



14 August 2013

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Dear Mr. Farkas

Deutsche Bank's response to the European Banking Authority's Consultation Paper on the determination of the overall exposure to a client or a group of connected clients in respect of transactions with underlying assets under Article 379 of the proposed Capital Requirements Regulation

Deutsche Bank (DB) welcomes the opportunity to comment on the EBA's consultation paper (CP) on the determination of the overall exposure to a client or a group of connected clients. We support the EBA's goal of ensuring that banks consistently measure, aggregate and control exposures to single counterparties across their books and operations.

To capture relevant exposures, the large exposures framework needs to provide supervisors with meaningful data, whilst ensuring that the volume of required information does not lead to information overload and a diluted focus on critical exposures.

We highlight several aspects of our more detailed response, as follows:

- 1) Exposures to natural persons should be exempted from the look-through (LT) requirement. By construction these pools are diversified on multiple dimensions and it is therefore doubtful that in practice a single individual could appear with sufficient frequency across different positions to create a large exposure. Further, confidentiality restrictions would lead to classifying such exposures as "unknown" exposures and consequently could disincentivise investment;
- 2) Some form of granularity threshold exemption for the LT requirement should be granted in order to focus on exposures that are of importance;
- 3) We believe it is appropriate to allow multiple unknown counterparties where banks can demonstrate, to the regulators' satisfaction, that these groupings are separate and distinct;
- 4) Recognising that there is a reporting time-lag (over which banks have no control), exposure identification should be based upon the most recent available information; and
- 5) We recommend grandfathering all positions acquired before 31 January 2010 in line with the Committee of European Banking Supervisors (CEBS) guidelines.



Our more detailed response is provided in the annex. We trust you find these comments helpful and please let us know if we can provide further information.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'A. Procter', with a long horizontal stroke extending to the right.

Andrew Procter
Global Head of Compliance, Government and
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Annex I – Overarching comments

1. Look-through Requirement - Exposures to Natural Persons

The requirement that all exposures, regardless of size, be the subject of identification is often not achievable. This is typically the case where the bank is not the originator, and the underlying exposures are to natural persons. Pool sizes vary according to transactions types – the following are indicative figures for some transaction types:

- Auto Loan securitizations: 10,000 - 20,000 exposures, each <EUR 30,000;
- Credit Card securitizations: Over 100,000 exposures (possibly much larger), each <EUR 5,000;
- Retail Mortgage-Backed Securities (RMBS) securitizations: Over 2,000 exposures, each EUR 100,000 - 400,000.

We believe these types of transactions should be **excluded from the Large Exposure calculations for the following reasons:**

- By construction these pools are diversified on multiple dimensions. It is very unlikely that a single individual could appear with sufficient frequency across different positions to create a large exposure. Single individuals also face natural constraints, as tabulated by consumer rating agencies and based on their aggregate borrowings compared with their borrowing capacity, which are reviewed in the process of credit extension;
- As they are subject to confidentiality restrictions, the majority of exposures would be classified as “unknown”. If these transactions are not exempted, their aggregate “unknown” exposure will be so large as to require large-scale divestment of these exposures, which would severely diminish bank support of the real economy; and
- Even if the underlying natural persons could be identified, the data collection effort would be enormous, involving (in DB’s case) more than 100 million names. In light of the first bullet, we believe this cost and expense would be grossly disproportionate.

Against that background DB proposes a full exemption for the following exposure types:

- Credit Card securitisations and pools;
- Residential Mortgage-backed securitisations and pools;
- Home Equity loan securitisations and pools;
- Auto Loan securitisations and pools;
- Student Loan securitisations and pools;
- Other personal loan securitisations and pools; and
- SMEs and small balance commercial securitisations.

We also recommend that the following exposures types receive a full exemption:

Securitisations and pools where full principal is guaranteed by a government agency

Securitisations and pools where full principal is guaranteed by a government agency should be exempted from the LT requirement to underlying borrowers, as investors are looking to the credit of the specific guarantor: the government agency.



Collateralized Loan Obligations (CLOs)

The ability to “see through” to the underlying obligors is easier in CLOs than it is for CMBS. However, the overall tenant concentration in the CLO universe to any particular obligor is low and declining as the market continues to mature and is further enhanced by the variability of the obligors. So far this year the ten largest obligors have accounted for about 8% of CLO issuance. This number was 10% two years ago. The 50 largest obligors in the most recent quarter have accounted for 26% of issuance vs. 28% last year and 29% in 2011 and the largest 250 obligors only represent about 60% of issuance. Average exposure for post-crisis deals has been around 0.5% and the maximum exposure in most deals is less than 2% of the pool size. In addition, the largest obligors vary significantly over time, as shown in the table below, three of the ten largest obligors in the most recent quarter were not in the top ten in the previous quarter.

Obligor	Q2 13 Rank	Q1 13 Rank
First Data Corp	1	1
ARAMARK Holdings Corp	2	3
HCA Holdings Inc	3	2
Community Health Systems Inc	4	5
Las Vegas Sands Corp	5	7
Nielsen Holdings N	6	9
Energy Future Holdings Corp	7	4
Delta Air Lines Inc	8	13
NEWAsurion Corp	9	21
SunGard Data Systems Inc	10	11

Source: S&P

Commercial Mortgage-Backer Security (CMBS)

Concentration in CMBS is even less of an issue than in CLOs. First, CMBS loans are structured with special purpose entities (SPE) which act as the borrower for that specific loan. The sponsor of the loan contributes the property to the SPE but this data is usually not tracked by the major data providers. Second, the loans are non-recourse to the borrower/sponsor so only the value of the underlying property and cash flow are relevant for assessing the securitization. Diversification also plays a large role in CMBS: the average (by count) loan represents 1.4% of any given deal that has declined during the post-crisis period. Last year the average loan was 1.6% of the deal and 1.9% in 2011.

As each underlying position is a separate counterparty, it is not reasonable to expect that any underlying position, even when combined with other exposures on a bank's balance sheet, would result in the creation of an additional large exposure for a financial institution.

2. Granularity

In order to focus on exposures that are truly of concern, DB believes that some form of granularity exemption should be granted. We recognize the EBA's concerns that the appropriate threshold for an exemption should be aligned with an exposure's potential contribution for large exposure purposes, rather than a percentage of transaction metrics.



Accordingly, we recommend that exposures be exempted from large exposure consideration where:

- (1) As proposed by EBA, the exposure represents less than 0.25 % of bank Core Tier 1; and
- (2) The exposure represents < 5% of the underlying asset pool, with the exemption of funds which are subject to mandatory clearing under EMIR.

We further recommend that, in cases where asset pools have some exposures that meet the standards above, those that do qualify under the standards should be exempted, with only the remaining exposures assessed under the large exposure framework. Hence, for example, where a securitisation has only one significant exposure, all other granular exposures would be excluded from the LT requirement.

3. Unknown Counterparty

In circumstances where the exact identity of a client cannot be identified, there may nonetheless be substantial information that may help classify the client.

The dichotomy of natural person/legal entity has already been discussed, and further taxonomies are likely to exist.

We believe it is appropriate to allow multiple “unknown counterparties” where these groupings may be demonstrated to be separate and distinct to the regulators’ satisfaction. Banks should be allowed flexibility in identifying and justifying these multiple counterparties subject to supervisory approval.

Such groupings would provide further information regarding exposures to regulators and provide more meaning to classifications, while remaining true to the intent of the large exposure review.

4. Credit enhancement through subordinate tranches

In order for subordinate tranches to lose their credit enhancement value, other underlying exposures must suffer writedowns at the same time.

In the current proposal, the EBA assumes this as a general condition, severe enough to remove all the benefit from subordination. Effectively, this suggests that securitisations should be evaluated in the context of “credit crisis” conditions.

We believe this goes beyond the intended scope of the Large Exposures calculation, and note in particular:

- a) *Large exposure concentrations versus significant exposures to a group or groups of counterparties whose likelihood of default is driven by common underlying factors*

CEBS 2009 paper “*CEBS Guidelines on aspects of the management of concentration risk under the supervisory review process*” discusses different types of concentration risk, and distinguishes Large Exposure concentration (to a single client or group of connected clients) as different from :

“Significant exposures to a group or groups of counterparties whose likelihood of default is driven by common underlying factors, such as:

- economic sector;
- geographic location;
- instrument or product type: e.g. credit risk mitigation measures (including, for example, risks associated with large indirect credit exposures to a single collateral issuer or collateral type).”



b) Recognition of credit enhancements

CEBS 2009 paper “*Guidelines on the implementation of the revised large exposures regime*” provides for full recognition of credit enhancement, consistent with this interpretation of large exposure.

The CRR (current Article 390(7)) expresses the following intent (with (m) “securitization positions” and (o) “units or shares in CIUs”):

*“In order to determine the overall exposure to a client or a group of connected clients, in respect of clients to which the institution has exposures through transactions referred to in points (m) and (o) of Article 112 or through other transactions where there is an exposure to underlying assets, an institution shall assess its underlying exposures **taking into account the economic substance of the structure of the transaction and the risks inherent in the structure of the transaction itself**, in order to determine whether it constitutes an additional exposure.”* (bold added)

A reasonable interpretation of “economic substance” in this context would imply recognition of the credit enhancement benefit of subordinate tranches for senior tranche holders.

Similarly the Basel Committee in its recent consultation “*Supervisory Framework for measuring and controlling large exposures*” (bcbs246) includes a full discussion of events to be considered, which mirrors the “*CEBS Guidelines on aspects of the management of concentration risk under the supervisory review process*” discussion.

The scope of the Large Exposure regime is clearly expressed in these documents. We see no legislative justification for the EBA to go beyond this common understanding.

Deutsche Bank believes that, within the intended scope of the Large Exposure calculation, the 2009 CEBS guidance is correct and should be continued, excerpted here in part:

“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 always be 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. The adjustment will, of course, also depend on the share that is invested in the tranche.”

5. Timely identification of exposures

At the hearing on 4 July, the EBA expressed a willingness to consider extending the minimum frequency for exposure identification from monthly to quarterly. DB would strongly support this change, as reporting for many securitizations is only available quarterly.

Recognising the time-lag associated with receiving information which banks cannot influence, we recommend that using the most recent information be permitted.

6. Issues related to fund holdings

The EBA should consider exempting or including specific granularity thresholds for mutual funds, that are subject to clearing requirements under EMIR and which therefore tend to have higher exposure concentrations with respect to its clearing members. Article 22 (1) of Directive 85/611/EEC (UCITS) limits the risk exposure to a counterparty of the UCITS in an OTC derivative transaction to 5% its assets or, if the counterparty is a credit institution, to 10% of its assets. The assumption is that all mutual funds that deploy CCP cleared OTC derivatives for risk management



purposes will fully consume these thresholds (in particular due to the need for cash margining required in central clearing, typically resulting in an exposure to the deposit bank above 5%) and, hence, will always be subject to the LT even if all other assets comply with the granularity requirement. Since central clearing is not only incentivized by regulators, but also mandatorily required for standardised OTC derivatives (EMIR), it should not be 'punished' under the large exposure framework.

7. Grandfathering

Under the CEBS Guidelines on the implementation of the revised large exposures regime (12-11-2009), specifications are given for the treatment of exposures to schemes with underlying assets according to Article 106(3) of Directive 2006/48/EC. As stated in Article 75 of these guidelines, a transitional period until December 31, 2015 for schemes acquired before January 31, 2010 is granted (grandfathering). According to this grandfathering, the acquired schemes can be treated under the specifications, which were applied prior December 31, 2010. Using this transitional period, banks are either able to implement the look-through approach or to restructure their portfolio accordingly.

In the EBA's proposed RTS a new transitional period is not specified and there is no indication of any intent to continue the existing grandfathering. This will result in an untimely termination of the transitional period which was granted within the national implementation of Directive 2006/48/EC in 2010. Banks will, therefore, be obliged to handle all exposures in accordance with the new regulation.

Assuming an early-2014 entry into force of this RTS neither the development and installation of a modified look-through-software-solution, nor the provisioning of the needed data by the end of 2013 is feasible.

Should no transitional arrangement be provided, banks will be forced to aggregate exposure to schemes with underlying assets acquired before and after January 31, 2010 under the unknown client. This may result in a violation of the large exposure limit.

We urge the EBA to continue the type of transitional arrangements provided CEBS guidelines and recommend continuing the grandfathering for all schemes acquired before January 31, 2010, as well as the implementation of a new grandfathering for schemes acquired before December 31, 2013.

8. Phasing-in

Recognising that the time period between the finalisation of this RTS and its entry into force leaves a very short time to undertake necessary system changes to accurately measure and gather relevant information, we recommend that EBA provides for suitable phase-in arrangements.



Annex II: Responses to specific questions in the CP

Q1: Is the treatment provided in Article 5 sufficiently clear and do the examples provided appropriately reflect this treatment?

Many aspects of the process described in Article 5 are sufficiently clear. However, we note that total exposure calculations in Example 4 are incorrect, as losses taken in the first loss tranche and protection afforded by the mezzanine tranche are not properly deducted from the exposure prior to calculation of the senior tranche exposure, as would actually occur according to the waterfall structure. We would suggest the additional language to Article 5 stating: “In the case where an institution holds multiple tranches of a securitization, the exposure value may be adjusted to reflect the maximum possible loss that the institution could face given the securitization’s capital structure”.

Similarly, we believe the analysis of securitization exposures is inconsistent with the intended scope of Large Exposures, and should be assessed according to the framework outlined in the CEBS 2009 document. Please see our General Comments for further discussion.

Q2: Is there an appropriate alternative way of calculating the exposure values in the case of securitisations, which would be compatible with the large exposures risk mitigation framework as set out by the draft CRR?

Please see point 4 where we recommend the recognition of the credit enhancement benefit of subordinate tranches for senior tranche holders.

Q3: Would the application of requirements provided by Article 6 (3) and (4) imply unjustified costs to the institutions? Would the introduction of a materiality threshold be justified on a basis of a cost-benefit analysis? Please provide any evidence to support your response.

We suggest exemption from the LT requirement of those exposures which represent less than 0.25% of bank Core Tier 1 and where the exposure represents less than 5% of the underlying asset pool. We also recommend excluding exposures to natural persons: by construction these pools are diversified and individuals are very unlikely to appear with sufficient frequency to constitute a large exposure. Further to that confidentiality restrictions would lead to classifying these exposures as “unknown” and effectively disincentivise investment. Lastly, multiple unknown counterparties should be created where banks can demonstrate to regulators’ satisfaction that these groupings are separate from each other and distinct. For further comments please see our points 1, 2 and 3.

Q4: Keeping in mind that such materiality threshold would need to be sufficiently low in order to justify that all unknown underlying assets of a single transaction would be assigned to this transaction as a separate client, what would be the right calibration? Would the reference value (the institution’s eligible capital) be appropriate for this purpose? Please provide any evidence to support your response.

As per our answer to Question 3, we suggest a further refining to the scope of the LT requirement and the exclusion of exposures to natural persons. Due consideration must be paid to confidentiality restrictions that would lead to classifying certain exposures as “unknown” and effectively disincentivise investment. Finally, multiple unknown counterparties should be created where banks can demonstrate to regulators’ satisfaction that these groupings are separate from each other and distinct. For more detail please see points 1, 2 and 3.



Q5: Would the requirement to monitor the composition of a transaction at least monthly, as provided by Article 6 (5), imply unjustified costs to the institutions? Please provide any evidence to support your response.

At the hearing on 4 of July, the EBA expressed a willingness to consider extending the minimum frequency for exposure identification from monthly to quarterly. DB strongly supports this change, as reporting for many securitizations is only available quarterly.

Recognising the time-lag associated with receiving information and lack of banks' influence over, we recommend that most recent information is allowed to be used.

Q6: Are there other conditions that could be met by the structure of a transaction in order to not constitute an additional exposure according to Article 7?

DB does not have specific comments on this question.