12 June 2009

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

Introduction

1. A revised large exposures regime is included in the amended Capital Requirements Directive[1] (referred to hereafter as the 'CRD'). The amendments will have to be transposed into Member States' national law by 31 October 2010 and will be applied from 31 December 2010.

2. The revised provisions on large exposures build on CEBS's advice to the European Commission. CEBS proposes to issue guidance on a number of aspects to ensure harmonised implementation across the Member States. The draft guidelines set out in this consultation paper focus on three aspects of the large exposures regime: the definition of 'connected clients', in particular 'interconnectedness'; the calculation of exposure values for arrangements with exposure to underlying assets; and reporting requirements. The last of these links into the COREP framework to ensure a unified European reporting system.

3. **CEBS presents its draft proposals of the implementation guidelines on these three aspects for public consultation, which will run until 11 September 2009**. Responses should be sent to the following email address: cp26@c-ebs.org. Comments received will be published on CEBS's website unless respondents request otherwise. In addition, a **public hearing will be organized on 7 September 2009 at CEBS's premises in London from 10:00 to 13:00 to allow interested parties to share their views with CEBS**.

4. CEBS would particularly welcome market participants' views on the questions set out at the end of each section.

[1] Capital Requirements Directive (CRD) is a technical expression which comprises Directive 2006/48/EC and Directive 2006/49/EC. Please note that in general references to "Directive 2006/48/EC" and "Directive 2006/49/EC" or "CRD" refer to the amended versions of the Directives. The amending Directive can be found under: http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=P6-TA-2009-0367&language=EN&ring=A6-2009-0139

Executive summary

5. The draft guidelines set out in this consultation paper build on CEBS's advice to the European Commission regarding the review of the large exposures regime. These guidelines focus on particular aspects where CEBS sees a need for further guidance in order to achieve convergent implementation and application of the revised CRD provisions. The paper is structured in three main parts: i) the definition of 'connected clients', in particular 'interconnectedness; ii) the treatment of schemes with exposures to underlying assets; and iii) reporting requirements for large exposures purposes.

6. For the large exposures regime effectively both to act as a backstop regime and to mitigate the impact on an institution of the failure of a counterparty, large exposures need to be clearly identified by institutions. This requires as a prior step that **connected clients** are identified. Consequently, the guidelines seek to provide clarity on the concept of interconnectedness, in particular when control issues or economic dependence should lead to the grouping of clients.

7. CEBS provides a non-exhaustive list of indicators of control that will guide institutions in the identification of control relationships. Even if the issue of control of one client over another does not apply, an institution is obliged to determine whether there exists a relationship of economic dependence between clients. If it is likely that the financial problems of one client would cause repayment difficulties for the other(s), there exists a single risk that needs to be addressed. An economic dependency between clients may be mutual or only one way. CEBS provides a non-exhaustive list of examples that illustrate possible dependencies between clients which should cause institutions to carry out further investigations regarding the need to group the clients.

8. CEBS also gives consideration to the possible connection of clients through a common main source of funding. If two counterparties are likely to draw on commitments from one institution (such as guarantees, credit support in structured transactions or non-committed liquidity facilities) at the same time, these counterparties may have to be considered as connected clients under certain circumstances.

9. The identification of connected clients should be an integral part of an institution's credit granting and surveillance process and every institution should have in place a robust process to conduct this identification. While institutions should strive to apply this process to all of their exposures, CEBS recognizes that this can be difficult in practice and proposes a proportionate approach: as a minimum, the process should be applied to all exposures that exceed 1% of an institution's own funds at a solo or consolidated level.

10. Exposures can arise not only through direct investments by institutions but also through **investments in schemes[2] which themselves invest in underlying assets**. Ideally, the underlying assets of a scheme should

[2] Such as collective investment funds (CIUs) and structured products (e.g. securitisations)

always be taken into account when calculating exposures for large exposures' purposes.

11. Therefore, CEBS considers that the look-through approach is a superior approach as it provides the most prudent treatment from a large exposures' perspective. However, CEBS also recognises that is not always possible or feasible to look through and proposes as an alternative a set of more conservative approaches to deal with such cases. CEBS believes that these approaches provide the right incentive to use the look-through approach and accordingly the decision on the most appropriate approach for a specific scheme should be left to the institution.

12. These fallback solutions reflect the greater uncertainty inherent in unknown underlying exposures (or entire schemes) by offering a conservative treatment that considers all unknown underlying exposures and schemes to belong to one separate group of connected clients. The examples set out in Annex 1 illustrate how these approaches would work.

13. CEBS also gives consideration to the differences of treatment for static portfolios where the underlying assets do not change over time and for dynamic portfolios where the treatment is more complicated as the relative portions of underlying assets, as well as the composition of the scheme itself, can change.

14. CEBS has also considered the application of the proposed approaches to tranched products and has developed a number of examples, which are set out in Annex 2, to illustrate how the different approaches would work.

15. CEBS believes that the harmonization of the **reporting requirements** for large exposures' purposes is fully necessary and proposes a common template with unique data-definitions for the information to be reported. CEBS presents in Annexes 3 to 5 its proposals for a common template and some illustrative examples.

16. This common template will be included in the COREP framework and as such the remittance dates and frequency of reporting which have been agreed for the COREP will also apply to large exposures' reporting. However, in the exceptional cases where exposures exceed the limit, the value of the exposure must be reported to the competent authorities without delay (i.e. as soon as the credit institution becomes aware of the breach). As these breaches are expected to be exceptional, and will not necessarily have common features, standardised reporting is not proposed.

Table of contents

Introduction 1

Executive summary 2

I. Background 5

II. Methodology 6

III. Connected clients 7

A. Definition of a group of connected clients in Article 4(45) of Directive 2006/48/EC 7

B. Interpretation of control 8

C. Exemption from the requirement to group clients in relation to "control" 10

D. Interpretation of economic interconnectedness (single risk) 10

E. Interpretation of connection through the main source of funding being common. 12

F. Control and management procedures in order to identify connected clients 13

G. Comments from the industry experts on the draft consultation paper 15

H. Consultation questions 16

IV. Treatment of exposures to schemes with underlying assets according to Article 106(3) of the CRD 17

A. Principles underlying the draft guidelines 17

B. Treatment of schemes with underlying assets 18

C. Treatment of tranched products 21

D. Consultation questions 23

V. Reporting Requirements 25

A. CRD amendments with regard to the reporting of large exposures 25

B. Description of large exposures reporting templates 27

C. Reporting of 20 largest exposures for IRB banks 32

D. Details on the composition of groups of connected clients 33

E. Consultation questions 34

Annex 1: Example of the application of partial look-through-base approach 36

Annex 2: Examples of the application of the proposed approaches to tranched products 38

Annex 3: Reporting 'Template 1' 43

Annex 4: Reporting 'Template 1' - references to COREP 44

Annex 5: Reporting Template 1 – Examples 45

I. Background

17. The previous large exposures framework applied to all credit institutions and investment firms falling within the scope of the CRD and the cross reference in Article 3(1)(b) of the latter Directive to Article 4(1)(1) of Directive 2004/39/EC (MiFiD).

18. Article 119 of Directive 2006/48/EC and Article 28 of Directive 2006/49/EC, require the European Commission (referred to hereafter as the 'Commission') to submit to the European Parliament and to the Council a report on the functioning of the large exposures provisions of the CRD. A review of the large exposures framework was therefore carried out by the Commission together with the European Banking Committee.

19. CEBS has contributed to this review by issuing two pieces of technical advice to the Commission. The first advice delivered during the course of 2006 included a stock-take of current supervisory practices[3] and a report on current industry practices[4].

20. CEBS's second technical advice focused on substantive aspects of the large exposures framework and was called for in two parts. Part 1 of the advice was delivered in November 2007[5] and dealt with the objectives of a large exposures regime - the purpose, the need for and appropriate levels of large exposures limits; whether the large exposures regime can be considered to be achieving its objectives; examination of the 'metrics' for the calculation of exposure values; and consideration of the extent to which the credit quality of a counterparty can or should be recognised. Part 2 of the advice was delivered in April 2008[6] and addressed the questions of credit risk mitigation and indirect exposures; treatment of inter-bank exposures; treatment of intra-group exposures and other group-related issues; trading book aspects; scope of application of the regime including the question whether a 'one size fits all' approach is desirable or not; consistency of definitions, in particular the definition of connected clients; treatment of breaches of limits; and reporting requirements.

21. Following up the review of the large exposures regime included in the amended CRD, CEBS proposes to issue guidance on a number of aspects of the revised rules to ensure their harmonised implementation across the Member States.

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[3] Supervisory stock-take on large exposures, published on 3 May 2006, http://www.c-ebs.org/Publications/Advice/2006/CURRENT-SUPERVISORY-PRACTICES-ON-LARGE-EXPOSURES.aspx

[4] Report on industry practices on large exposures, published on 31 August 2006, http://www.c-ebs.org/Publications/Advice/2006/INDUSTRY-PRACTICES-ON-LARGE-EXPOSURES.aspx http://www.c-ebs.org/Advice/LE_industryreport.pdf

[5] First part of CEBS's second technical advice, published on 06 November 2007 : http://www.c-ebs.org/Publications/Advice/2007/CEBS-PUBLISHES-THE-FIRST-PART-OF-ITS-TECHNICAL-ADV.aspxhttp://www.c-ebs.org/Advice/documents/LE_Part1adviceonlargeexposures.pdf

[6] Second part of CEBS's second technical advice, published on 03 April 2008: http://www.c-ebs.org/Publications/Advice/2008/CEBS-PUBLISHES-ADVICE-ON-THE-REVIEW-OF-THE-LARGE-E.aspx

II. Methodology

22. CEBS has developed its technical advice to the Commission in a manner consistent with the Commission's better regulation agenda. CEBS has done that by following, as far as time constraints allowed, the Impact Assessment (IA) guidelines that have been developed by the 3L3 Committees[7]. The guidelines are consistent with the Commission's own IA methodology but have been refined to take account of the regulatory objectives of the 3L3 Committees and their existing working practices.

23. The draft guidelines set out in this consultation paper build on CEBS's second advice to the Commission. Nevertheless, CEBS has conducted a high-level IA when developing the draft guidelines on connected clients and treatment of schemes with underlying assets and has included the main findings of the IA exercise in this paper. An IA was not conducted for the guidelines on reporting requirements since the proposed reporting template and guidance will be included in the COREP framework for which an overall IA will be conducted. CEBS sought advice from an IA adviser and followed the methodology set in the 3L3 IA guidelines.

24. On connected clients, CEBS assessed the cost and benefits of issuing detailed guidelines against the current situation. CEBS has concluded that there is a clear cost/benefit analysis case for choosing to issue detailed guidelines, as set out in this consultation paper. While it is likely that there will be some additional costs for institutions as a consequence of the requirement to meet the guidelines, the benefits appear to outweigh the costs. Clear rules for the identification of connected clients (cluster risk) will improve risk management of these risks, foster a level playing-field and provide a positive contribution to financial stability.

25. On the treatment of schemes with underlying assets, CEBS has considered the costs and benefits of applying the 'full look-through' approach or of applying a combination of approaches compared with the current situation. CEBS has concluded that a combination of approaches appears to address major failures in this area while keeping costs to a minimum. The application of the 'full look-through' approach also addresses the market failure, but appears to impose large costs on institutions and does not fully consider the benefits of granularity or tranched exposures.

26. Members and Observers from the Consultative Panel were invited to nominate industry experts to provide technical input to CEBS's work[8]. These industry experts were invited to comment on a previous draft of the guidelines. The experts provided CEBS with their technical input on a number of important aspects and have significantly contributed to the finalisation of the draft guidelines now published for consultation.

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[7] The Impact assessment guidelines have been published on 30 April 2008: http://www.c-ebs.org/getdoc/9681fba5-2521-4b10-8e80-ac98f9a4e26c/3L3-Committees-reinforce-their-commitment-to-the-p.aspx

[8] The list of industry experts is published on CEBS's website: http://www.c-ebs.org/getdoc/b4e8fb8b-6b94-47cd-a311-8006be40c753/Large-Exposures.aspx

III. Connected clients

27. During the previous consultations and public hearing on the revised large exposures regulation, it became clear that there were varying interpretations by institutions of the interconnectedness element of Article 4(45) of Directive 2006/48/EC. In addition, many of the industry representatives did not see the need to view interconnected clients as one risk and objected to keeping the entire Article in the CRD.

28. The large exposures regime is a backstop regime designed to limit the impact on an institution of a counterparty failing. Idiosyncratic risk represents the effects of risks that are particular to individual borrowers. The objective of the definition on connected clients in the CRD is to identify clients so closely linked by idiosyncratic risk factors that it is prudent to treat them as a single risk. In market failure terms the regime aims to mitigate a negative externality, i.e. the wider systemic impact of a failure. In this context, the risk of counterparties being connected needs to be addressed prudently. However, in the past, varying levels of application of the requirements in Article 4(45) to groups of connected clients indicate a lack of clarity regarding the concept of interconnectedness. This implies a regulatory failure.

29. For the regime effectively both to act as a backstop regime and to mitigate such failures, large exposures need to be clearly identified by institutions. This requires as a prior step that connected clients are identified. Consequently, there is a need for regulators to be clear on the concept of interconnectedness, in particular when control issues or economic dependence should lead to the grouping of clients, although this has to be an area of discretion based on some general principles. The development of comprehensive guidelines as set out above seeks to ensure that institutions are aware of their responsibilities in this area and to provide assistance in properly identifying interconnections.

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

30. *"Group of connected clients" means:*

    (a) two or more natural or legal persons, who, unless it is shown otherwise, constitute a single risk because one of them, directly or indirectly, has control over the other or others; or

    (b) two or more natural or legal persons between whom there is no relationship of control as set out in point (a) but who are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, in particular funding or repayment difficulties, the other or all of the others would be likely to encounter funding or repayment difficulties"

31. The concept of connected clients is applied in two different contexts in Directive 2006/48/EC. Apart from large exposures, it is also applied when categorizing clients into the retail market portfolio (see Article 79 of

Directive 2006/48/EC). However, in these guidelines CEBS is focusing on the application of Article 4(45) in relation to the large exposures regulation only.

32. The definition of connected clients as per Article 4(45) of Directive 2006/48/EC refers to interconnectedness arising from the following:
    - one client has control over the other;
    - the clients are interconnected by some form of material economic dependency; or
    - the clients have a main common source of funding within the institution, its group, its connected party or associate in the form of credit support, potential funding or direct, indirect or reciprocal financial assistance.
33. In cases of divergence between the opinion of the institution and that of the competent authority, it is the competent authority which decides whether a client must be regarded as part of a group of connected clients.
34. The definition of control in Article 4(9) in Directive 2006/48/EC is specifically aimed at describing the conditions for requiring a consolidated annual report. While the concept of connected clients within the large exposures regime includes control, as defined in Article 4(9), it also covers interconnectedness arising through other means such as economic dependence. These draft guidelines seek to provide clarity on interconnectedness however it arises.

B. Interpretation of control

35. The institution must first rely on the CRD definition of control (Article 4 (9) of Directive 2006/48/EC) which is taken from the accounting definition (Article 1 of Directive 83/349/EEC on consolidated accounts). Control means the relationship between a parent undertaking and a subsidiary or a similar relationship between any natural/legal person and an undertaking.
36. This means that control is presumed to exist when the client owns directly, or indirectly through subsidiaries, more than half of the capital or voting power of an entity, unless, in exceptional circumstances, it can be clearly demonstrated that such ownership does not constitute control.
37. Normally, a client owning 50 % of the shares/voting power of another client will be able to exercise one or more of the powers mentioned below. This is even the case when there are two equal partners/owners who share the power and govern the entity jointly.
38. However, control may also exist when the client owns less than half of the voting power of an entity or does not hold any participating interest in the entity at all.
39. In those cases, the institution should refer to indicators of control that are seen in cases where the client is able to exercise one or more of these powers:
    - power to direct the activities of the other entity[9] so as to obtain benefits from its activities;

[9] In this context, a client which is a natural or legal person (undertaking).

- power to decide on crucial transactions such as the transfer of profit or loss;
- power to appoint or remove the majority of directors, the supervisory board, the members of the board of directors or equivalent governing body where control of the entity is exercised by that board or body;
- power to cast the majority of votes at meetings of the board of directors, general assembly or equivalent governing body where control of the entity is exercised by that board or body; and/or
- power to co-ordinate the management of an undertaking with that of other undertakings in pursuit of a common objective, for instance in the case where the same natural persons are involved in the management or board of two or more undertakings.

40. In cases where the institution needs to make a discretionary judgement, these indicators, along with other relevant indicators used for accounting purposes, could be used in order to identify a control relationship.

41. There will be some situations where there could be a requirement to include an entity in more than one group of connected clients, for example, in the case of an entity in which two persons/companies hold 50:50 participations if they exercise a common influence on the entity. The same applies to a case where a client has entered into a "shareholders' agreement" with other shareholders so as to obtain the majority of the voting power of an entity and this implies that all of the shareholders involved have control over the entity. A natural or legal person that is a partner in one or more (limited) partnerships also exercises control over these (limited) partnerships and (limited) partnerships are therefore to be included in the group of connected clients of every one of their partners.

42. It follows from the control criterion that exposures to entities within the same group as the reporting institution are to be regarded as a single risk. All entities within the same group are connected clients, although exposures to some or all of them may be exempted from the large exposures regime depending on how the Member State has implemented Article 113(4)(c).

43. It follows from the definition above that horizontal groups according to Article 12 of the Directive 83/349/EEC on consolidated accounts, which draw up consolidated accounts and a consolidated annual report, are to be grouped as connected clients. This is the case if an undertaking is related to one or more other undertakings because they all have the same parent or are managed on a unified basis. This management may be pursuant to a contract concluded between the undertakings, or provisions in the Memoranda or Articles of Association of those undertakings, or if the administrative management or supervisory bodies of the undertaking and of one or more other undertakings consist for the major part of the same persons.

44. The entire exposure to a connected client must be included in the calculation of the exposure to a group of connected clients, it is not limited to, nor proportional to, the formal percentage of ownership.

45. It should be understood that the control situation is not just for a transitional period but seems reasonably stable. In Article 4(45) of Directive

2006/48/EC the wording "*unless it is shown otherwise*" is used. It should be interpreted in the sense that if the institution is able to demonstrate that what seems to be a control relationship truly is not, then there is no requirement to group the clients. Most notably, this would be the case for owners of shares without voting rights. However, in cases where control exists, it is not relevant that the client for the time being does not actually exercise its potential control. Accordingly, voluntarily self-imposed limitations on the exercise of control such as legal ring-fencing or statements of a similar nature issued by the client do not obviate the need to consider such clients as connected.

C. Exemption from the requirement to group clients in relation to "control"

46. For subsidiaries where the majority of the shares are owned by the central government, and exposures to the central government[10] receive a 0 % risk weight under the Directive 2006/48/EC, there is no requirement to group the subsidiaries as connected clients. This also applies to subsidiaries controlled by regional or local authorities under the same central governments. In such cases, even though the owner has control over each subsidiary, the risk connected with the exposure to one subsidiary is normally not related to the risk of the exposures to other subsidiaries. In addition, the failure of one subsidiary, which is a separate legal person, does not necessarily impose a duty on the owner to invest more capital. If the owner still decides to do so, it is assumed that this ultimately could be financed by raising revenues.

D. Interpretation of economic interconnectedness (single risk)

47. Even if the issue of control of one client over another does not apply, an institution is obliged to determine whether there exists a relationship of economic dependence between clients. If it is likely that the financial problems of one client would cause repayment difficulties for the other(s), there exists a single risk that needs to be addressed. An economic dependence between clients may be mutual or only one way.

48. Dependence might arise in the context of business interconnections (such as supply chain links, dependence on large customers or counterparty exposures) which are not linked to respective sectoral or geographic risks, and suggests that the clients involved are exposed to the same idiosyncratic risk factor. If this idiosyncratic risk materializes, the solvency of one or both obligors can be threatened. Consequently, interdependencies between enterprises (or persons) due to bilateral business relationships may lead to default contagion which is independent from sectoral or geographic risk. The fact that the existence of common idiosyncratic risk factors may lead to default contagion for otherwise independent clients, is the core of the

[10] It was implicitly understood in the original advice from CEBS of April 2008 that this exemption is limited to 0 % risk weighted governments (and their regional and local authorities), as the default of 0 % RW governments is outside the scope of the risks that the large exposures regime is designed to address.

concept of economic interconnectedness[11]. Sectoral concentration is a common risk affecting all entities in the same industry, geographic risk is a risk affecting all entities in the same region whereas interconnectedness is an idiosyncratic risk that arises in addition to sectoral and geographic risk. Therefore sectoral and geographic concentrations fall outside the scope of the large exposures regime and are addressed by other means such as Pillar 2.

49. The rationale for the definition of economic interconnectedness in Article 4(45)(b) is to identify dependencies that a client cannot overcome without experiencing repayment difficulties. However, even if a client is depending on another client through, for instance, a business relationship, it could still be possible for the client to find a replacement for this business partner (in case of his default) or to compensate for such a loss by other means, for example through reduction of costs, concentration on other sectors etc. This may cause practical problems, such as lower margins or other inconveniences, but as long as the institution comes to the conclusion that the client will be able to cope with such a situation without facing repayment difficulties, there is no requirement to consider such clients to be interconnected. On the other hand, if it is likely that a client would not be able, for example, to cope with the loss of an important customer, i.e. the institution comes to the conclusion that the failure of such a customer would lead to repayment problems for the client, then these clients must be considered to be interconnected.

50. The following examples are illustrations of possible economic dependence between clients, where institutions should carry out further investigations regarding the need to group these clients:

    - when one counterparty has guaranteed fully or partly the exposure of the other counterparty and the guarantee is so significant for the issuer that the issuer is likely to default if a claim on the guarantee occurs. If the guarantee is not significant, meaning that the potential liability if it materializes would not threaten the issuer's solvency, the guarantee relationship is covered through the Credit Risk Mitigation rules or counterparty substitution;
    - the owner of a residential/commercial property and the tenant who pays the majority of the rent;
    - the producer of a given product and the only buyer of this product;
    - a producer and vendors that this producer is depending on and which it would take time to substitute;
    - undertakings that have an identical customer base, consisting of a very small number of customers and where the potential for finding new customers is limited; and
    - for the retail market:
        - the debtor and his/her co-borrower;

[11] This definition of a common idiosyncratic risk factor was developed for the purpose of analyzing aspects of the IRB model, but it is applicable also for large exposures purposes.

- the debtor and his/her spouse/partner if by contractual arrangements or marriage laws both are liable and the loan is significant for both; or
- the debtor and a collateral provider or guarantor, provided that the collateral or guarantee is so substantial for the issuer to the extent that his/her/its ability to service the liabilities will be affected if the guarantee or collateral is claimed by the institution.

51. It is not possible to give a comprehensive list of possible cases of economic interconnectedness. Each case will have its own characteristics, and the identification of interconnected clients requires thorough knowledge of the customer/client and not least a consciousness about connected risks among the institution's staff.

52. Institutions that operate in a well defined geographic area only, or in an area dominated by one specific industry (sector), are not more affected in their conduct of business by the connected clients' rule than other institutions. Geographic and sectoral concentration risks are not covered by the large exposures requirements but by Pillar 2 of the CRD.

E. Interpretation of connection through the main source of funding being common

53. If two counterparties are likely to exploit commitments from one institution (such as guarantees, credit support in structured transactions or non-committed liquidity facilities) at the same time, these counterparties may be considered to be connected clients. The intention is not to include cases where the two counterparties draw on the same funding source because the money market or market for commercial paper in general is in trouble, but when the need for funding is caused by a problem which is specific to the clients in question. It could also be a funding problem specific to the category of clients or products in question.

54. In relation to interconnectedness and funding in general, it is clear that the CRD requires institutions to identify clients that are connected due to reliance on the same funding entity and that this entity as the sole source of funding is not easily replaceable. The connected clients in this case are not able to overcome their dependence on this entity for funding even by taking on practical inconvenience or higher margins. Clients that are depending on their existing source of funding simply because they are not creditworthy do not belong in this category.

55. An illustrative case in relation to connected clients due a common source of funding is the following: where a bank has committed itself to be the existing or potential funder or provider of credit support to more than one conduit or SPV under similar conditions and where it is possible that all of these commitments may materialize into exposures at the same time because they are dependant on the same funding entity. As an example, an entity provided liquidity for a number of different conduits, and relied on issuing commercial paper (CP) in order to finance the conduits. The conduits had no other source of funding and invested in long-term assets. As the asset quality of the conduits came into question, the loss of trust in the

market was immediate and significant, and the funding entity was unable to issue new commercial paper. Consequently, it could not provide the necessary funds to refinance all the conduits. Therefore, the bank, as the main guarantor for the conduits, had to fund the whole structure. Although the different conduits were not invested in the same assets and were legally independent as they were owned by separate trusts, it is obvious that the different conduits constituted a group of connected clients as they formed a single risk. This risk was not a sectoral risk, as it was the specialization in product and niche in the money market or, more specifically, the market for commercial paper, which caused the dependence. The moment there was no market for new commercial paper of the funding entity, the limited scope, competence and solidity of these SPVs became evident.

56. While the above example refers specifically to conduits and the problems experienced in the commercial paper market, 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 funding used, but rather it is dependent on entities receiving all or the majority of their funding from a common source which cannot easily be replaced. As is general for the concept of interconnectedness, it is a case by case assessment.

57. However, it should be noted that a common source of funding solely due to geographic location does not in itself lead to a requirement to connect clients. Small and medium sized entities will in many cases not have the capacity or commercial incentive to use other than their local bank, and in addition for most of them the personal relationship with their banker is the key to better financial services. This fact does not in itself justify that these clients should be regarded as interconnected, even though they have a common source of funding. Such a situation differs from funding dependencies described in this chapter because the motivation for sharing a common source of funding is the geographic location and because such a common source of funding can normally be replaced.

F. Control and management procedures in order to identify connected clients

58. It should be an integral part of an institution's credit granting and surveillance process to identify possible connections between clients at the earliest possible time. It is in the interests of the institution to identify all possible connections in order that it has a clear understanding of its exposures. In this regard it is incumbent on all institutions to use all the information at their disposal to identify connections; this includes publicly available information. It is expected that at a minimum institutions will increase their efforts to identify connections as exposures grow or reach a certain threshold.

59. To have information about connected clients is essential in limiting the impact of unforeseen events. Accordingly, the information required should be available to the institution. The data that needs to be collected may go beyond the institution's client and include legal or natural persons connected to the client. Information about business links or economic dependencies is not usually captured by the existing information systems of banks. The

necessary inputs require tapping into "soft information" that typically exists at the level of individual loan officers and relationship managers.

60. In relation to the identification of interconnected clients, every institution should have in place a robust process for determining connected clients. CEBS does recognize the possibility of practical difficulties in determining interconnectedness for all the exposures of an institution. Notwithstanding this, the institution must be in a position to demonstrate to its competent authority that its process is commensurate to its business. In addition the process should be subject to on-going review by the institution to ensure its appropriateness. It will rarely be possible to implement automated procedures for identifying economic interconnections, therefore case by case analysis and judgement will be required. Consequently, for the identification of economic interconnections, institutions need to rely primarily on the expertise of their loan officers and risk managers. Therefore, an institution's board of directors and senior management must ensure that adequate processes for the identification of economic interconnections are in place and risk managers and loan officers are sufficiently trained in this regard. Such processes need to be proportionate to the relative size of the loan. Furthermore, institutions should also monitor for changes to interconnections, at least in the context of their normal periodic loan reviews and when substantial expansions of the loan are planned.

61. In this regard, while an institution should strive to apply its process to all exposures, CEBS expects that as a minimum, the process would be applied to all exposures that exceed 1 % or more of own funds at a solo or consolidated level.

62. A crucial point in the process is the first time an exposure is granted to the client, or the first time an exposure reaches a level that requires individual handling from the institution. At this point, there is normally a loan officer involved and personal contact between the loan officer and the client. This opportunity to collect information relevant to disclosure of connected clients should be utilised.

63. Normally, the institution's largest exposures will be allocated to loan officers dedicated to follow the client on a regular basis. This includes personal contact as well as scrutinizing accounts and reports. The occasions to develop a deeper understanding of the client's business and possible dependencies are there and the collection of such information is a normal part of conducting prudent banking.

64. The credit institution has to assess for example the diversity of the client's customer base or of the tenants. In cases where the institution has identified interconnectedness, it has to acquire information on the other entity(ies) in the group of connected clients if this is necessary to form a view on the creditworthiness of its customer. The credit institution, however, is not obliged to investigate, whether the other entity, to which its client is interconnected, itself is part of other groups of connected clients, as long as the other entity is not a client of the credit institution.

G. Comments from the industry experts on the draft consultation paper

65. As part of the process of developing this consultation document CEBS consulted a number of experts from the industry to get initial technical feedback on the proposals. Where it was deemed appropriate, the issues raised by the industry experts have been included in the consultation paper. However, there were two issues raised by a number of participants that require specific attention at this stage. These issues refer to:

i) One-way connectedness

66. A number of experts commented that the inclusion of one-way connectedness would be an extension of the large exposures regime. It is very clear from the Directive text that including one-way connections is not an expansion of the regime as it is explicitly covered by Article 4(45)(b) of Directive 2006/48/EC "... if one of them were to experience financial problems, the other or all of the others would be likely to encounter repayment difficulties". There is no premise here that the dependency needs to be mutual. Given that it is clear from the above that the large exposures regime encompasses one-way as well as mutual connectedness the issue raised by the industry experts has not been addressed in this paper or included in the questions to which responses are sought through this consultation.

ii) Connections through a common source of funding

67. A number of experts raised concerns that CEBS would expand the large exposures regime by incorporating requirements in relation to connections through a common source of funding. However, it was an explicit decision by the Commission, Council and Parliament to expand the definition of connected clients in this regard. Therefore, the definition of connected clients in Article 4(45)(b) has been expanded by the amended Directive[12] as follows:

> *"(b) two or more natural or legal persons between whom there is no relationship of control as set out in point (a) but who are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems,* ***in particular funding or repayment difficulties****, the other or all of the others would be likely to encounter* ***funding*** *or repayment difficulties"*

68. Consequently, with the inclusion of the above text in the definition of connected clients, it is clear that connections through a common source of funding are also covered. Therefore, this issue raised by the industry experts has also not been addressed in this paper or included in the list of questions.

[12] Proposal for a Directive of the European Parliament and of the Council amending Directives 2006/48/EC and 2006/49/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements, and crisis management (http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=P6-TA-2009-0367&language=EN&ring=A6-2009-0139).

H. Consultation questions

69. CEBS would like to ask participants in this consultation who believe that the present proposals have shortcomings or are burdensome to provide suggestions on how these proposals can be amended. Such contributions will deliver very valuable input and give indications about how these guidelines can be improved after the consultation. The following questions are of particular interest for CEBS:

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

IV. Treatment of exposures to schemes with underlying assets according to Article 106(3) of the CRD

70. Exposures can arise not only through direct investments of institutions but also through investments in schemes[13] which themselves invest in underlying assets. Consequently, when a credit institution invests in a scheme it is exposed on the one hand to the risk associated with the scheme manager/depositor and on the other hand to the credit and market risk linked to the underlying assets of the scheme. Therefore, ideally, the underlying assets of a scheme should always be taken into account when calculating exposures for large exposure purposes.

71. The revised large exposure rules include the treatment of exposures to underlying assets. The new Article 106(3) is included in the amended CRD: "*In order to determine the existence of a group of connected clients, in respect of exposures referred to in points (m), (o) and (p) of Article 79(1), where there is an exposure to underlying assets, a credit institution shall assess the scheme or its underlying exposures, or both. For that purpose, a credit institution shall evaluate the economic substance and the risks inherent in the structure of the transaction.*"

72. Article 106(3) makes clear that institutions have to separately assess for large exposure purposes schemes with underlying assets in order to determine the existence of groups of connected clients. Institutions are required to assess whether the scheme itself, its underlying assets or both are interconnected with the institution's clients (including other schemes) and therefore should be grouped together with such connected clients for the purpose of the large exposure requirements. Article 106(3) does not, however, specify under what circumstances the scheme or the underlying exposures or both have to be assessed. Article 106(3) also does not provide an option for institutions to choose between these three approaches but requires institutions to decide on the basis of "the economic substance and the risks inherent in the structures" which approach is the most suitable for a scheme. Further, Article 106(3) does not explain what an institution should do if a look-through is not possible or too burdensome.

73. In addition, there is evidence to suggest that institutions' exposures to schemes with underlying assets are not being consistently (or prudently) treated for the purposes of determining the existence of a group of connected clients with regard to the large exposure requirements. This leads to the increased risk of the large exposure limits being breached and consequential risks of firm failure, which can result in negative externalities. Therefore, CEBS has developed the draft guidelines set out below on the appropriate treatment of various structured instruments.

A. Principles underlying the draft guidelines

74. CEBS developed the draft guidelines on the basis of the following principles:
    - the guidelines should provide comprehensive prudential guidance for different kinds of schemes with underlying assets;

[13] Such as collective investment funds (CIUs) and structured products (e.g. securitisations)

- the look-through approach is considered to be the superior approach for determining interconnectedness of the underlying assets with the institution's clients as it provides the most prudent treatment from a large exposures' perspective;
- because it is not always possible or feasible to look through, the guidelines should provide prudent alternative approaches that adequately deal with such cases. In these approaches, greater uncertainty should be reflected in a more conservative treatment;
- regardless of the question of interconnectedness of the underlying assets to other schemes or direct exposures to clients, risk arising from schemes themselves should be recognised.

B. Treatment of schemes with underlying assets

75. Potential losses stemming from schemes with underlying assets can arise from two sources: the risk associated with the scheme itself and the risk associated with the underlying assets of the scheme. Article 106(3) makes clear that these two sources of risk need to be taken into account in the determination of the existence of a group of connected clients. The different nature of the two sources implies that different factors should be taken into account when assessing the materiality of the risks stemming from each source, and therefore the need to apply look-through to cope with the risk stemming from the underlying assets or to limit the investment in a specific scheme to cope with the risk stemming from the scheme itself. In the case of the risk stemming from the underlying assets one important factor would be the degree of diversification in the scheme. While in the case of the risk stemming from the scheme itself the legal framework applicable to the fund managers would be an important factor to take into account.

76. Regarding the risk of the underlying assets, taking into account the burden that a compulsory full look-through approach could impose in some cases, CEBS's proposal consists of a number of options that introduce incentives to look through instead of applying a more conservative treatment. Thus the decision on the most appropriate approach for a specific scheme is left to the institution.

77. However, institutions should whenever feasible use the most risk sensitive approach and should be able to demonstrate to the competent authorities that regulatory arbitrage considerations have not influenced their choice. Competent authorities would expect that the institution's decision is justified in terms of the relative risk that the scheme could pose in terms of breaching the large exposures limits and the cost to mitigate that risk by the look-through. For example, if an institution makes an investment that represents 5% in terms of its own funds in a fund with a very granular and dynamic portfolio, the marginal contribution of this scheme to the "unexpected idiosyncratic credit risk" of the institution may be low, while the cost of a full look-through of this portfolio may be high. Conversely, if the institution invests in a non-granular and static portfolio the contribution of this scheme to the "unexpected idiosyncratic credit risk" of the institution could be material while the cost of a full look through is not likely to be very high. Therefore, competent authorities would expect that in the latter case

institutions aim to look through to the scheme and to fully justify their decision when it is not the case.

78. Where an institution cannot ensure that there are no interconnections between the institution's clients and the underlying assets of a scheme, prudential treatment cannot allow for such exposures and schemes to be considered as independent counterparts. Such an approach would open the door to regulatory arbitrage because the number of schemes in an institution's portfolio is not limited and they can be reproduced at will. Thus an institution would always be able to avoid breaches of its large exposure limits by suitably small investments in a large number of schemes. Therefore, all unknown exposures from schemes should be considered as belonging to one single group of connected clients. CEBS is aware that this solution would disregard the possibility of interconnection between the unknown exposures and the portfolio of the institution. However, CEBS believes that limiting the investment in schemes where a look-through approach is not possible or feasible is sufficiently restrictive and mitigates the possible idiosyncratic risk of a client or a group of connected clients.

79. The fall back solutions set out below reflect the greater uncertainty inherent in unknown underlying exposures (or entire schemes) by offering a conservative treatment that considers all unknown underlying exposures and schemes to belong to one separate group of connected clients, although the degree of conservatism would vary a lot case by case. For an institution that mainly invests in very granular and dynamic investment funds this approach would be conservative, while for an institution that normally does not invest in schemes but decides to use a scheme to circumvent the large exposure rules by investing in a scheme with only one or a few assets in which the institution has already directly invested close to 25% of its own funds this approach would be not conservative at all. Therefore, as pointed out above, it is important to require that institutions should be able to demonstrate to the competent authorities that regulatory arbitrage considerations have not influenced their choice of looking through or not.

80. However, the fall-back solutions do allow firms to treat all the underlying exposures of a scheme that can be identified in accordance with the normal rules.

81. An important issue in the context of look-through is the question of changes in the underlying assets of a scheme. For static portfolios where the underlying assets do not change over time, an assessment can be made once and does not need to be monitored in the future. For dynamic portfolios the treatment is more complicated as the relative portions of underlying assets as well as the composition of the scheme itself can change. In these cases a look-through or partial look-through approach must always be accompanied by on-going monitoring of the composition of the scheme. On-going in this context means that the monitoring frequency must be appropriate to the frequency and materiality of the changes in the underlying assets of the scheme.

82. Moreover, a prudential treatment needs to take into account that interconnectedness between the underlying assets of different schemes or schemes themselves are possible.[14]

83. As a result of these considerations, CEBS proposes that institutions apply one of the following approaches for the treatment of exposures to schemes with underlying assets according to Article 106(3) for the purpose of determining the interconnectedness of the underlying assets in the scheme with other clients:

    a) Full look-through: The institution may identify and monitor over time all exposures in a scheme and assign them to the corresponding client(s) or group(s) of connected clients.

    b) Partial look-through approach[15]: The institution may look through to the x known exposures in a scheme and assign them to the corresponding client(s) or group(s) of connected clients. The remaining exposures shall be treated as unknown exposures in accordance with (d) below.

    c) Mandate-based approach: Where the credit institution is aware of, and can place reliance on, the complete mandate of a scheme (e.g. in the case of certain CIUs), the institution may use this information to probe that the scheme is not connected with any other direct or indirect exposure in the institution portfolio, and therefore should not be added to the group of unknown exposures.

    d) Unknown exposures: All exposures where the institution does not look through by any of the methods described above are to be regarded as being entirely related to one entity and shall be considered as one specific group of unknown connected clients.

84. Institutions should follow the following principles when applying the approaches above:

    - Institutions shall consider the risk arising from the scheme itself other than the risk stemming from the underlying assets. Such risk shall be recognised for the purposes of establishing the existence of a "group of connected clients. [16]
    - If an institution is aware of interconnections in a scheme, they shall be recognised for the purposes of establishing the existence of a "group of connected clients".
    - The respective exposure amounts only need to be included in proportion to the institutions' share of interests in the scheme.
    - If an institution can ensure that there are no interconnections between unknown underlying assets of a scheme, it may treat these exposures as separate groups of unknown connected clients as long

[14] A report by S&P, 16 Feb 2009, for example, shows "that there is a significant similarity or "overlap" between CLO portfolios with an average pair of transactions having 28% of their portfolios in common."
[15] Annex 1 presents some examples on the application of the 'partial look-through' and 'mandate-based' approaches.
[16] Such interconnections may arise due to "servicer risk" or "originator risk" in e.g. securitisations, or due to reliance on a central manager in the case of CIUs.

as the institution can ensure that there are no interconnections between these exposures and the institution's portfolio (including underlying assets of other schemes).

C. Treatment of tranched products

85. In cases of non-structured products the losses derived from the default of a counterparty in the scheme is proportionate to a direct investment in the underlying assets. In the case of structured products the calculation of the losses also depends on the credit enhancements linked with the specific tranches. As far as these enhancements are legally enforceable, CEBS considers that they should be taken into account for large exposures purposes. The proposed treatment recognises the credit risk mitigation that subordination of tranches provides to the structure, which is consistent with the general requirement for institutions to use the most risk sensitive approach feasible. The tranches benefit from large exposures reduction by credit enhancement. Only for first loss tranches (i.e. 1250% RW) is no mitigation recognised among them.

86. The thinking behind the proposed treatment is the following: For any given position that an investor may hold in a securitisation, there is a protection stemming from subordinated tranches equal to the size of this subordination. No matter which underlying exposure defaults first, a given position will be always protected by the junior tranches, by an amount equal to their size. Thus, the initial exposure to a given name should be "adjusted" and reduced by an amount equal to the size of all junior tranches. Of course, the adjustment will also depend on the share that is invested in the tranche.

87. Even though risk mitigation should be always recognised, the proposal includes a conservative layer. Credit risk mitigation will not be recognised when first loss tranches benefit from the credit enhancement of other first loss tranches. This is why first losses are treated as a set (FL) in which an investor participates in a certain percentage, precluding risk mitigation recognition among them.

88. For granular portfolios, the treatment results in an assignment to "unknown exposures". In the cases of structured products with many names, the size of each of them will be extremely small (and probably small than the size of first loss tranches). For such situations, the formula will require recognising for investors into the first loss tranche a large exposure equal to each underlying name, and for the investors into the senior tranche, no large exposure at all. This is an appropriate treatment as investors in senior tranches in highly granular pools will be probably asking for the treatment of "unknown exposures". As it can be seen, the formula will not assign any exposure to the underlying names.

89. The proposed treatment for structured products when the look through is applied can be summarised as follows and should be read in conjunction with the examples included in Annex 2 of this paper. The analysis will have to be conducted for every tranche T in which an institution holds a position.

For FIRST LOSS POSITIONS (FL):

For a given position in the first losses set (FL, the sum of all tranches that meet the "first loss" definition) being evaluated, it will be considered that the institution holds an exposure (ExpLE(i,FL)) with respect to each of the underlying names (i), equal to the name's exposure (Exp(i)) but without exceeding the size of the first loss tranches set outstanding at each date (FL) scaled down according to the institution's participation in the first loss tranches set (%FLP).

$$ExpLE(i, FL)=Min[Exp(i); FL \times \%FLP]$$

For the remaining POSITIONS (T):

For a given position in tranche (T) being evaluated, it will be considered that the institution holds an exposure (ExpLE(i,T)) with respect to each of the underlying names (i), equal to the name's exposure (Exp(i)) in excess to the amount of all tranches subordinated to T (ST). This amount won't be higher than the size of the tranche being evaluated (T) and will have to be scaled down according to the institution participation's in that tranche T (%PT).

$$ExpGR(i,T)=Min[Max[Exp(i)-ST;0];T] \times \%PT$$

90. The examples for tranched products set out in Annex 2 illustrate how this would work under the different approaches. The examples only refer to the credit risk arising from the underlying assets and do not refer to the risk arising from the scheme itself.

91. The proposal has to be dynamic because the limits vary as losses affect the underlying pool. Continuous evaluation of the scheme's performance would therefore be necessary.

92. However, and because it is not always easy to reassess the portfolio on a continuous basis, it may happen that "de facto" the first loss tranche is exhausted but the institution that invests in the more senior tranche has not yet recognised this fact for large exposures purposes. For that reason it may be sensible to use a haircut for the recognition of the mitigation effect of the subordinated tranches to the one being evaluated (see example 2 in the Annex).

93. With respect to the treatment of tranched securitisation positions, one member has doubts that the proposed treatment sufficiently captures the risks involved in such an investment for the following reasons: Once an institution has invested in a tranche of a structured product there is the risk that any name in the portfolio can cause a loss because the first loss piece may be exhausted before this name defaults. There is no way of getting rid of this risk until the first loss tranche is exhausted. The proposal of non-consideration of the exposure until the first loss piece is exhausted may mislead the institution into giving additional loans to this name during this period. When later the first loss piece is exhausted and the indirect exposure has to be charged the large exposure limit may be exceeded and the institution may be forced to reduce that exposure to comply with the limits regardless of the market conditions and therefore with the risk of selling with losses that will depend on how liquid the instrument is. It is thought that the only solution to take into account all risks involved in such a transaction is that every tranche should be taken into account from the outset. However, this could be unduly burdensome where an institution

holds securitisation positions in different tranches which are separated by one or more tranches held by other parties. In this particular case, the offset of tranches held by the institution protects to a certain degree from it taking losses. Therefore, it would be reasonable to charge against the large exposures limit for a certain obligor only the minimum of the total exposures to this obligor in the securitised portfolio and the maximum amount that could be lost from the securitisation positions held by the institution in this securitisation transaction (which could be less than the notional amounts of securitisation positions held). For example where the institution is invested in a junior tranche of 5 and in a senior tranche of 5, but another party is invested in a mezzanine tranche of 10. If the total exposure to a certain obligor in the securitised portfolio is 12, the institution could in any event not lose more than 5.

94. CEBS recognises that the variety and diversity of structured products can be large and therefore case by case specificities should be properly accounted for when implementing these principles. However, CEBS firmly believes that the convergent application of the principles stated in this paper will be a valuable contribution to the effectiveness of the prudential framework.

D. Consultation questions

95. CEBS invites the views of respondents to the consultation on its proposals, in particular on the following questions:

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?

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)?

13. What are your views about the proposed treatment for tranched securitisation positions?

14. Do you consider the proposed treatment of tranched 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 tranched 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?**
16. **In which cases is there no risk from the scheme itself so that it can be excluded from the large exposure regime?**

V. Reporting Requirements

96. In Article 74(2) of the CRD a new requirement has been added stating that for the communication of the calculations under Article 75 (thus including large exposures) and through Article 110 explicitly referring to large exposures reporting to the competent authorities, uniform formats, frequencies and dates of reporting must be in place by 31 December 2012. Therefore CEBS has to produce guidelines to facilitate the introduction of a uniform reporting format at the latest by December 2011/January 2012.

97. CEBS has considered various possible options for reporting that could best meet the objectives laid down in these provisions and is of the opinion that reporting based on reports defined by the competent authorities is the appropriate approach. Reports defined by the competent authorities (i.e. the development of a common template with common definitions of the information requested) would allow them to analyse the large exposures of the institutions on a horizontal basis and to make comparisons between different institutions. Furthermore, the definitions/risk metrics used in the reports of different institutions would be identical (which would not be the case if the internal reports of the institutions were used), and the processing of all the data received by the competent authorities would be facilitated.

98. The CEBS's work on COREP covers reporting requirements on Pillar 1 of the CRD, including large exposures. However, the reporting of large exposures has so far been omitted from that framework. In this context, the templates developed for large exposures' reporting and presented in the following guidelines will be included in the COREP framework. Therefore, large exposures' reporting will be based on the same standards (i.e. formats and platform) as the other COREP data. The development of the template was undertaken on the basic principle of the framework, i.e. to identify the items to be included on a "need-to-know"-basis.

99. Building further on the lessons learned from COREP, CEBS recognizes that harmonization can only be successful if an identical template with unique data definitions for the information requested can be agreed among the competent authorities of the Member States in order to ensure that the institutions are reporting the same items in the same columns.

100. This section starts with a description of the CRD amendments with regard to the reporting of large exposures. The main reporting table (Template 1) is described in the text breaking it down into the information components required by Article 110(1) of the CRD using examples for illustration and also including open questions. The overall reporting table as well as all the definitions and illustrative examples are presented in Annexes 3, 4 and 5. In addition, the examples provided in Annex 5 are presented in an Excel spreadsheet where the calculations are visible.

A. CRD amendments with regard to the reporting of large exposures

101. Reporting frequency: Article 110(2) of the CRD no longer includes the former national discretion with regard to the reporting frequency. Consequently, the CRD now requires that reporting of the information on large exposures is carried out at least twice a year. As the large exposures

tables will be integrated into the COREP framework, the remittance dates and the frequency of reporting agreed will be adopted. COREP sets a general upper limit of quarterly reporting as the maximum from 2012.

102. Scope of reporting: In its advice, CEBS stressed that it would be important that exposures exempted from the large exposure limits should not be left out of the reporting requirements. This argument was taken up in Article 110(1) of the CRD which now requires that information about every large exposure, i.e. exposures that equal or exceed the 10% limit, shall be reported to the competent authorities, "including large exposures exempted from the application of Article 111(1)" (e.g. intra-group exposures, exposures to sovereigns, etc; see Article 113 of the CRD).

103. Content of reporting: Article 110(1) of the CRD requires credit institutions to report to the competent authorities as a minimum the following information about every large exposure (including large exposures that need not be considered for the 25% large exposure limit, see Article 111(1)):

(a) *" the identification of the client or the group of connected clients to which a credit institution has a large exposure;*

(b) *the exposure value before taking into account the effect of the credit risk mitigation, when applicable;*

(c) *where used, the type of funded or unfunded credit protection;*

(d) *the exposure value after taking into account the effect of the credit risk mitigation calculated for the purpose of Article 111(1)".*

Furthermore, credit institutions using the internal ratings based approach shall report their "*20 largest exposures on a consolidated basis, excluding those exempted from the application of Article 111(1)*".

104. Analysis of concentrations: In Article 110(3) of the CRD the former national discretion was removed and it now stipulates that credit institutions shall "analyse, to the extent possible, their exposures to collateral issuers, providers of unfunded credit protection and underlying assets pursuant to Article 106(3) for possible concentrations and where appropriate take action and report any significant findings to their competent authority". Given the institution-specific nature of such an analysis, no standardised reporting scheme is proposed here.

105. Report of breaches: In general, exposures are to be reported at the reporting date. However, as credit institutions shall comply at all times with the limits laid down in Article 111(1) of the CRD, an additional ad hoc-reporting requirement is stipulated in Article 111(4) of the CRD17 with regard to breaches of the backstop limit. In the exceptional cases where exposures exceed the limit, the value of the exposure shall be reported to the competent authorities without delay (i.e. as soon as the credit

[17] See also the quarterly reporting requirement of breaches of limits according to Article 31 lit. e) CAD ("*institutions shall report to the competent authorities every three months all cases where the limits laid down in Article 111(1) and (2) of Directive 2006/48/EC have been exceeded during the preceding three months*").

institution becomes aware of the breach). Where the circumstances warrant it, the competent authorities may allow the credit institution a limited period of time (based on circumstances and severity) in which to comply with the limit. Therefore, the ad hoc-reporting should also include the cause of the breach together with the plans to rectify the situation. As these breaches are expected to be exceptional cases and will have specific features, no standardised reporting is set up for the reporting of the breaches.

B. Description of large exposures reporting templates

106. The template (Template 1) is constructed based on the four blocks of information given in Article 110(1) of the CRD which are:

    (a) Identification of client or group of connected clients;

    (b) Exposure value before CRM;

    (c) Type of credit protection;

    (d) Exposure value after CRM

(a) Identification of client or group of connected clients

107. According to Article 110(1) (a) of the CRD the credit institution shall report "the identification of the client or the group of connected clients" to which it has a large exposure. This wording should not be interpreted as a choice for the credit institution either to report the exposure to the client or the sum total of the exposures to the group of connected clients. Rather, the name (and code) of the group of connected clients as well as the individual clients themselves should be reported[18].

108. CEBS proposes two alternatives to fulfil this reporting requirement:

    (i) **2-Templates-Approach:** the full information required by Article 110(1) of the CRD is only reported for those exposures that exceed the 10% limit (as a single client or as a group of connected clients). In this case, two templates are needed. The second template would provide additional information on the composition of the group(s) of connected clients (giving the identification of the individual clients and the respective total net exposures).

    (ii) **1-Template-Approach:** the full information required by Article 110(1) of the CRD is reported for all those exposures that exceed the 10% limit (for a single client or a group of connected clients) and in addition for all clients constituting the group(s) of connected clients (i.e. regardless of whether they exceed the 10% limit or not.

109. In a first informal reaction to the draft consultation paper, the majority of the industry experts consulted favoured the 2-Template approach.

110. In many EU countries credit reporting has been established as an automated process, taking into account the remarkable volume of credit

[18] See also Note of the Council of the EU, Brussels, 19.11.2008, No (9).

reports. This allows reporting institutions to generate and submit their reports by electronic means and competent authorities to register and analyse the credit information systematically/automatically.

111. A precondition for an unambiguous identification is that an individual identification number for each "reporting institution", for each "client/borrower" and for each "group of connected clients" is used. This unique identification number then has to be used consistently by the reporting institution to fulfil its reporting requirements.

112. However, the nationally established coding systems are diverse and range from the use of institute-specific identification codes to centralised databases organised and administered by the competent authorities. While the institute-specific, decentralised system implies the least administrative burden for the reporting institutions, only a centralised system ensures that only one code for each client or group of connected clients (locally and cross-border) is used for the national reporting system. Thus, the centrally administered code allows the competent authority to identify and check the existence of large exposures to one and the same client (thus determining the systemic relevance/risk concentration of a single client having several large exposures at different banks). However, in both cases (centralised/decentralised system), an internationally active institution reporting on a consolidated basis needs to be able to identify clients with multiple business connections within the group (as the 25% limit needs also to be complied with on a consolidated basis).

113. Relevant columns of Template 1:

Identification of Counterparty		
Code (group or individual)	Institution	Name (group or individual)
LE 1.1	LE 1.2	LE 1.3

114. **Column LE 1.1 (Code)**: The code for identification should allow the unambiguous identification of the client or group of connected clients. The actual composition of the code depends on the national reporting system. In use are serial (alpha)numeric numbers giving no additional information, but also codes that give some further information like whether it is a credit institution or whether it is a single client or a group of connected clients.

115. **Column LE 1.2 (Institution):** Because of the diversity of the coding systems it is necessary to provide further identification characteristics, like whether the counterparty is a credit institution or whether it belongs to the group of the reporting credit institution (i.e. intra-group exposures). Therefore, in column LE 1.2 the following information is to be given:

- "1" ... for non-credit institutions
- "2" ... for credit institutions (i.e. the counterparty meets the definition in Article 3(1) lit c) CAD[19] or Article 107 CRD[20]).

[19] Article 3(1) lit. c) CAD defines as follows: "*'institutions' means credit institutions and investment firms*".

- "3" ... for intra-group credit institutions
- "4" ... for intra-group non-credit institutions

116. **Column LE 1.3 (Name):** Finally, for identifying the large exposures counterparty, the name of the client or the group of connected clients is to be reported. Again, the naming of the counterparty, especially in cases of groups of connected clients, depends on national or institutional practice.

(b) Exposure value before CRM

117. According to Article 110(1)(b) of the CRD the credit institution shall report "the exposure value before taking into account the effect of the credit risk mitigation, when applicable".

118. Relevant columns of Template 1:

Exposure value before CRM							
Exposure before risk provisioning					(-) Value adjustments and provisions	Total net exposure	% of own funds BB before CRM
Total:	Of which: Assets	Of which: Derivatives	Of which: Off-balance sheet	Of which: Indirect exposures			
LE 1.4	LE 1.5	LE 1.6	LE 1.7	LE 1.8	LE 1.9	LE 1.10	LE 1.11

119. **Column LE 1.4**: The total exposure before risk provisioning (LE 1.4) constitutes the sum of LE 1.5, LE 1.6, LE 1.7 and LE 1.8.

120. **Columns LE 1.5 to LE 1.8:** The total exposure before risk provisioning (LE 1.4) is to be broken down into the following four categories (as referred to in Article 74 of Directive 2006/48/EC and Article 29 of Directive 2006/48/EC, excluding exposures in Article 106(2) of Directive 2006/48/EC):

    - **"Assets"** (LE 1.5) – the balance sheet value before value adjustments and provisions;
    - **"Derivatives"** (LE 1.6) – the balance sheet value before value adjustments and provisions;
    - **"Off-balance sheet"** (LE 1.7) – the off-balance sheet value before value adjustments and provisions; and
    - **"Indirect exposures"** (LE 1.8) - According to Article 117 of the CRD, a credit institution may use the substitution approach where an exposure to a client is guaranteed by a third party, or secured by collateral issued by a third party. Such indirect exposures are to be reported in the framework of regular reporting, as the overall exposure with regard to a client (group of connected clients) has to

[20] Article 107 of the CRD defines as follows: "*the term 'credit institution' shall cover the following: (a) a credit institution, including its branches in third countries; and (b) any private or public undertaking, including its branches, which meets the definition of 'credit institution' and has been authorised in a third country*".

be counted towards the 25% limit (see also Example 1 in Annex 5). Furthermore, indirect exposures arising from credit linked notes should also be reported in this column (see also Example 6 in Annex 5[21]).

121. **Column LE 1.9:** Here, the value adjustments and provisions against the gross exposure given in LE 1.4 before CRM, i.e. the sum of value adjustments and provisions for LE 1.5, LE 1.6, LE 1.7 and LE 1.8 is to be reported. This is a deduction item marked (-).

122. **Column LE 1.10:** The total net exposure, i.e. the sum of LE 1.4 and LE 1.9, is to be reported in LE 1.10.

123. **Column LE 1.11:** In order to calculate the 10% limit, the value of LE 1.10 is divided by Tier 1 plus Tier 2 as defined in COREP CA 1.3.LE). Please note that it is proposed to calculate the 10% limit on the basis of Tier 1 plus Tier 2 given in COREP CA 1.3.LE. CEBS is aware that this approach is a more conservative treatment for countries which have made use of the national discretion in Article 13(2) CAD. However, CEBS considers that the benefit of having just one calculation rather than two (as for the 25% limit, see LE 1.19) outweighs this inaccuracy.

Example (Credit Linked Note)[22]:

The reporting institution (own funds 100) has 2 large exposures (SPV 10 and Bank B 20). Within the reporting period a credit linked note (CLN) of 5 is bought from the SPV (i.e. the reporting institution sells protection), the underlying reference asset being Bank B.

Reporting Bank (own funds 100) buys CLN

- SPV loan 10 and CLN 5 referencing Bank B
- Bank B loan 20

Exposure value before CRM							
Exposure before risk provisioning					(-) Value adjustments and provisions	Total net exposure	% of own funds BB before CRM
Total:	Of which: Assets	Of which: Derivatives	Of which: Off-balance sheet	Of which: Indirect exposures			
LE 1.4	LE 1.5	LE 1.6	LE 1.7	LE 1.8	LE 1.9	LE 1.10	LE 1.11
15	15					15	15%
25	20			5		25	25%

[21] The Commission's answer to CRDTG-question No. 247 is very definite about the issue of indirect exposures: "both the exposure to the issuer of the note and to the obligor of the protected reference exposure have to be counted towards the limits for the respective client or group of connected clients"; See Answer to CRDTG question No. 247 on the website of the European Commission (> Regulatory Capital > Capital Requirements Directive Transposition Group).

[22] See also Example 6 in Annex 5.

(c) Type of credit protection

124. According to Article 110(1)(c) of the CRD the credit institution shall report "where used, the type of funded or unfunded credit protection".

125. CEBS is of the opinion that a breakdown into unfunded credit protection (LE 1.12), funded credit protection (LE 1.13) and real estate (LE 1.14) would be reasonable and sufficient. A further breakdown, e.g. into cash, mortgages, shares, debt securities, etc. would not add significant additional value from a supervisory perspective, especially against the background of the strict CRD requirements regarding the eligibility of collateral, treatment of mismatches and application of haircuts.

126. Relevant columns of Template 1:

Type of credit protection		
(-) Unfunded credit protection	(-) Funded credit protection	(-) Real estate
LE 1.12	LE 1.13	LE 1.14

127. **Column LE 1.12 (Unfunded credit protection):** The portion of the exposure which is guaranteed and which is assigned to the protection provider rather than to the original client; this is a deduction item marked (-).

128. **Column LE 1.13 (Funded credit protection):** The portion of the exposure covered by collateral provided by the original client; this is a deduction item marked (-).

129. **Column LE 1.14 (Real estate):** Deduction of 50% of the value of eligible property according to the requirements of Article 115 of the CRD); this is a deduction item marked (-).

(d) Exposure value after CRM

130. According to Article 110(1)(d) of the CRD the credit institution shall report "the exposure value after taking into account the effect of the credit risk mitigation calculated for the purpose of Article 111(1)".

131. Relevant columns of Template 1:

Exposure value after CRM					
Exposure value after CRM	(-) Article 113(3) and (4) exemptions if applicable	Exposure value after application of exemptions and weighing		% of own funds (total)	% of own funds (banking book)
			Of which: Banking book		
LE 1.15	LE 1.16	LE 1.17	LE 1.18	LE 1.19	LE 1.20

132. **Column LE 1.15**: The exposure value after CRM (LE 1.15) constitutes the sum of LE 1.10, LE 1.12, LE 1.13 and LE 1.14.

133. **Column LE 1.16**: The amount that is reducing the exposure value for large exposures based on the national implementation of Article 113(3) and (4) of the CRD.

134. **Column LE 1.17 and LE 1.18**: The total exposure value after application of exemptions and weighting is to be reported in LE 1.17 (= sum of LE 1.15 and LE 1.16). The share of LE 1.17 that belongs to the banking book is reported in LE 1.18.

135. **Column LE 1.19 (% of own funds, total):** In order to verify the 25% limit, the value of LE 1.17 is compared to the amount of own funds for large exposure purposes as given in COREP CA 1.3.LE (= total own funds relevant for the limits of large exposures when additional capital to cover market risks is not used) or COREP CA 1.6.LE (= total own funds relevant for the limits of large exposures when additional capital to cover market risks is used, i.e. when the discretion in Article 13(2) CAD is exercised) (see also Example 5 in Annex 5)

136. **Column LE 1.20 (% of own funds, banking book):** In order to verify the 25% limit, the value of LE 1.18 is compared to the amount of own funds for large exposure purposes given in COREP CA 1.3.LE (= total own funds relevant for the limits of large exposures when additional capital to cover market risks is not used).

C. Reporting of 20 largest exposures for IRB banks

137. Article 110(1), last sentence, of the CRD requires the reporting of the 20 largest exposures on a consolidated basis[23]. However, to limit the administrative burden, the additional reporting requirement was limited to institutions that apply the IRB approach (i.e. credit institutions subject to Articles 84 to 89 of the CRD). Furthermore, the scope of this reporting requirement excludes exposures that are exempted from the application of Article 111(1) of the CRD. These exposures shall be reported in the same way as large exposures according to Article 108 of the CRD.

138. Examples to comply with Article 110(1), last sentence, of the CRD:

   - an IRB bank with no large exposures (as defined in Article 108 of the CRD) has to report its 20 largest exposures (Template 1, calculation based on column LE 1.10, i.e. after provisioning, before CRM);

   - an IRB bank with 5 large exposures (a group of connected clients is treated as one single client) must report its 15 next largest exposures;

[23] The 10% limit is considered to be high from a risk management point of view. Therefore, larger institutions in particular usually don't have many large exposures due to the volume of their own funds. Extending the reporting to the 20 largest exposures gives the competent authorities useful information on the risk profile of these institutions which they would otherwise not receive via regular reporting.

- an IRB bank with 5 large exposures of which 2 are exempted, must not only report these 5 large exposures but should complete its reporting by including its 17 next largest (non-exempted) exposures;
- an IRB bank with 20 or more large exposures must report the large exposures and nothing else;
- a SA bank needs only to report its large exposures (as defined in Article 108 of the CRD).

139. However, CEBS would like to point out that there are Member States where the information in question is available to the competent authorities through other channels, e.g. credit registers. In those cases, the reporting of the 20 largest exposures should not be requested twice.

D. Details on the composition of groups of connected clients

(a) 2-Templates-Approach

140. As only those clients meeting the definition of large exposures (according to Article 108 of the CRD), i.e. those (group(s) of connected) clients whose exposures exceed the 10% limit, are to be reported in Template 1, an extra template (see Template 2 below) is needed to report the composition of the group(s) of connected clients. In the first column (LE 2.1) the identification number of the group of connected clients is to be reported, in the next four columns the identification data (LE 2.2 to LE 2.4) and in the last column (LE 2.5) the total net exposure (after provisioning, before CRM)[24] of all individual clients constituting the group to which an exposure exists that contribute to the value of the large exposure to the group of connected clients.

141. **Template 2:**

Identification of Group of Connected Clients				
Code (group)	Code (individual)	Institution	Name	Total Net Exposure
LE 2.1	LE 2.2	LE 2.3	LE 2.4	LE 2.5

[24] LE 2.5 corresponds to LE 1.10.

Example (Identification of Counterparty in 2-Templates-Approach):

The reporting institution (own funds 100) has 5 large exposures, 2 of which have to be grouped. Overall, this group of connected clients consists of 4 clients.

The identification part of Template 1 is to be filled in as follows:

Identification of Counterparty		
Code (group or individual)	Institution	Name (group or individual)
LE 1.1	LE 1.2	LE 1.3
12345678	2	Bank A
12345679	1	Individual A
12345680	3	Bank B
12345681		Group A
12345682	2	Bank C
12345683	1	Individual B

Template 2:

Identification of Group of Connected Clients				
Code (group)	Code (individual)	Institution	Name	Total Net Exposure
LE 2.1	LE 2.2	LE 2.3	LE 2.4	LE 2.5
12345681	12345682	2	Bank C	20
12345681	12345683	1	Individual B	15
12345681	12345684	1	Individual C	5
12345681	12345685	1	Individual D	2

(b) Alternative: 1-Template-Approach

142. If only one template is used to comply with Article 110(1) of the CRD, an additional column needs to be included in the identification part of Template 1 – i.e. splitting LE 1.1 into two columns: "Code of group of connected clients" (LE 1.1.1) and "Code of individual client" (LE 1.1.2).

E. Consultation questions

143. CEBS invites the views of respondents to the consultation on its proposals, in particular on the following questions:

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

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

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?

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).**
21. **Do you agree with the proposed reporting of CRM, in particular to differentiate only between “unfunded”, “funded” and “real estate”?**
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?**
23. **Please provide examples where the reporting instructions are not clear to you.**
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.**
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.**

Annex 1: Example of the application of partial look-through-base approach

Partial look-through approach		
The bank (capital resources of 1000) looks through to Companies X and Y from Scheme A, all other counterparties from Schemes A and B are unknown		
Consequently company X and company Y will be assigned to the corresponding client or group of connected clients		
The unknown exposures of 310 in total (80 from Scheme A and 230 from Scheme B) will be considered as a separate counterparty		
Scheme A		
Total	160	100%
Company X	50	31%
Company Y	30	19%
Unknown	20	13%
Unknown	20	13%
Unknown	30	19%
Unknown	10	6%
Scheme B		
Total	230	100%
Unknown	230	100%
LE return		
Own funds	1000	
@ 25%	250	
Exposures		

Company X	50	5%
Company Y	30	3%
Unknown exposures	310	31%
Scheme A	160	16%
Scheme B	230	23%

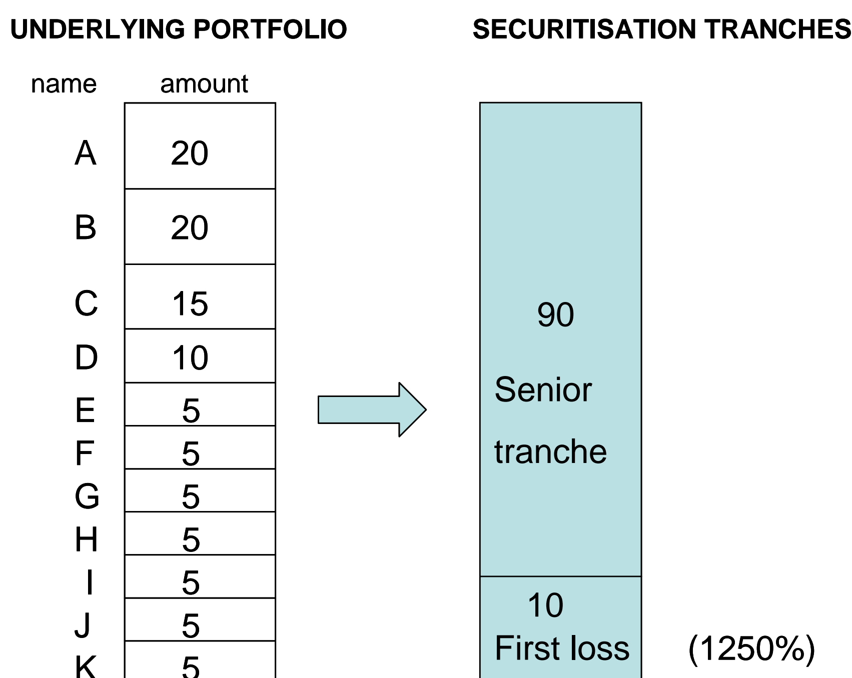
Annex 2: Examples of the application of the proposed approaches to tranched products

The following examples of a structured product illustrate how the proposed treatment could work under the different approaches. The examples only refer to the credit risk coming from the underlying assets and do not refer to the risk coming from the scheme itself.

EXAMPLE 1

A. FULL LOOK-THROUGH (this example illustrates the case where the look through is applied)

The structure of the product is the following:



Assumed that Institution 1 has invested 90 in the Senior tranche and Institution 2 has invested 10 in the first loss tranche.

The treatment for large exposures purposes should be the following:

Institution 1, on the senior tranche must recognise:

0 with debtors D to K

5 with debtor C

10 with A and B

Institution 2, on the first loss tranche:

5 with debtors E to K

10 with debtors A to D

Assumed that in the next period counterparty K defaults and a loss of 5 is registered. Then, once this loss is known institutions 1 and 2 must reassess the exposures. Therefore, just after the default:

Institution 1, on the senior tranche must recognise:

0 with debtors E toJ

5 with debtor D

10 with debtor C

15 with A and B

Institution 2, on the first loss tranche:

5 with debtors A to J

B. PARTIAL LOOK-THROUGH

This example assumes that only the names A and B are known, for the rest the institutions only know that the maximum amount invested is 20.

The treatment for large exposures purposes should be the following:

Institution 1, on the senior tranche must recognise:

10 with A and B

10 to add to the rest of the unknown exposures

Institution 2, on the first loss tranche:

10 with debtors A and B

10 to add to the rest of the unknown exposures

C. MANDATE-BASED APPROACH

This example assumes that no names are known, institutions only know that the maximum amount which can be invested in each counterparty is 20 and counterparties can only belong to the UK pharmaceutical sector, and the institution has no other direct or indirect investments in that sector.

The treatment for large exposures purposes should be the following:

Institution 1, on the senior tranche must recognise:

10 to the FUND

Institution 2, on the first loss tranche:

10 to the FUND

D. RESIDUAL APPROACH

This example assumes that no names are known and the institutions do not know the maximum amount invested in each counterparty nor have any clue to the nature of the investments based on the mandate.

The treatment for large exposures purposes should be the following:

Institution 1, on the senior tranche must recognise:

90 to add to the unknown exposures

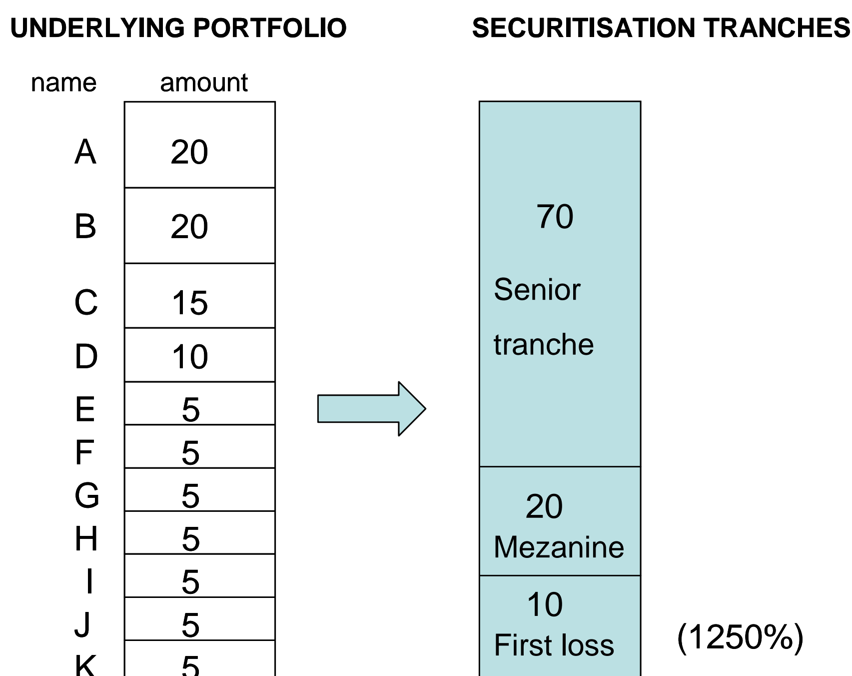
Institution 2, on the first loss tranche:

10 to add to the unknown exposures

More examples on how the full look-through approach could be implemented for more complex structures are provided below:

EXAMPLE 2

In this example a mezzanine tranche is added to the structure and a haircut of 50% is used to compute the mitigation effect for the mezzanine tranche.



The treatment for large exposures purposes should be the following:

Institution 1 on the Senior tranche :

0 with A to K

Institution 2 on Mezzanine tranche:

0 with E to K

5 with D

10 with C

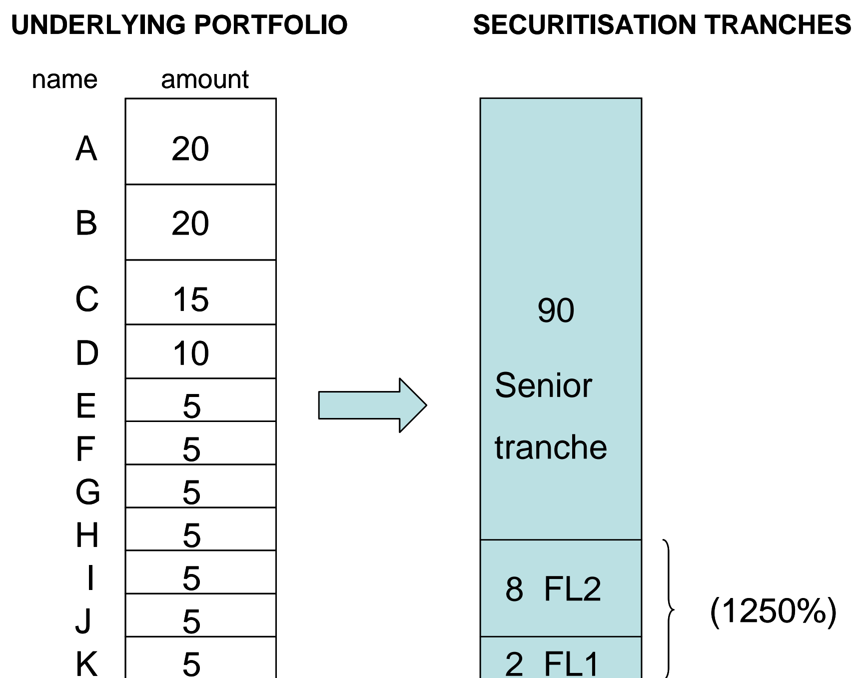
15 with A and B

Institution 3 on First Loss tranche:

5 with E to K

10 with A to D

<u>EXAMPLE 3</u>



The treatment for large exposures purposes should be the following:

Institution 1 on the Senior tranche :

0 with D to K

5 with C

10 with A and B

Institution 2 on First Loss tranche 2:

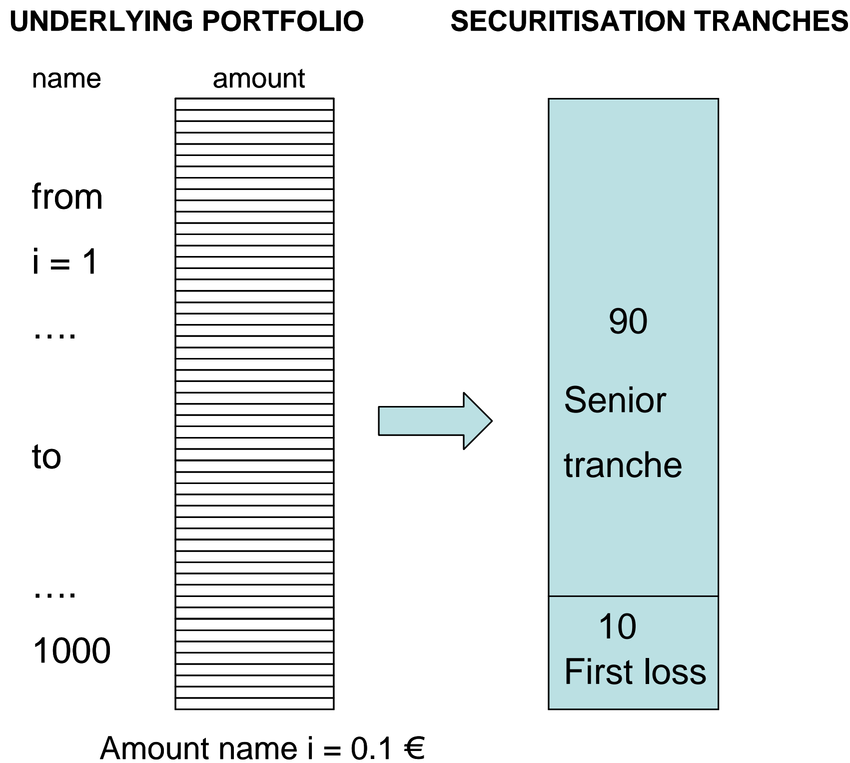
5 with E to K

8 with D to A

Institution 3 on First Loss tranche 1:

2 with A to K

EXAMPLE 4



The treatment for large exposures purposes should be the following:

Institution 1 on the senior tranche:

0 with debtors i= 1 to 1000

Institution 2 on the first loss tranche:

0.1 with debtors i=1 to 1000

Annex 3: Reporting 'Template 1'

Identification of counterparty			Exposure value before CRM								Type of credit protection			Exposure value after CRM					
			Exposure before risk provisioning													Exposure value after application of			
			Total																
Code	Institution	Name		Of which: Assets	Of which: Derivatives	Of which: Off-balance sheet	Of which: Indirect exposures	(-) Value adjustments and provisions	Total net exposure	% of own funds before CRM	(-) Unfunded credit protection	(-) Funded credit protection	(-) Real estate	Exposure value after CRM	(-) Article 113(1) + (4) exemptions if applicable	exemptions and weighting	Of which: Banking book	% of own funds total	% of own funds BB
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20

Annex 4: Reporting 'Template 1' - references to COREP

ID	Label	Legal References & Comments
COLUMNS		
1	Code	Identification code for the counterparty assigned by the supervisor in the country of origin of the institution
2	Institution	1 for non-credit institutions; 2 for credit institutions (counterparty meets the definition in Article 3(c) of Directive 2006/49/EC or Article 107 of Directive 2006/48/EC); 3 for intra-group credit institutions
3	Name	Name of the counterparty
4	Exposure before risk provisioning: Total	Columns 5+6+7+8; Article 74 paragraph 1 of Directive 2006/48/EC and Article 29 of Directive 2006/49/EC, excluding the exposures in Article 106 paragraph 2 of Directive 2006/48/EC. Exposure value without taking into account value adjustments and provisions, conversion factors and the effect of credit risk mitigation techniques. For derivative instruments subject to Annex III of Directive 2006/48/EC, the exposure will correspond to the Exposure Value for Counterparty Credit Risk calculated according to the methods laid down in Annex III of Directive 2006/48/EC.
5	Of which: Assets	Balance sheet value before value adjustments and provisions; assets referred to in article 74 of Directive 2006/48/EC not included in any other category. (Banking- and trading book)
6	Of which: Derivatives	For derivative instruments subject to Annex III of Directive 2006/48/EC, the exposure will correspond to the Exposure Value for Counterparty Credit Risk calculated according to the methods laid down in Annex III of Directive 2006/48/EC. Value before value adjustments and provisions; items included in Annex IV of Directive 2006/48/EC. (Banking- and trading book)
7	Of which: Off-balance sheet	Off- balance sheet value before value adjustments and provisions; items included in Annex II of Directive 2006/48/EC. (Banking- and trading book)
8	Of which: Indirect exposures	Guarantees provided for other clients, Article 117 paragraph 1 of Directive 2006/48/EC. Credit risk mitigation techniques that increase the exposure on the guarantor or third party via substitution. Indirect exposures arising from credit derivatives. (Banking- and trading book)
9	(-) Value adjustments and provisions	Sum of value adjustments and provisions for columns 5+6+7+8; value adjustment and provisions included in the corresponding accounting framework (Directive 86/635/EEC or Regulation 1606/2002) that affect the valuation of assets and off-balance sheet items according to Article 74 paragraph 1 of Directive 2006/48/EC.
10	Total net exposure	Columns 4+9
11	% of own funds before CRM	10 / of own funds (Tier 1+Tier 2, COREP 1.3.LE)
12	(-) Unfunded credit protection	Unfunded Credit Protection as defined in Article 4 (32) of Directive 2006/48/EC and referred to in Articles 113 to 117 of Directive 2006/48/EC that reduces the exposure on the counterparty. The amount to report is defined in Article 117 paragraph 2 of Directive 2006/48/EC.
13	(-) Funded credit protection	Article 4 definition 31 of Directive 2006/48/EC. The funded credit protection referred to in Articles 112 to 117 that reduces the exposure on the counterparty. The amount to report is defined in Articles 114 and 115 of Directive 2006/48/EC.
14	(-) Real estate	Eligible real estate referred to in Article 115 of Directive 2006/48/EC
15	Exposure value after CRM	Columns 10+12+13+14
16	(-) Article 113(1) + (4) exemptions if applicable	Article 113(1) exemptions and Article 113(4) exemptions if applicable
17	Exposure value after appl. of exemptions and weighting	Columns 15+16
18	Of which: Banking book	Share of 17 which belongs to the Banking book, Article 30 paragraph 1 of Directive 2006/49/EC.
19	% of own funds total	17 / of own funds (Tier 1+Tier 2, COREP 1.3.LE), or if ND of Article 13(2) CAD has been exercised 17 / of own funds (Tier 1+Tier 2 + Tier 3, COREP 1.6.LE)
20	% of own funds BB	18 / of own funds (Tier 1+Tier 2, COREP 1.3.LE)

COREP CA Template 2.6.3	(-) deductions from own funds	Article 106(1) third subparagraph of Directive 2006/48/EC
COREP CA Template 1.6.6 or 2.6.3	(-) additional capital requirement in trading book	Additional capital requirements for the part of the exposure in the trading book which exceeds the 25% according to Article 31(b) of Directive 2006/49/EC. In case of institutions 25% or 150 mio (or lower limit set by the supervisor).

Annex 5: Reporting Template 1 – Examples

(These examples are also presented in an Excel spreadsheet annex to this consultation paper)

1	Code	Identification code for the counterparty or group based on national practices	Ex. 1:		Ex. 1:	Ex. 2:	Ex. 3:		Ex. 4:	Ex. 5:				Ex. 6:		
2	Institution	"1" for non-credit institutions; "2" for credit institutions (counterparty meets the definition in Article 3(c) of Directive 2006/49/EC or Article 107 of Directive 2006/48/EC); "3" for intra-group credit institutions			Alter-native:											
3	Name	Name of the counterparty or "Group"	Bank A	Bank B	Bank A	Company A	Bank A	MDB	Bank A	Bank B	Bank C	Bank D	BCD group	SPV	Bank B	SPV/B group
4	Exposure before risk provisioning: Total	5+6+7+8	100	50	100	120	70	50	150	15	20	20	55	15	25	40
5	Of which: Assets	Assets referred to in Article 74 of Directive 2006/48/EC not included in any other category.	100	10	100	100	70	50	150	15	20	20	55	15	20	35
6	Of which: Derivatives	Balance sheet value before value adjustments and provisions											0			
7	Of which: Off-balance sheet	Off- balance sheet value before value adjustments and provisions				20							0			
8	Of which: Indirect exposures	Article 117 paragraph 1 of Directive 2006/48/EC. Credit risk mitigation techniques that increase the exposure on the guarantor or third party via substitution. Indirect exsposures arising from credit derivatives		40									0		5	5
9	(-) Value adjustments and provisions	Sum of value adjustments and provisions for 5+6+7+8					-40			-5			-5			
10	Total net exposure	4+9	100	50	100	120	30	50	150	10	20	20	50	15	25	40
11	% of own funds BB before CRM	10 / of own funds (Tier 1+Tier 2, COREP CA 1.3.LE)	25%	13%	25%	40%	10%	17%	50%	10%	20%	20%	50%	15%	25%	40%
12	(-) Unfunded credit protection	Eligible unfunded credit protection	-40								-10		-10			
13	(-) Funded credit protection	Eligible funded credit protection				-15			-65				0			
14	(-) Real estate	Eligible real estate				-40						-2	-2			
15	Exposure value after CRM	10+12+13+14	60	50	100	65	30	50	85	10	10	18	38	15	25	40
16	(-) Article 113(1) + (4) exemptions if applicable	Article 113(3) exemptions and Article 113(4) exemptions if applicable						-50					0			
17	Exposure value after appl. of exemptions and weighing	15+16	60	50	100	65	30	0	85	10	10	18	38	15	25	40
18	Of which: Banking book	Share of 17 which belongs to the Banking book	60	50	100	65	30	0	75	10	10	18	38	15	25	40
19	% of own funds total	17 / of own funds (Tier 1+Tier 2, COREP 1.3.LE), or if ND of Article 13(2) CAD has been exercised 17 / of own funds (Tier 1+Tier 2 + Tier 3, COREP 1.6.LE)	15%	13%	25%	22%	10%	0%	28%	10%	10%	18%	38%	15%	25%	40%
20	% of own funds Banking book	18 / of own funds (Tier 1+Tier 2, COREP CA 1.3.LE)	15%	13%	25%	22%	10%	0%	25%	10%	10%	18%	38%	15%	25%	40%
		Own funds Tier 1 + Tier 2 +Tier 3 (COREP CA 1.6.LE)	400	400	400	300	300	300	300	100	100	100	100	100	100	100
		Own funds Tier 1 + Tier 2 (COREP CA 1.3.LE)	400	400	400	300	300	300	300	100	100	100	100	100	100	100
COREP CA Template 2.6.3	(-) deductions from own funds	Article 106(1) third subparagraph of Directive 2006/48/EC											0			
COREP CA Template 1.6.6 or 2.6.3	(-) additional capital requirement in trading book	Additional capital requirements for the part of the exposure in the trading book which exceeds the 25% according to Article 31(b) of Directive 2006/49/EC. In case of institutions 25% or 150 mio (or lower limit set by the supervisor).								-20			-20			

Details on the Examples set out in the table above (and in the Excel spreadsheet annex to this consultation paper)

Example 1: Bank X (own funds 400) – The reporting Bank X uses the substitution approach (Alternative: no substitution)

- Bank A loan 100
- Bank B guarantees 40
- Bank B loan 10

Example 2: Bank X (own funds 300) – The reporting Bank X uses the financial collateral comprehensive method.

- Company A loan 100
- Bank X provides guarantee of 20 for company A
- RRE collateral 80, i.e. 50% = 40
- Bank C bond 20 as collateral (haircuts according to CRM 5)

Example 3: Bank X (own funds 300)

- Bank A loan 30 (40 provisions, gross amount 70)
- Loan 50 to multilateral development bank with 0% risk weight

Example 4: Bank X (own funds 300)

- Bank A loan 150 (65 funded credit protection)
- Trading book exposure 10
- Additional capital requirements for trading book 20 (200%)

Example 5: BCD Group (own funds 100) - The reporting Bank X has 3 large exposures vis-à-vis Bank A, Bank B and Bank C. The three banks are interconnected and therefore grouped into “BCD group”.

- Bank B loan 10; value adjustment on loan 5, i.e. exposure value = 15
- Bank C loan 20 (guarantee by central government 10, i.e. exposure value of loan = 10)
- Bank D loan 10 + 10 mortgage (value of property = 4)

Example 6: Bank X (own funds 100) - The reporting bank X (own funds 100) has 2 large exposures (SPV 10 and Bank B 20). Within the reporting period a credit linked note (CLN) of 5 is bought from the SPV (i.e. the reporting institutions sells protection), the underlying reference asset being Bank B.

- SPV loan 10 and CLN 5 referencing at bank B
- Bank B loan 20