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EUROFINAS COMMENTS ON THE CEBS CONSULTATION PAPER (CP10)

Eurofinas, the European Federation of Finance House Associations, is the main voice of the consumer credit industry at the European level. Founded in 1959, the Federation currently represents 15 National Associations, in turn bringing together more than 1,050 finance and credit institutions, the "hard core" of which is consumer credit, car financing and industrial credit. Together, Eurofinas members financed over 331 billion euros in new business and outstandings exceeded 554 billion euros in 2004. Companies represented by Eurofinas employ some 69,500 individuals.

Eurofinas welcomes the opportunity to comment on the CEBS consultation CP10 ("Validation") and would like to express it thanks to CEBS for being able to take part in the Technical Hearing on the paper that was held in London on the 6th of October.

This letter reflects the Eurofinas views on the CP10 guidelines and is to be read in conjunction with the European Banking Industry Committee's reaction on the topic.

If you have any questions on the points made in this paper, please do not hesitate to contact Jacqueline Mills directly on +32 2 778 05 71 or at j.mills@eurofinas.org.

We thank you for taking the time to examine our comments.

Yours faithfully,

Mr Pierantonio RUMIGNANI
VICE-PRESIDENT OF EUROFINAS AND CHAIRMAN OF THE EUROFINAS ECONOMIC AFFAIRS COMMITTEE

Mr Marc BAERT
EUROFINAS DIRECTOR GENERAL

EUROFINAS

EUROFINAS RESPONSE TO THE CEBS CP10 CONSULTATION: GUIDELINES ON THE IMPLEMENTATION, VALIDATION AND ASSESSMENT OF ADVANCED MEASUREMENT (AMA) AND INTERNAL RATINGS BASED (IRB) APPROACHES

This paper represents Eurofinas' views on CP10. It is divided into two sections. Section 1 includes broad, high level remarks on the paper and attempts to provide feedback to certain questions posed in the CP10. Section 2 addresses aspects of more technical detail.

SECTION I: GENERAL COMMENTS ON THE CP10

1. Eurofinas believes that, ultimately, the success of applying CP10 guidelines in such a way that progress is made towards achieving a level playing field for advanced EU institutions will depend on the *willingness of supervisors to cooperate* pragmatically and in an open-minded fashion, both amongst themselves and with their supervised institutions, with the intention of *keeping the administrative burden for institutions down to a minimum*. Furthermore, supervisors should *avoid as far as possible making additional demands on institutions further to those already described in the CP10 paper* as a minimum. As the guidelines are already very extensive and supervisors may add to them if they so deem appropriate, it is our opinion that the administrative burden will not be reduced and that the CP10's contribution to a true level playing field remains to be seen in practice.

2. In this context, our Federation would welcome clarification as to the exact status of the paper. It should be made clearer that the CP10 contains *guidelines* which are *recommendations* and not prescriptive rules. Thus, we urge CEBS to adapt the wording of the paper to reflect this and to make clear distinctions between the guidelines themselves and suggestions or illustrations. (See EBIC's list of modal verbs, "shoulds" that are better expressed as "coulds"). Furthermore, we would suggest that the key priorities and principles be highlighted in some way to differentiate them from examples.

3. The current drafting of the paper appears to us to be a mixture of high level principles and prescriptive technical guidelines. We would therefore also encourage CEBS to work on a *consistent level, preferably using a principles-based approach*. In conjunction to this approach, CEBS should work to obtain far-reaching commitment from its members so that agreement to abide by these principles whenever possible is obtained. In our view a level playing field will only be attained if supervisors *keep additional requirements at the national level down to an absolute minimum*.

4. In order to produce a more understandable set of guidelines and, as the respect of minimum conditions for applying advanced methodologies under the CRD is a matter of continuous importance for producing adequate capital requirements, we would also request that CEBS *refer to its previous, principles-based work on the Supervisory Review Procedure in CP03* whenever appropriate instead of developing additional work and guidelines in the CP10 paper as is currently the case.

5. Additionally, Eurofinas pleads for a certain amount of flexibility in the use of the CP10 guidelines, particularly during the early stages of CRD application. In other words, in the beginning of the process, supervisors should take into account the fact that certain "reasonable breaches" of their expectations may occur as institutions (as well as supervisors) are having to follow steep learning curves. Such cases should be explicitly permitted in the CP10 guidelines if the nature of the breach is such that it is temporary, does not cause major concern and the institution demonstrates its intention to remedy and improve rapidly.

6. Regarding the proposed procedures for cooperation between supervisors in the pre-application, approval and post-approval stages for model validation, Eurofinas welcomes the explicitly expressed intention that CEBS expects supervisors, home and host, to have reached agreement within the given time period of six months and that the consolidating supervisor having to make a decision on its own in case of disagreement is to be an exceptional occurrence. Nevertheless, in practice, the feasibility of this statement will

again depend on the actual level of cooperation and trust prevailing amongst supervisory authorities and therefore it remains to see whether or not this will be workable.

7. It is important that divergences of opinion must be sorted out amongst supervisors themselves and *not* via the institution as an intermediary. In general, when there is disagreement among supervisors on an aspect relating to the use of the IRB approach for credit risk or the AMA approach for operational risk, Eurofinas would welcome, in addition to the six month limit, clearer definitions of procedures and timetables to resolve these issues, in such a way that a potential lack of accord amongst the authorities in question does not result in the cumbersome situation of the institution not knowing where it stands and how or when the problem will be resolved.

SECTION II: SPECIFIC REMARKS ON MORE TECHNICAL ELEMENTS OF THE CP10

Issues with Model Validation Procedures

8. Within the procedures for model validation, the possibilities for supervisors to ask applicants to undertake additional analysis should be somewhat limited. While we fully understand that this can be necessary, we would appreciate that this be highlighted as a high-level principle in the CP10. Similarly, the possibility for supervisors to use the institution's own resources should also be constrained. Eurofinas is concerned that if no reasonable procedures are put in place to control supervisors' requests, the requirements for institutions will become unnecessarily demanding.

9. We are of the opinion that the documentation list required under §57 relating to the control environment in general and in particular to an institution's IT structure may be unclear to the reader. It should be made apparent that the information relating to IT elements should exclusively refer, in a material way, to advanced methodology applications. Overall, we are concerned that the required documentation list is excessive and will result only in increasing the administrative burden for institutions.

10. In line with our above remarks on flexibility in the early stages of CRD application (see point 5), the implementation plan in §58 of CP10 should *not* be a "*binding* description of the institution's own implementation dates (…)" but should rather be a *best efforts* commitment that the institution will endeavour to respect. Furthermore, given that institutions have to provide such a plan, the conditions under which supervisors may impose the roll-out sequence should be made known in the CP10. We would argue that an imposed roll out sequence should only be allowed if an institution is clearly not making sufficient efforts to respect its own time table.

Guaranteeing Proportionality for Smaller Institutions

11. Our Federation would like additional explanations to be given in the CP10 on how supervisors envisage applying the proportionality principle to *small* institutions when they are automatically presumed to be *sophisticated* institutions if they chose to adopt advanced methods. We have concerns that this may lead to more burdensome treatment for these institutions. Moreover, our members have expressed concern that some of the CP10 guidelines, particularly those pertaining to *internal governance*, may prove to be too ambitious for smaller institutions.

Recognition of Specificities of Certain Businesses

12. On more specific, technical issues, additional clarity on certain guidelines is required to avoid repeated, lengthy discussions on what different institutions can or cannot do when they deal with *similar businesses or products*. For instance, certain real estate exposures make up low default portfolios of a small number of large exposures. Due to these characteristics, little data is available for these portfolios and institutions performing this business would like to be guaranteed indefinite partial use. If the same data issues effect every institution granting such real estate finance, it would be worthwhile once and for all to have such portfolios approved for permanent partial use. The alternative would be the costly option of each institution having to justify themselves separately to their own supervisors, thus replicating the process for businesses with similar risk profiles as many times as there are institutions, with the risk of the outcome being potentiality different in

each case. Thus, it is the Federation's firm belief that the establishment of a set of common practices relating to specific businesses to be shared by supervisors across Europe would greatly contribute to promoting a level playing field.

Aggregating Retail Exposures: The Case for Excluding Consumer Credit Exposures

13. Eurofinas urges CEBS to reconsider paragraphs 155 and 156 of the CP10 in the case of consumer credit exposures. We would argue that consumer credit exposures should not be aggregated for the following reasons:
    1) They are made to individuals while the one million Euro threshold and aggregation requirement *applies only to SMEs* under the IRB approach (*Art 86, §4 (a) of the CRD).*
    2) Furthermore, this requirement must be applied to the total amount owed by the obligor to the entire group including any parent undertakings and their subsidiaries. Therefore, every institution would have to consolidate all exposures across the group for each individual retail loan exclusively for the purpose of defining the retail portfolio, independently of the scope of consolidation. This would seem to suggest that a credit institution would have to consider companies that are a part of a group of institutions or of a financial holding and therefore are not subject to regulation.
    3) Consolidation of borrowers' exposures for the exclusive purpose of defining the retail portfolio would not be technically feasible due to partially non-existent access for legal reasons as well as to different information system architectures and code systems.
    4) The case of a client possessing exposures totalling more than €1 million with several entities of a group is likely to occur only very rarely and should therefore be neglected from a risk point of view.

    We would thus suggest that §155 be explicitly applicable to *SME retail exposures only* and it should be made clear that the methods provided in §156 are only *illustrations* of ways an institution can deal with the aggregation task and are by no means mandatory.