CONFEDERACION ESPAÑOLA DE CAJAS DE AHORROS

POSITION PAPER
February 2008

CECA response to CEBS Consultation paper (CP16):

Second consultation paper on CEBS technical advice to the European Commission on the review of the Large Exposures rules

CECA, the Spanish Confederation of Savings Banks (Cajas de Ahorros) was created in 1928 with the aim to join its members' forces and represent Spanish Savings Banks Sector. CECA is formed of the 45 Spanish Savings Banks, which are one of the most important players in Spanish financial system: their total assets reached €1.1billions, 24.050 branches in Spain and 124.139 employees in 2007.

Spanish Cajas are credit institutions that act and are organized as private enterprises. They have the legal status of private institutions. Spanish Cajas are independent institutions which compete directly and individually with each other and with other financial institutions, and they are free to decide on their territorial expansion.

As credit institutions with foundational origins, Cajas pursue the following main objectives: (1) universal provision of financial services; (2) economic efficiency; (3) promotion and competition and avoidance of monopolistic practices; (4) contribution to welfare and redistribution; and (5) promotion of regional and community development. From their inception, Cajas are required to channel the surpluses that are not allocated to reserves toward project that fall under their "Obra Social" scheme (community investments projects).

Spanish Cajas are subject to the same legislation that applies to other types of credit institutions (commercial and cooperative banks) in terms of transparency, solvency and consolidation.

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Preliminary comments

Spanish Confederation of Savings Banks (CECA) welcomes the initiative of the European Commission (EC) to promote a consistent regulation for large exposures. This initiative will contribute to reduce disparities among different national legislations and to guarantee the necessary level playing field across countries.

Nevertheless (and although this argument will be deployed in our response to the specific questions), in our opinion, the new rules regarding large exposures should be consistent with the existing regulation in related aspects, such as requirements in the field of own funds.

Finally, and before going into deeper analysis and giving answer to some of the specific question raised in the consultation paper, we believe it is worth mentioning the work carried out by CEBS in this occasion. In addition, we appreciate this opportunity to share our views regarding the CP16. Our response to the specific question will be structured in the same way as that of CEBS paper.

Definition of Large Exposures (connected clients)

Q2. Do you agree with the proposal and suggested interpretation of 'control' and of 'interconnectedness'? Do you find the guidance/examples provided in both cases useful? Please explain your views, provide examples. And where relevant provide feedback on the costs and benefits.

This topic requires an adequate harmonization, since national rules differ significantly.

The large exposures regime should apply, according to the Capital Requirements Directive, to significant exposures to a single counterparty or to a group of connected counterparties.

The CRD defines two kind of links:

- Control relationship.
- "Interconnectedness" of clients.

As regards the definition of control relationship, CEBS proposal is very similar to Spanish legislation. In our opinion, the Spanish industry has already implemented efficient procedures regarding the treatment of exposures to counterparties belonging to the same group. So, Spanish credit institutions already identify control relationship links existing among different counterparties.

As for the interpretation of "interconnectedness" of clients, we can see the need of taking into account this element when assessing risks. That is why institutions take into account these elements (sectorial and supply concentration, limited client base…) when they review the risks posed by each specific client.

As for the large exposures regime, using this definition will result in a very difficult and costly practical implementation that will deviate from the objective of simplicity of the framework argued by CEBS representatives. Burden of proof lying on the institutions and having to assess the connection between their clients could easily result in institutions having to justify the reasons for not considering each pair of counterparties as interconnected or to assess the level of interconnectedness between them.

In addition some of the examples given in the CP16 are very difficult to separate from sectorial concentration; witch will be included in the Pillar 2 exercise.

Finally, paragraph 95 of the consultation paper proposes that an entity should, in principle, not be included in more than one group of connected clients. This may prove to be extremely difficult if we consider the cases where clients are "interconnected" as well as being part of a business conglomerate

Based on these arguments we propose revision of the treatment of clients "interconnectedness". We propose the definition of high principles that could guide institutions and supervisors in their dialogue, in order to achieve a common assessment of the level of connection between counterparties. In this scenario we consider unnecessary the obligation of routinely assess the connection of clients.

If this proposal is finally adopted, a set of guidelines to clarify the circumstances to be taken into consideration to evaluate the economic relationship among counterparties (that could be drawn up by the EC) would be welcome.

Definition of Exposures Value

Q3. In your view, how should exposure values for on-balance sheet items be calculated, gross or net of accounting provisions and value adjustments? Please provide examples to illustrate your response and feedback on relevant costs and benefits.

As regards on-balance sheet items there does not seem to be significant problems. Barely, regarding assets held for sale with capital surplus, in order to calculate the value of such exposures, surpluses should not be taken into account provided they are not considered as eligible own funds.

Q5. Do you think that low risk items should receive a 0% conversion factor? Do you believe that there is room to apply conversion factors between 0% and 100 % in a large exposures regime? Which items could in your opinion receive a conversion factor different of 100%, and for which reasons? Please explain your views and provide feedback on the costs and benefits of such an approach.

We believe that in the definition of the exposure value there should be a perfect alignment between the CCF defined in the CRD for credit risk and the ones used for large exposures calculations. We should not forget that CCF's try to anticipate the exposure in the event of default of a specific client, providing the best estimate for those cases. It could be argued that theses CCF's are even conservative for the large

exposures regime if we consider the sudden nature of "unforeseen events", especially if they are related to larger counterparties.

Q7. CEBS would welcome comments on the proposed set of principles. Are they appropriate for allowing Advanced IRB institutions to use their own exposure calculations? Please provide feedback on the costs and benefits that you consider would arise from adopting such an approach.

In our opinion, the use of the institutions' own exposure calculation methods for LE regulation as well as for capital requirements and internal steering would allow institutions to harmonise and streamline calculations, risk monitoring and internal/external/regulatory reporting. The proposed set of principles is clear and acceptable. The harmonisation would also reduce IT and reporting costs.

Q8. In the context of schemes with underlying assets, do you agree that for large exposures purposes it is necessary to determine whether the inherent credit risk stems from the scheme, the underlying assets or both? Do you agree that the proposed principles are appropriate to identify the relevant risk in a large exposures back stop regime? Are there other relevant criteria that you wish CEBS to consider? Please explain your views and where relevant please provide feedback on the costs and benefits.

We agree with the view that a case-by-case treatment should be given to such transactions due to the difficulties to establish a fixed set of rules that can be apply consistently for all structured transactions. Therefore, as it was included in our comments to the CP14, it is preferable to have a principles based approach.

We would like to comment on the example presented in Annex 3. This treatment was presented to the industry at the Madrid meeting and showed up certain problems. First of all, in line with the principles agreed, entities will either assign their risks to the SPV or the underlying assets depending on the risk assessment the make. In the latter case, taking Example 1, It makes no sense to assign risks to the scheme only because there aggregated remaining exposures does not ad up to the full amount of the senior tranch.

Another problem is the treatment in case of two first-loss tranches explained in Example 2. Taking this example and comparing it with a similar one where instead of the two first loss positions there is just one with an amount of 10 and then splitting the amount between two investors (80%-20%) the results of the exposure assign will be as follows:

	Annex 3 Example 2		One first-loss tranch example	
	Investor 3	Investor 2	Investor 3 (20%)	Investor 2 (80%)
Exposures with A-D	2	8	2	8
Exposures with E-K	2	5	2	3
Exposure with SPV	0	0	0	0

The situation presented in Example 2 for Investor 2 is, from a risk taking perspective, better than if he shares a unique first-loss tranch. Assuming the default of the full amount of one of the underlying assets E to K, the losses for Investor 2 can not exceed 3. In addition, shall it be an underlying asset with an exposure lower than Investor's 3 stake, we see no reason why the treatment for Investor 2 should be different than Investor's 1.

Based on these limitations and despite the appreciation for the effort to further work in achieving a harmonized implementation, which we see necessary, Annex 3 should be eliminated from the document.

Credit Risk Mitigation

Q9. Do you agree that for large exposures purposes there can be cases where it is justified to treat mitigation techniques in a different way from the treatment under the minimum capital requirements framework? Please explain your view and provide examples. And where relevant, please provide feed back on the costs and benefits.

We do not share CEBS´ view on this issue. Rather, we believe that the treatment of mitigation techniques should not differ from the capital requirements regime as this would lead to disproportional costs for the institutions. Especially in terms of physical collaterals do we believe that there are more liquid markets for collaterals than just real estate collaterals. A "one size fits all" approach does not appear to be the best solution from our point of view. For that reason, and due to the fact that the implementation of new CRM techniques would cause disproportionate costs to institutions with little benefits, we would strongly recommend aligning the CRM techniques with those already applied in the CRD.

Q10. Do you agree that the three alternatives set out for the recognition of CRM techniques are the relevant ones? Do you think there are other alternatives CEBS should consider? Please explain your views and provide examples. And where relevant, please provide feedback on the costs and benefits.

We agree with proposal 1 made by CEBS. In our view, proposal 2 and even more so, proposal 3 would lead to disproportionately high implementation costs as well as to higher costs resulting from running a further calculation model.

Q12. Do you support CEBS' proposal that institutions that use the simple method should follow the minimum capital rules (substitution approach) instead of applying the haircuts included in the current large exposure rules? Please explain your views and where relevant provide feedback on the costs and benefits.

We do not agree with the proposed treatment for SA entities which use the simple method. Limitations of the substitution approach have led us to the more risk sensitive comprehensive method. A higher risk weight in the earlier, which is the end result of the capital rules, can be justified in the lack of management sophistication for institutions that use the simpler method, but a different case is the definition of the exposure. The large exposure rules is based on limits on the maximum exposure level with a single client and it does not take into account nor the credit quality of the counterparty, nor the sophistication of the institution in managing credit (Pillar 1) or concentration risks (Pillar 2).

Therefore, we believe that there should be a common set of rules for entities, at least for the ones using the SA. In order to cope with the intention of keeping the framework as simple as possible, we propose for both cases a method based in establishing the effects of the collateral on the exposure, using the regulatory haircuts for financial collaterals.

Q13. Do you agree that physical collateral should not in general be eligible for large exposures purposes? Do you support CEBS' views that residential and commercial real estate should be eligible and that the current large exposures rules should be applied instead of the minimum capital rules? Please explain your views and provide examples. And where relevant, please provide feedback on the costs and benefits.

As mention in CEBS document, especial attention should be given to the liquidity of this type of collateral. If institutions can prove the existence of liquid markets, we do not see why there should be differences between these assets and others.

As for the treatment of residential and commercial real estate, we concur with CEBS view in the lack of relevance in the large exposures regime and with the analysis made.

Trading Book issues

Q15. Do you consider that two different sets of large exposures rules for banking and trading book are necessary in order to reflect the different risk in the respective businesses? What could be the costs/benefits of this? Please explain your views and provide as appropriate feedback on the cost and benefits of this.

We clearly see how the treatment for the banking book and the trading book need to be different. Large exposures regime is hardly the place to tackle concerns about the liquidity of the components of the trading book of an institution.

Intra-group exposures

Q21. What are your views on the proposals/options for the scope of application of the large exposures regime?

CECA considers it unnecessary to establish limits on own funds for risks derived from intragroup exposures. Supervisory authorities already have mechanisms (apart from large exposures regime) to supervise these circumstances within a group. Such limits could harm liquidity management within internationally active groups or even condition strategic decisions, such as those relative to acquisitions of other financial entities.

Sovereigns, international organizations, multilateral development banks and public sector entities

Q26. What are your views on the proposal to remove the national discretion and to automatically exempting exposures to sovereigns and other international organizations (within Art 113.3 (a – f)), as well as some regional governments and local authorities? Please explain your views.

We support a harmonized treatment of this kind of exposures as well as the view that in the event of such clients defaulting is exceptional event, with severe results which fall outside a normal regulatory framework. Therefore agree with the proposal to remove national discretion and exempting these exposures from the regime.

Interbank exposures

Q31. Given the market failure and costs/benefit analysis set out, what treatment would you consider appropriate for interbank exposures?

We propose the exemption from the large exposures regime for interbank exposures that do not represent a permanent or long term way of financing. We agree with the views expressed by industry representatives at the last public hearing on the subject. Credit institutions are highly regulated and supervised this, in addition to the short term that characterized these kinds of exposures, limits the possibility of having an "unforeseen event".

As pointed out on CP 16, institutions tend to use known and local counterparties for their funding and liquidity management. Having the 25% limit may result in higher operational costs and having to work with less known counterparties that may result in a higher risk.

On normal bases, interbank exposures canalize the funds resulting from treasury management of the institutions and rarely represent long term funding as it could be the typical relation with other kinds of clients. This provides an institution with great deal of

Breach of limits

Q34. Respondents' views on the approaches to non trading book breaches of the limits would be welcomed. Please explain your views and provide examples and feedback on relevant costs and benefits.

A harmonised maximum limit to large exposures would be welcome. As a general principle, such limit should not be exceeded (with specific exceptions).

Moreover, a transitory regime (grandfathering) would be reasonable, at least for those circumstances foreseen in paragraph 295:

- A new control relationship (as a consequence, for instance, of mergers or acquisitions between two previously unconnected entities).
- An affiliation between the institution itself and a financial group (so its exposures to an individual counterparty must be added to those previously maintained by the group to such counterparty).

In both circumstances, supervisory authorities should be entitled to permit transitory excesses.

In our opinion, entities should agree with supervisory authorities a reasonable schedule to bring the exposure into compliance with the limit. This schedule could address the following aspects:

- Counterparties exposures maturities plan.
- Eligible own funds recovery plan.
- Counterparties exposures renewal policy.

Anyway, the deduction of the entire exposure would be, undoubtedly, disproportionate. Otherwise, the deduction of the excess from own funds would be reasonable.

Reporting issues

Q35. What are your views on the 3 reporting options? Please explain and provide feedback on the costs/benefits of CEBS´ initial views.

The ESBG is in favour of the proposal to have supervisory reporting with immediate indication of breaches of the backstop limit. However, we would like to stress our concerns of repeating the experience of COREP. Specifically, the goal of developing at EU level a standardised reporting template could result in agreeing to adopt the most voluminous and detailed currently in use in the EU. In the context of the LE framework especially, there is a need to use a simple reporting format.

On the other hand, we are opposed to any reporting under Pillar III, as the market in not in a position to control the extent to which an institution complies with a supervisory regime. In addition, the disclosure

of information relating to large exposures would raise confidentiality problems.

Q36. Do you support CEBS' thinking on the purpose and the benefits of regular reporting using predefined reporting templates?

The provision of predefined templates to be used by all the entities when reporting to supervisors imply, in our opinion, some advantages:

- Allows entities to establish standardised procedures to obtain information.
- All entities under the same supervisory authority will be subject to common reporting requirements.
- They would be helpful in order to implement an internal discipline in relation with the review and control of the large exposures.

In this sense, we deem that the reporting should be based on templates defined by the supervisor, and should be common for all entities.

Regarding the content of the common reporting frame and taking into account Spanish Savings Banks experience, below you may find our considerations:

- We deem that it is not necessary to report those risks which, after applying mitigation techniques or the exemptions established, show an exposure lower to the ten per cent of own funds. On the other hand this should not prevent entities from establishing internal tools to control these risks.
- It is not necessary to detail the composition of the exposure subject to the limit. We deem that it is not necessary to break down the deal amount and the provisions constituted. On the contrary, we deem reasonable to offer information on the risk mitigation techniques which have been applied.
- Regarding indirect exposures, we deem that they should only be reported when the guarantee supplier is also considered as a large exposure.
- As mentioned in previous answers, we deem that interbank and intragroup exposures should not be reported. Over the reasons mentioned in each case, reporting them will cause an excessive administrative burden compared with the importance of risk to be supervised.
- Due to the reasons above explained, we do not consider necessary to report, on a regular basis, on the structure of the economic linked groups with whom entities maintain large exposures. In our opinion, the check-out of the structure of such groups is an issue that should fall under the supervising process laid down in Pillar II, and that should be also limited to those cases of special attention identified by the supervisor.

Q37. What is your opinion on CEBS' initial thinking regarding the elements to be reported under the large exposures regime?

A normal situation with a limited number of clients or none being categorized as large exposures makes unnecessary a burdensome reporting framework. We believe that a limited and harmonized reporting

framework should be in place and that a reporting framework as the one propose by CEBS can be justified for those entities with a high level of concentration. For further harmonization, the characteristics of this entities qualifying for a "full reporting" could be set across the EU and, as proposed, both the limited and the full reporting jointly defined.

If supervisors need information to assess systemic risk they have ways to require it less demanding for the industry as a whole and more efficient in pinpointing their concentration concerns for specific institutions.

Credit risk management

Q38. Do you agree with CEBS' views on the recognition of good credit management? Please explain your views.

We agree with CEBS view that the recognition of good credit management is somehow included in the proposals and that developing it further could introduce a not desired complexity in the framework. Also we concur with the view that, under a limit based backstop regime, is not justify exempting advanced institutions.