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CEBS Consultation paper 31

Guidelines on aspects of the management of concentration risk under the supervisory review process

Euroclear response

The Euroclear group is the world's leading provider of domestic and cross-border settlement and related services for bond, equity, fund and derivative transactions. User owned and user governed, the Euroclear group includes the International Central Securities Depositary (ICSD) Euroclear Bank, based in Brussels, as well as the national Central Securities Depositaries (CSDs) Euroclear Belgium, Euroclear Finland, Euroclear France, Euroclear Nederland, Euroclear Sweden and Euroclear UK & Ireland.

We are pleased to be given the opportunity to provide our view on the consultation issued by the Committee of European Banking Supervisors regarding *Guidelines on aspects of the management of concentration risk under the supervisory review process*.

General comments

We would like to note that concentration per se is not necessarily only creating risks – it may also be the result of an institution's risk mitigation strategy and thus contribute to lowering the institution's risk profile.

The risk mitigation strategy can lead to a preference for some forms of concentration over diversification. This can be the case, for example, when funding is concentrated in long-term stable sources; or when the predominant business lines offer relatively stable revenue-generating capabilities (as is the case, among others, with clearing and settlement services for clients). In these circumstances, diversification is not always desirable and may not be in line with the institution's risk appetite. This is, for example, the case of Euroclear Bank which as ICSD has a long-standing strategy to be a limited purpose bank concentrating its service offering on securities clearing and settlement related activities. This limitation in scope of Euroclear Bank's banking activities has been widely recognised as beneficial for the safety of the financial markets.

Along the same lines, a risk mitigation strategy can also lead to a preference for certain forms of concentration over others. An institution may, for example, express preference for holding or receiving as collateral well-rated assets, compared to lesser quality ones. Even though concentration in such assets is not desirable per se, the benefits of diversification would not unambiguously outweigh the worsening of the portfolio's quality.

The CEBS consultation paper seems to start from the assumption that there should be a "positive relationship between the degree of concentration and the level of capital". We believe that such a relationship can only unequivocally hold when identified concentrations can be considered to lead to a worsening risk profile, compared to either diversification or other forms of concentration, or compared to the absence of risk mitigation measures (for example in the case of concentrations in collateral portfolios).

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Specific comments: General considerations

Guideline 1
We believe that a well-documented concentration risk policy should be established "at both group and solo level, *as appropriate*". The Guidelines should include a possibility to exclude some group entities for which (some or all) the risks and potential risk concentrations are not material. Including group entities which do not face material risks would be overly burdensome; it would not add meaningful information and may even be counterproductive if it delays the documentation and analysis of concentration risk. This would be the case, for example, for the Euroclear CSDs, which face only limited financial risks.

Guideline 3
We agree that institutions should be allowed to assess themselves which risk concentrations are significant. This is of particular importance where uncommitted exposures are concerned. When uncommitted credit lines, for example, can be cancelled unilaterally with immediate effect, or when such lines can only be drawn against good quality collateral, risk concentrations are unlikely to materialise.

Guideline 5
In line with the comment related to group-wide policies under Guideline 1, we believe that limit structures should not necessarily be put in place at the highest level of consolidation. Firms should therefore rather "set top-down and group wide concentration limit structures, *when appropriate*".

With regard to mitigation techniques, though institutions should not over-rely on specific mitigation instruments, it should be noted that not all instruments are equal in that respect and that concentration in, for example, well-rated government bonds should not be treated similarly to concentration in lesser-quality assets.

Guideline 6
For the reasons outlined above under Guidelines 1 and 5, we propose to specify that reporting of concentration risk should be carried out "at both consolidated and solo level, *as appropriate*".

Specific comments: Individual risk areas

Credit risk
We would appreciate more clarity on how the recommendations included in CP31 relate to the recently amended Large Exposures rule.

Guideline 8
In relation to the definition of connected clients, please note that "common main sources of funding" are difficult to assess if not publicly disclosed.

Operational risk
Guideline 11
We feel that the definition and understanding of operational risk concentrations still needs to be further refined.

For example, we would like to understand how the requirements outlined in CP31 regarding the management of operational risk concentrations relate to the requirements of the Advanced Measurement Approach. Institutions applying the AMA

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are already deemed to include relevant scenarios in their assessment of capital needed for operational risk. One or a few of these scenarios may cover potential risks concentrations.

We believe that HFMI and LFHI loss events should only be considered as contributing to concentration risk if they have a common cause (which may be reasonably high-level, like inadequate controls or procedures). Otherwise, there are no indications that this is not pure coincidence, and should therefore not be treated as a risk concentration.

Guideline 12
We believe that there is some confusion in the text regarding the role of Internal Audit, which, to our understanding, is to ensure that existing procedures are adequate and are adequately applied, not to assess exposures to risk.

Guideline 13
We are not sure to understand what is meant by "non-contractual commitments". We cannot see which types of commitments could be established without contract.

Guideline 21
We do not consider that there should always be a "positive relation between the degree of concentration and the level of capital". We have presented arguments in favour of this comment under our “General comments” to the paper. We appreciate CEBS’ thoughtful analysis under §112-113 in this respect.

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