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The Director General delegate

Paris, September 10th 2009

FBF comments on the Consultation Paper related to the Large Exposure Regime

Dear Sir,

The French Banking Federation (FBF) is the professional body representing over 450 commercial, cooperative and mutual banks operating in France. It includes both French and foreign-based organizations. The French Banking Federation (FBF) is pleased to take the opportunity to answer to this consultation and to indicate the comments and questions raised by the consultation paper.

Within the framework of the Capital Requirement Directive review, the large exposure regime is revised. The amended CRD will be implemented on Dec 31st 2010. The CEBS has published a consultation paper on the draft guideline which focuses on 3 aspects: connected clients, treatment of exposure to schemes with underlying assets and reporting requirement.

We support the objective of CEBS's guidelines which is to ensure common and convergent supervisory implementation of the revised CRD in Europe.

However we feel that these guidelines could be more precise to avoid a multiplicity of interpretations: regarding connected clients, the proposed guidelines in relation to the interpretation of control and to the interpretation of economic interconnectedness are not sufficiently clear. About the treatment of exposure to schemes with underlying assets, we think that the proposal could provide more flexibility; it is impossible to apply such treatment to securitization schemes. Regarding questions of reporting requirements, we agree with the proposed net exposure calculation and the proposed reporting of Credit Risk Mitigation. We also ask some precisions in the reporting instructions. We are in favor of the "2 templates approach" which requires all information at group level and a lighter reporting at clients level while the "1 template approach" requires all information for all clients constituting the groups and seems to be burdensome.

Please find our detailed comments attached. The FBF is at CEBS' disposal for any further discussion on these issues.

Yours sincerely,

Pierre de Lauzun

Mr Arnoud VOSSEN
Secretary General
CEBS
Tower 42 (Level 18)
25 Old Broad Street
London EC2N 1HQ

18, rue La Fayette 75440 Paris cedex 09 • Tél. : 01 48 00 52 52 • Fax : 01 42 46 76 40 • Minitel : 3617 AFB1 • www.fbf.fr
A Bruxelles : rue de Trèves, 45 • B-1040 Bruxelles • Tél. : 32 2 280 16 10 • Fax : 32 2 280 30 11

Answers to the Consultation Questions & Comments on the Consultation Paper related to the Large Exposure Regime

❖ Connected clients

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.

No, the guidelines in relation to the interpretation of control is not sufficiently clear, especially when there are two equal partners/ owners who share the power and govern the entity jointly.

The point 37 presumes that the control relationship exists when a client owns 50% of the shares/ voting power of another client.

And the point 44 in the consultation paper indicates that
"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."

It seems to us that it may lead to an over-declaration of the exposure linked to the entity jointly controlled by two equal owners.

Example:

We suppose that one entity A is co-controlled by B and C. One bank D lends 600 MEUR to A.

We understand that the control relationship exists both for A & B and A & C.
A & B, like A & C, are considered as a group of connected clients.
When the bank D builds up its large exposure statements, as the entire exposure must be taken into account, the bank D has:

- ⇨ 600 MEUR face to the connected clients group A&B;
- ⇨ 600 MEUR face to the connected clients group A&C.

If our understanding is right, it seems to us that the loan of 600 MEUR from bank D to A is over-declared, as 1 200 MEUR is declared by the bank D for two groups of connected clients while only 600 MEUR is exposed to risk.

2. Are the guidelines in relation to the Exemption from the requirement to group clients in relation to control sufficiently clear or are there issues which need to be elaborated further or which are missing? Please provide concrete proposals on how the text should be amended.

Yes, it is clear.

3. Are the guidelines in relation to the Interpretation of economic interconnectedness (single risk) sufficiently clear or are there issues which need to be elaborated further or which are missing? Please provide concrete proposals on how the text should be amended.

No, the guidelines in relation to the interpretation of economic interconnectedness are not sufficiently clear because :

a) they can be subject to different interpretations and,
b) they would be very difficult to implement in practice

On the first point, it seems to us that the boundary between economic interconnectedness and sectoral /geographic concentration is quite unclear and fuzzy. For some economic sectors with only a limited number of players (such as commercial aircraft production), there may well be apparent economic interconnectedness, but it is unclear how the default of a key player could happen in the absence of a more general downturn at sector level. Consequently, there is significant risk that the concept will be applied in a very heterogeneous ways by banks and regulators across Europe.

Besides, there may be an over-declaration of some exposures.

We suppose that the firm A is a supplier of two important automobile producers B and C. B and C are A's only customers, each represents 50% of the turnover of A. That's to say A depends either on B or on C. As the economic interconnectedness exists, A&B, like A&C, is considered as a group of connected clients.

It is the same case as in the example held up in the answer to question 1. Any exposure on the firm A will be over-declared.

On the second point, it seems to us very difficult, such as indicated in the point 51, to implement the economic interconnectedness identification in the practice as each case has its own characteristics. The particularity of each case makes it virtually impossible to model this identification in information systems. The appreciation should be done manually and case by case, which may lead to a lack of consistency in the practices within institution and among institutions.

On one hand, any manual process may generate a high operational risk. On the other hand, any institution of important size may have many counterparties and/or connected clients group to declare within the large exposure framework and the case-by-case economic interconnectedness identification would be a time-consuming manual process. Therefore, it would be very difficult to respect the short remittance deadline.

Further, the information requirement to analyse and further document the absence of such interconnectedness would be very onerous. As an example, it seems unrealistic to track tenants in detail for residential/commercial property as mentioned in point 50.

4. Are the guidelines in relation to the Interpretation of connection through the main source of funding being common sufficiently clear or are there issues which need to be elaborated further or which are missing? Please provide concrete proposals on how the text should be amended.

No, the guidelines in relation to the interpretation of connection through the main source of funding being common seem confusing.

First, should we consider all the institutions in the same country as a group of connected clients due to the importance of inter-bank funding?

Secondly, the points 53 and 55 are not clear. Our understanding on the point 53 is the following:
Two counterparties, which are likely to benefit from commitments from an institution at the same time, may be considered as connected clients. The need of funding should be specific to the clients and/ or the category of clients or products in question.
The drawing from the same funding source due to the general market (money or commercial paper) disruption doesn't lead to the connection of the counterparties in questions.

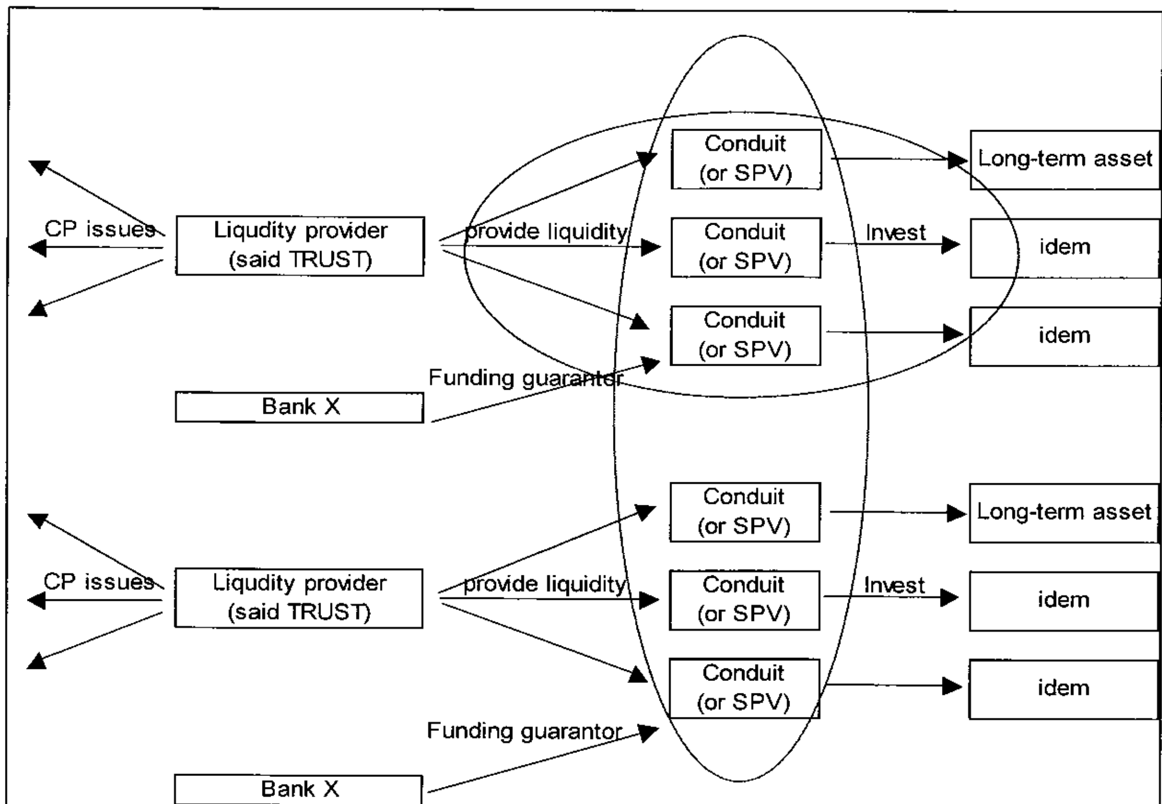
Therefore, the point 53 seems contradictory with the point 48 which indicates that the sectoral and geographic risks fall outside the scope of the large exposure regime and are addressed by other means such as Pillar II.

Besides we are wondering what could be the difference between the "category of clients" taken into account in the present consultation paper for the large exposure regime and the "sector" handled in Pillar II.

Regarding the point 55 related to the illustrate case, we need some precisions:

A bank committed itself as a funding guarantor for different conduits in separated Trusts under similar conditions. As these conduits are dependent on the same funding source, should all of them be considered as "connected clients" (cf. conduits included in the circle in red)? In that case, the limit of 25% of own funds will be easily exceeded.

Or should we understand that only the conduits in the same Trust (cf. conduits included in the circle in blue) should constitute a group of connected clients?



Further if the intention of the CEBS is that all ABCP conduits sponsored by an institution should be considered as a connected client, we feel that this approach would create a confusion between idiosyncratic credit risk (covered by the large exposure regime) and liquidity risk (which is not).

Indeed, while the reliance of the conduits on the CP market creates a funding risk for the sponsoring institution which is addressed in other part of the regulatory framework, the various ABCP conduits do not constitute a single credit risk as ultimately, the sponsoring institution would be exposed to the conduits assets and not the conduits themselves.

In the example, if the CP market were to close, the liquidity lines granted by the sponsoring institution would be drawn, without necessarily for the conduit to fall in default (because precisely this liquidity line is used to ensure refunding of CPs to investors). Moreover, once those lines are drawn, the bank would calculate its large exposures by applying transparency to the underlying assets and not to the conduits.

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

We understand that the 1% threshold is applied to the gross exposure. This threshold seems to us too low and should be applied to the net exposure.

Further if the intention of the CEBS is that all ABCP conduits (asset-backed commercial papers) sponsored by an institution should be considered as a connected client, we feel that this approach would create a confusion between idiosyncratic credit risk (covered by the large exposure regime) and liquidity risk (which is not).

Indeed, while the reliance of the conduits on the CP (commercial paper) market creates a funding risk for the sponsoring institution which is addressed in other part of the regulatory framework, the various ABCP conduits do not constitute a single credit risk as ultimately, the sponsoring institution would be exposed to the conduits assets and not the conduits themselves.

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

We understand that the 1% threshold is applied to the gross exposure. This threshold seems to us too low and should be applied to the net exposure.

For a large institution, there will be a lot of counterparties with exposure of at least 1% of the own funds. As indicated in the answer to the question 3, if the identification of the connected clients cannot be easily modeled in the information systems, it seems illusory to expect that the identification process be applied to such a great number of counterparties.

Moreover, we are wondering whether we have to carry the identification process for very short-term exposures that represent an important amount, such as delivery and settlement risks.

Further, there seems to be a contradiction between the stated threshold and the requirement to apply economic interconnectedness analysis to retail exposures as it is implicit in the examples in point 50.

It seems to us that it would be more realistic:

- to apply a higher threshold (of at least 3% of the own funds?), and
- only to banking book exposures and,.
- excluding retail exposures

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.

The relative guidelines are clear but we will meet the same difficulties as mentioned in the answers to the questions 3 and 5.

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?

It would be very useful if CEBS could give some precise guidelines for connected clients identification to avoid any inconsistency of interpretation and to facilitate the implementation in the information systems.

Finally, on the definition of the group of connected clients, could we declare clients of the same group separately and override the capitalistic link for dissimilar activities in a Group, Shell Company?

❖ Treatment of exposure to schemes with underlying assets

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?

No, we don't think that the proposal provides sufficient flexibility for institutions to deal with different types of schemes for the three reasons below:

8.1 Both the partial look-through approach and the residual approach (not look through at all) seem overly conservative for institutions in terms of complying with the 25% limit as all the unknown exposures of schemes should be considered as one single group of connected clients.

8.2 The mandate-based approach is not realistic because it seems to us impossible to probe that the scheme is not connected with any other direct or indirect exposures in the institution portfolio while the underlying assets in the scheme are unknown.

8.3 As consequence of the points 8.1 and 8.2, we would have to adopt the full look-through approach, which seems to us burdensome, especially for large institutions which may have a lot of schemes with underlying assets in their portfolio.

On one hand, it will be very difficult to identify all the exposures in the schemes and it will be a time-consuming process. On the other hand, the additional cost in terms of information systems for the implementation of these exposures identification seems to us too high.

Further, there are a lot of practical issues that prevent applying full transparency:

- In most securitisation schemes, the name of the underlying exposure is not known and cannot be disclosed because of national banking secrecy. Moreover in some cases (bilateral loans), the loan contract stipulates that the bank can not reveal anything regarding the loan contract (though it is possible to securitize it because the due diligence in case of default are made by an independent expert)

- Applying transparency on securitisation or UCITS investments is operationally complex since there are no common references on counterparties between the asset manager or the originator of the securitisation and the bank holding such exposures.

9. Do the fall-back solutions (approaches b) to d)) appropriately take into account the uncertainty arising from unknown exposures and schemes?

Yes, but these two approaches seem to us overly conservative (cf. answer 8.1 to the question 8).

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?

Yes, the partial look-through approach provides additional flexibility but this approach seems to us overly conservative (cf. answers 8.1 and 8.3 to the question 8 and answer to question 12).

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?

No (cf. answer 8.2 to the question 8).

Example 1 C. is misleading what should the bank do if it had exposure in the pharmaceutical sector?

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)?

Yes, we believe that the residual approach is too conservative (cf. answer 8.1 to the question 8).

The assumption of full correlation that is implicit in grouping to a single 'unknown exposure' client has no economic merit in the context of idiosyncratic risk.

While we understand the need to provide for an additional layer of conservatism when a full look-through is not applied, we consider the approach proposed is not proportionate to the risk involved. We would suggest:

- Either to allow the allocation of unknown exposures to several 'unknown' client groups (e.g a fixed number depending on the institution size and or several fictive clients representing countries and/or asset classes)
- Or to apply a haircut to the total exposure to the 'unknown client' to account for diversification.

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

Globally, we think that it will be very difficult and burdensome to implement the proposed treatment, and thus very costly for the institution.

Moreover, in Annex 2, example 2, page 40, the application of the haircut on the mezzanine tranche has not been specified. Should a haircut of 50% be applied systematically to mezzanine tranches?

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?

The proposed treatment doesn't seem completely appropriate to us, particularly for the institutions that invest in the FL tranches: with an investment of 10, 75 have to be declared in the large exposure (cf. example 1 in annex 2 of page 38), while the maximum of this investment is limited to 10.

Institutions will be penalized in terms of capacity to lend regarding the counterparties corresponding to the underlying assets of any tranched securitization positions in which they are investors of the junior tranches.

Further we do not think that ignoring the protection provided by a first loss tranche to another more senior 'first loss' tranche is appropriate, especially if 'first loss' is defined as 'receiving a 1250% RW'. As it has been raised to the attention of the supervisors, ratings agencies have recently downgraded senior RMBS tranches to level where they receive a 1250% RW in the RBA. This would preclude the correct application of the treatment presented in point 88 for granular portfolios. Additionnaly, it is unclear whether this would result in an allocation of all such RMBS position to the 'unknown' client, or to a multiple of the total exposure to that same 'unknown' client.

We rather suggest to exclude ABS with retail underlyings from the scope of application of this regime because we know that given the size of the underlying exposure they would not be relevant for the large exposures calculation while add all these tranches together could lead to a high amount of "unknown exposures" that would be inappropriate.

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?

The question is not clear to us.

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

We think that non-consolidated UCITS managed by an institution should be excluded from the large exposure regime.

❖ Reporting requirement

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

Yes, we agree with the proposed net exposure calculation.

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

No, we don't agree with the proposition that the 10% limit should be applied to the net exposure (column 10) because the exempted exposures, such as the intra-group exposures and the exposures to sovereigns weighted at 0%, are included in the calculation.

We are wondering why the exposures weighted at 0% should be taken into account. It seems to us unduly burdensome to fulfill a large exposure declaration for counterparties that are eligible to a 0% weight in accordance to the CRD and are considered "without risk" for the solvency ratio.

It would be more appropriate to declare only exposures to counterparties that don't benefit from a 0% weight and are considered risky

Regarding the intra-group exposures, due to the 10 % limit, we are afraid that a lot of subsidiaries of a parent institution will have to fulfill a large exposure declaration for their exposures on their parent institution, which will be useless and burdensome.

Moreover, in reference to points 123 and 135, we do not understand why the 10% limit should be systematically calculated on COREP 1.3 LE base (i.e. T1+T2) while the 25% limit is calculated either on COREP 1.3 LE base or on COREP 1.6 LE base (i.e. T1+T2+T3). The calculation base should be the same to determine the two limits.

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?

It seems to us that the exposure linked to the CLN is double counted, once under the bank B as indirect risk and the other under the SPV as direct risk.

In our understanding, the maximum loss of the Bank X on this CLN is limited to 5:
On one hand, this exposure should be declared as indirect risk under bank B as it supports finally the risk; on the other hand, as a protection buyer, SPV should benefit from the risk mitigation linked to this CLN.

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).

The 1-Template-Approach offers the advantage to handle only one template. Nevertheless, we understand that approach requires to report all information for groups but also for all clients constituting the groups while the 2-Template-Approach only requires all information at groups level and a lighter reporting at clients level (cf. point 108). The level of detail in the 1-Template-Approach seems to us unduly burdensome. Consequently, we are in favor of the 2-Template-Approach.

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

Yes, we agree with the proposed reporting of CRM.

But we would like to have a precision regarding the "real estate", to which value the reduction of 50% is applied: the market value or the original value after taking into account the amortization?

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?

No, the proposed reporting is already complicated enough. More information request would be burdensome.

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

First, we cannot see in the "Template 1" of Annex 3 any regulatory credit conversion factor, while the article 113 (4) (i) of the revised CRD specifies the cases in which CCF can be applied:

"Member States may fully or partially exempt the following exposures from the application of Article 111(1) (i) 50 % of medium/low risk off-balance-sheet documentary credits and of medium/low risk off-balance sheet undrawn credit facilities referred to in Annex II and subject to the competent authorities' agreement, 80 % of guarantees other than loan guarantees which have a legal or regulatory basis and are given for their members by mutual guarantee schemes possessing the status of credit institution;"

Do you suggest that the gross exposures must be declared after taking into account the CCF?

Secondly, we think it will difficult to trace the correct weight as only the breakdown between balance sheet and off balance is requested in the new reporting, without any differentiation of the risk typology, such as

- securities and credit risk for balance sheet,
- guarantee given to counterparties and undrawn credit facility for off balance sheet.

The weights applied to each risk typology may be different.

Thirdly, the rule for haircut application is not specified in the example 2 of annex 5 (haircut applied while the bank bond is taken into account as a collateral).We would like to have a precision on this haircut application.

Finally, we find the examples in annex 5 (page 45) a bit confusing.

In the example 4, an additional capital is expected as the trading book exposure exceeds the 25% limit but no calculation is done.
Nevertheless, in the example 5, all the counterparties have respected the 25% limit but an additional capital has been calculated. We think that it is a mistake.

The most confusing example is the 6, where the banking book exposure exceeds the 25% limit. We understood that it was forbidden for any institution to exceed this limit for banking book exposures.

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.

In general, it seems to us difficult to codify any group of connected clients as the component of each group of connected clients (identified or unknown) may change from a quarter to another.

In France, the current national practice is to use the code Siren to codify counterparties but only French counterparties have a real Siren code. Foreign counterparties should wait for a "fictive" Siren code attributed by the French Banking Commission after the first large exposure declaration thanks to the counterparties details (physical address, activity code...) provided in the first declaration.

In the proposed declaration template, no counterparty details is requested, so if the French national practice remains the same, we are wondering how foreign counterparties would be identified by the competent authority.

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.

One code is missing in the template 1 of annex 4 for the institution: in fact, there are 4 possible codes, of which "4" for intra-group non-credit institution.

26. We have two additional questions below:

26.1 Will there be a grace period for institutions to rectify any breaches of the 25% limit, which would be due to:

- the consideration, for the first time, of groups of connected clients;
- the grouping of all unknown clients as one separate group of connected clients.

26.2 In case that a family owns a large corporate, should we take into account all personals loans to the family for the interconnectedness appreciation of this corporate?