not be a significant amount of exposure that would fall into the unknown category, particularly if our comments on the need to assess the counterparty to which the exposures are recorded are not taken on board. Although asset level disclosure may not be available for all schemes, firms will have had to undertake risk assessment and due diligence in determining whether to invest or not, aggregate pool information will therefore have been analysed. Therefore it is not true to infer from a firm's inability to obtain information on each underlying exposure that there is inadequate risk management. Therefore we think that geographic, sectoral, asset type concentration limits and pool granularity should be taken into account. We think that what we have suggested may have been what was meant by the fourth bullet in paragraph 84, but think that the text could be more clearly expressed.

C Treatment of tranching products

- 13. What are your views about the proposed treatment for tranching securitisation positions?**
- 14. Do you consider the proposed treatment of tranching securitisation positions when look through is applied as appropriate? Do you think that the proposed treatment sufficiently captures the risks involved in such an investment?**
- 15. With respect to the treatment of tranching securitisation positions If it was be required to take every tranche into account from the outset instead of the proposed treatment, would such a treatment address all risk involved in such a transaction and would it be sufficient for addressing concerns on undue burdens?**

We found the written explanation of the proposed approach very confusing and would not have been able to make sense of it without the examples provided the annex.

Members have indicated that the methodology proposed does not accord with the way that they record such exposures for risk management purposes and therefore would require significant systems enhancements (see paragraph above regarding information availability). As noted in our response to CP 14, and as above, firms will first determine whether it is appropriate to record their exposures to the scheme or the underlying assets (according to the factors listed above). The purpose of creating tranching structures is to transform the risk. The tranching will take account of the individual exposures as well as the correlation between them to create a blended risk exposure to the underlying pool representing a particular credit quality. The losses suffered on a particular tranche would therefore be influenced by not only the default of particular underlyings but potentially over-collateralisations and income received, which may have been trapped in the transaction for this purpose. There is not, therefore, a direct correlation between failure of an individual assets and the loss suffered by an investor. The grossing up of exposures, therefore, would not reflect the risk inherent in them, as the scenarios, which are represented by the grossing up, are mutually exclusive. In addition the consultation gives no guidance on how liquidity facilities or senior swaps might be treated, when they are in a priority position to the investors.

As regards the first loss position, where a firm has deducted this exposure we think the guidance should be enhanced to clarify that there is no exposure to record for large exposures purposes, because the position has already been effectively written off and therefore nothing further can be lost, i.e. in accordance with Article 106.1.

As a result we think that the guidelines require further consideration and a more case-by-case approach should be facilitated which takes account of the factors that we have identified. In addition we think that when considering whether to aggregate 'unknown' exposures, geographic, sectoral, asset type concentration limits should be taken into account as well as granularity.

- 16. In which cases is there no risk from the scheme itself so that it can be excluded from the large exposure regime?**

As noted above, where exposures are deducted from capital we do not believe that there is any exposure to record for large exposures purposes. In addition we think that the initial determination as to whether to record exposures to the vehicle, the assets or both should be assessed in accordance with the source of the risk and the factors that we outline in answer to question 8

V Reporting requirements

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

We assume that CEBS is proposing that this means the exposure value after taking account of value adjustments and provisions, as such this is clear, although we do not believe that this is required by the Directive. The term 'net' at this stage could cause confusion since it means prior to CRM.

However we think that there is a prior and far more important issue, which requires further discussion – what is the exposure value that should be used before and after CRM? It would appear that the guideline requires accounting numbers to be used. However the CRM rules in the Directive will be applied to the regulatory balance sheet, and many off balance sheet exposures may not be recorded at all for accounting purposes. In addition it is not clear how securitised assets, de-recognised for regulatory purposes, would be treated. This approach also represents a significant change from the approach outlined in CP 16 and we would like to understand CEBS rationale for the change.

Furthermore as regards netting and regulatory exposure values, it is important to note that for many exposures counterparty netting is integral to the determination of the exposure value, for example in the EPE approach to counterparty risk. We believe that this was the reason for the inclusion of 'when applicable' within Article 110(1)(b), i.e to reflect the fact that some exposures would be recorded net even prior to CRM (in fact in certain places the Directive requires this).

We also believe that the guidance should make clear that where an exposure has been written off for regulatory purposes there is nothing to record for large exposures purposes as the firm cannot lose further amounts, in accordance with Article 106(1).

18. Do you agree that the 10% limit should be calculated as proposed in column LE 1.11 above?

As we have noted in our previous submissions on the Large Exposures review, the basis of calculation of the 10% in the Directive has been unclear. We believe that the 10% should be calculated on the post CRM basis and then the analysis provided of the gross and net amounts.

19. Regarding the example about the Credit Linked Note (set out in the text above and in Annex 5 as example 6), bank X is the protection seller and reports its potential exposure to Bank B as indirect exposure (5). Do you believe it is correct to report such exposures in column 8 or would they be better reported in column 5 as direct exposures, because they did not arise as a consequence of substitution?

Whether the exposure is recorded as direct or indirect, there will be an inflation of the exposures recorded, which will not necessarily be clear from the reporting form. Therefore members have no strong view as to over whether it should be reported as direct or indirect.

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).

Members question whether provision of this level of detail is necessary given the burden that would be imposed in delivering it. Members think that this will result in the reporting of thousands of names and question what supervisors will do with the information once received; the return will likely be very long and difficult to follow for both reporters and

supervisors. Such a requirement also goes well beyond the requirements of the CRD. Articles 110 and 111 describe a 'client or group of clients' but we understand that to mean that the exposure will be to a single client or to a group of clients, not that the group needs to be broken down.

That said, and taking account of our response to question 19, Members think that a two-template approach would be more practical out of the two.

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

No.

This differentiation is not a distinction that members currently make and would require significant systems changes to deliver. Although we note the provision in Article 110, the differentiation between funded and unfunded may be particularly problematic. We seek further clarity on how this information would be used.

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?

We do not believe that LE1.8 – indirect exposures – is required by the Directive. As noted in the consultation, Article 110(3) specifically states that firms are only required to analyse exposures to collateral issuers 'to the extent possible', to reflect the practical difficulties associated with this analysis, on which we have commented before. In particular, collateral agreements are flexible in terms of what customers will provide by way of collateral and this will change frequently and within the framework of the agreement the firm has no control over the collateral movements. This requirement would have very significant systems implications. Article 110(3) therefore takes a pragmatic approach to the reporting of possible concentrations, taking action and reporting to the competent authority, to reflect the fact that it is not possible to do this in a consistent manner for regular reporting purposes and would be extremely difficult to deliver under the current submission deadlines. We therefore recommend that the guidance make clear that this would only apply where firms are using the substitution, 'simple', method for capital purposes and not where it is used the comprehensive approach, which applies a haircut instead.

23. Please provide examples where the reporting instructions are not clear to you.

As noted above, we think that the determination of exposure value requires further consideration.

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 do not believe the proposal to adopt individual counterparty codes to be used by all firms as practical, nor is it clear who will administer this database. Given our Members operate across many jurisdictions, not just in Europe, we believe that the administration of this database will be extremely burdensome, and question how firms will be expected to report new exposures to entities that are not on the database if they arise around the reporting

deadline. We think that it would be a more practical use of both firm and supervisory resource if firms' own identification codes are used. These can then be explained to the supervisor as part of the normal dialogue.

25. Are the references to COREP provided in this paper and in Template 1 – as set out in Annex 4 - clear and sufficient or is further guidance required? If yes, please specify the problems.

We would note that not all countries currently use the COREP framework as set out. As such members would like to highlight that significant systems requirements may be required as a result.