

Swedish Bankers' Association

Svenska Bankföreningen

POSITION PAPER
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Committee of European Banking Supervisors
By email to:
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Consultation paper CEBS Guidelines on aspects of the management of concentration risk under the supervisory review process (CP31)

The Swedish Bankers' Association welcomes the opportunity to comment on the draft guidelines on concentration risk.

We agree with the comments made by the European Banking Federation (EBF), but we would also like to further highlight the following issues.

General comments

We believe that the guidelines on concentration risk should clarify that institutions are not required to identify a certain amount of their capital specifically meant to cover concentration risk. Rather that capital requirements are calculated as a whole against the total risks that banks face.

We are of the opinion that concentration risk is not a risk area of its own but rather a feature within the other risk types, except for inter-risk concentrations. Therefore, these guidelines should be placed in other guidelines dealing with respective risk area instead. This would avoid the problem that parts of the guideline on concentration risk are more or less the same as the guidelines under each specific risk area. Over time there is a risk that the guidelines will develop in slightly different ways which might lead to problems with the interpretation. This is especially obvious in the areas of concentration risk in operational risk and liquidity risk.

Concentration risk and diversification should be assessed jointly. Diversification might have been overestimated in certain asset classes in the recent past, but it is also true that a well-diversified structure makes an institution more resilient and should be incentivized as a good risk management practice. Therefore we agree with the suggestion from the EBF to include in guideline 7 the combined assessment of both concentration risk and diversification of the bank under the ICAAP and SREP in Pillar 2.

We welcome the explicit respect for the principle of proportionality. But we think this should be complemented with a principle of relevance as well. This is to make clear that the

principles should only be applied when relevant. It is not likely that all principles would be relevant to all institutions.

Guidance on the measurement of concentration risk at national level has already been produced by the Swedish supervisory authority. We expect them to be adjusted to be in line with the CEBS guidelines, but there should be a call for harmonisation among European countries in order to avoid potential conflicts stemming from differing legacy norms or national guidelines.

Detailed comments

We welcome the flexibility of the phased implementation of the guidelines (paragraph 12). We also agree that the guidelines may require modifications to the institutions' current procedures, but we would like to point out that it may also require modifications to the supervisory authorities' current procedures.

Guideline 1:

The advice on the treatment of concentration risk at both group and solo levels (paragraph 22) is not clear to us. To us concentration risk is naturally made at group-level i.e. the highest consolidated level of a cross-border bank. We agree that the concentration risk policy should be adequately documented, but the policy will be defined according to the structure of each banking group.

The wording seems to imply that there is a generally accepted correct way of managing concentration risk at the solo and sub-consolidated levels. In reality both supervisors and institutions are struggling with the contradiction between the Banking Groups' legitimate wish to benefit from their diversified structures (which is an inherent part of any bank's value added to society, to diversify away risks) and the host national supervisors assignment to protect national taxpayers from paying the bill in the event of liquidation – and liquidation is always at the solo level. Even if these guidelines cannot present any clear answers, just acknowledging the difficulties inherent in this question would help much more than simply dodging it.

Guidelines 3:

According to paragraph 27, banks are required to correctly price its risks in line with its view of the potential evolutions in financial markets and the economic environment. It is our opinion that this requirement goes too far. Not even in the use test of the IRB framework there is a requirement to consider the credit risk in the price setting. To be able to do this in the area of concentration risk would be very difficult since it is difficult to measure concentration risk on single transactions rather than on portfolio level. Hence we suggest deleting this requirement.

Paragraph 29 states that stress testing should be performed on an institution-wide basis. It is our opinion that concentration risk should be assessed at the highest consolidated level.

Guideline 4:

Guideline 3 requires institutions to have a framework for the identification of intra- and inter-risk concentrations and guideline 4 requires institutions to have a framework for the measurement of intra- and inter-risk concentrations. Since it is our opinion that concentration risk is not a risk area of its own we think that there should not be a requirement that the

institutions should have a separate organisation for concentration risk. Our suggestion is to delete the requirement of framework and instead require that intra- and inter-risk concentrations are identified and measured.

Guideline 5:

In paragraph 34 CEBS suggests that active management of risk exposures is required to mitigate the potential emergence of concentrated exposures within portfolios. In our view one option to this must also be to capitalise the bank instead of mitigating the exposure.

According to paragraph 35 an institution should set top-down and group-wide concentration risk limit structures for exposures. To us the use of limit structures is only one of many ways to manage concentration risks. Other ways would be hedging or capital allocation and pricing to create a good structure. It is our opinion that an institution must have the possibility not to manage a concentration risk if the bank actively decides to take on concentration, for instance as part of its business model.

Guideline 7:

As stated in the guidelines concentration risk is of big importance in the banks ICAAP and capital planning frameworks. It is however our opinion that concentration risk should be assessed from the overall perspective of the banking group together with diversification characteristics. The guideline can be read in a way that implies that concentration risk can be measured independently of the underlying risks involved and subjected to a separate additional capital charge. We strongly oppose this. The guidelines should instead state that banks should identify concentrations of risk which have not been adequately addressed with the help of established models.

Guideline 8:

Paragraph 55 states that interdependencies between creditors which may go beyond sectoral or geographic links may only become apparent under stressed circumstances and that stress testing would be a helpful tool to gauge the size of these hidden concentrations. This is a very demanding requirement and the question is if it is realistic to believe that the stress tests will be that sophisticated.

Guidelines on operational risk (11 and 12):

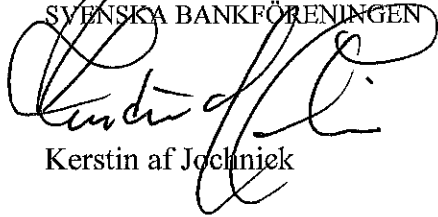
As stated under general comments it is our opinion that the guidelines under the different risk areas should be dealt with under respective risk area. The guidelines on operational risk are relevant for operational risk management, but are already covered in the framework for operational risk. As is stated in paragraph 67 the concept of operational risk concentration is new and the understanding, from both supervisors and institutions, are in an early stage. Therefore it is our suggestion that the section on operational risks is deleted. Only the parts of inter-risk analysis related to operational risk should be a part of concentration-risk specific guidelines.

Guidelines on liquidity risk (13-16):

The Basel Committee's consultation paper on "International framework for liquidity risk measurement, standards and monitoring" as well as the "Possible further changes to the capital requirements directive" (CRD IV) from the European Commission, introduce new requirements for liquidity risk. Since the suggested guidelines overlap with the suggested new rules and since the nature of liquidity risk are not an issue on loss estimation it is our

suggestion that also the section on liquidity risk is deleted. Only the parts of inter-risk analysis related to liquidity risk should be a part of concentration-risk specific guidelines.

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