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EBF Response to EBA consultation paper on Guidelines on Connected Clients (EBA/CP/2016/09)

Key points:

- A broader application of the economic dependency criteria would involve a significant operational effort by banks as the number of groups of connected clients may increase substantially. Clear instructions and definitions which are operationally manageable are needed.
- In accordance with the purpose, when establishing a group of connected clients, only clients which are assessed to in fact constitute a single risk should form a group of connected clients. Thus, when assessing interconnectedness based on control relationship and/or economic dependency, actual substantiality and material impact on credit risk in the individual case is to be considered.
- We do not support tying economic dependency to the existence of general financial difficulties irrespective of their duration and how serious their consequences are for the lending institution.
- The EBA's proposal to reduce the threshold to 2% of the eligible capital which triggers the investigation of potential economic connections would override the Basel framework jeopardising the level playing field. The 5% level is already a conservative threshold as long as large exposures are defined as those which overcome the 10% of bank's eligible capital. We do not see the rationale for applying any other level than the 5% ensuring alignment with the Basel framework.
- Moreover, such an important change, changing the threshold from 5% to 2%, should not be implemented via an EBA guideline but should rather be done through a revision of the level one regulation. The threshold is an essential element and should be interlinked with the European Commission potential revision of possible restrictions in the definition of eligible capital definitions.
- Interconnectedness through control differs fundamentally from interconnectedness through economic dependency. Any obligation to link these in a prescriptive and mechanical manner may lead to unintended outcomes and far-reaching requirements for the formation of groups of connected clients. We are opposed to such an approach as currently proposed, as this would go beyond the requirements set in Article 4 (1) (39) b) of the CRR, however we recognise that where there is a clear risk of a default of an obligor through their economic connection leading to high and material likelihood of default of the counterparty it should be recognised and included in a large exposure assessment, based on analysis of the individual case by the relevant analyst

General Remarks

- The principals described in these guidelines will significantly change the ones currently used by banks. Although some changes to current procedures may be required concerning the equity stake and control criteria, significant efforts will be needed on the "economic dependency" topic. Although economic dependency is used as a criterion for defining financial interconnectedness between clients, this is normally used in a very restricted group of clients. A broader application of this criterion would involve a significant operational and IT effort by banks which will have to adjust and change substantially their procedures (collection of information, definition of new rules, interconnection with other areas that use the concept of connected clients, validation, etc.) and IT systems. The approach should be changed to encompass only cases (individually assessed) where there is a high and material likelihood of economic connections causing a default of an obligor and, additionally, a transitional period should be envisaged by the present Guidelines to accommodate those changes.

- Clear instructions and definitions, which are also operationally manageable, are needed. The list provided in item 23 need additional clarifications.
- We note in example E2 presented in section 3.2.3., the variation to main case (no direct exposure to source of risk), that the costs of identifying connections with customers with whom no customer relationship exist is highly likely to surpass the expected benefits of these provisions. It will be a manual task to identify such a group where the relation is dependent on a customer to whom the institute has no exposure and limited knowledge about them. The identification process will be very burdensome and will rely on subjectivity. What has to be the exact criteria for the relationship with the common customer with no direct exposure if it has to be identified as connected client? In case institutions manage to identify such customers how should that information be applied as information on such a customer is in most cases very limited and not necessarily providing an accurate picture of this customer.
- Since information on suppliers or other counterparts that are dependent on the large corporate is often not made public, economic interdependence is most often revealed by evaluating the credit risk of the supplier or dependent party itself. A proper identification process therefore can only be bottom up, which makes it operationally complex. Further, any form of economic dependence that a supplier has to one single client will be reflected in its internal rating and form an integral part of the admission policies. It should suffice to have auditable principles or policies for monitoring economic interdependencies, instead of requiring banks to monitor and report exposures that are perhaps not even material.
- We regret that the EBA Guidelines fail to acknowledge in the “Draft cost-benefit analysis” section that the proposed rules may have a relatively greater impact in institutions of a more local nature that may face greater costs to adjust their business in such a strategic manner.
- Tying economic dependency to the existence of general financial difficulties irrespective of their duration and how serious their consequences are for the lending institution is something in our view goes too far. This is at odds with the purpose of Article 4 (1) (39) (b) of the CRR. Its purpose is grouping borrowers that constitute a single idiosyncratic risk which – were it to materialise – could pose a threat to an institution’s continued operation as a going concern and is thus subject to a supervisory limit. This is only the case, however, if the failure of one client would very likely lead to substantial, sustained funding or repayment difficulties on the part of another client. The purpose of the provision therefore suggests an interpretation of the term ‘repayment difficulties’ such that these should not only be temporary but instead substantial and existence-threatening. We therefore believe that, as rightly set out in the 2009 CEBS Guidelines, the criterion of ‘substantial, existence-threatening repayment difficulties’ should be retained. Otherwise there is the threat of restricted lending capacities that could also adversely affect, in particular, the provision of funds to SMEs and would thus run counter to political efforts at European level.
- The 2% trigger for the procedure set out in Chapter 8 appears to be quite low compared to the definition of a large exposure (10 %). In our opinion, the capital threshold for identifying potential economic interconnections between clients should always be based on the materiality of the impact in the case of repayment difficulties; in this regard, the 2% trigger is too restrictive, potentially leading to the establishment of non-significant groups of connected clients and increasing banks’ efforts without meaningful prudential benefits. In addition, the 2% trigger is inconsistent with the threshold recommended by Basel, harming the level playing field between European banks and banks from other jurisdictions. A trigger for the procedure of investigating potential economic connections of 5 % seems more appropriate. Moreover, the EBA Guidelines provide no rationale supporting the decision to lower the threshold to 2% (and not 4% or 3%, for instance). EBF Members would be keen to further discuss with the EBA how the threshold has been identified, calibrated and which further considerations should be made.

- In any case, the investigation required by the 2% should not imply any additional documentation to be provided by the institutions. Finally, we would appreciate it to be clarified whether the threshold is intended to be applied at group or single counterparty level.
- Since according to Article 395 of the Regulation n. 575/2013, "an institution shall not incur an exposure […] to a client or group of connected clients the value of which exceeds 25% of its eligible capital" without making any distinction between control relationship or economic dependency criteria used to determine the interconnectedness among clients, the possibility introduced in this consultation paper to have counterparties mapped in more than one group also for Central Governments would lead to an unjustified multiple counting of banks' exposures. Besides the operational complexity of the proposed assessment which would require an additional and burdensome investigation of economic relations, we are particularly concerned about this *de facto* additional large exposure requirement, which seems unduly penalising. We deem that the EBA should be aligned with the CRR purposes and that some specification should be introduced in the guidelines to clarify that no duplication of exposures should be made for the large exposure rule.
- We emphatically reject the proposed criteria for defining economic dependency through a common source of funding (paragraph 28 of the draft EBA Guidelines) (see also question 07). These would, in particular, have serious consequences for existing ABCP programmes. Sponsor banks would, for example, be forced to group the relevant purchasing companies or legally separated special-purpose vehicles into a group of connected clients. This is neither economically nor legally justified and would seriously restrict the financing of real-economy projects through this prudentially recognised product.
- The proposed close relation between grouping based on control and grouping based on economic dependency is inappropriate in our view. Interconnectedness through control differs from interconnectedness through economic dependency. This is already acknowledged by the 2009 CEBS Guidelines (see paragraph 53) and the rule in the CRR and CRD III. In the case of control, a contractual position/position under company law gives rise to a control relationship, so that shifts of assets by a controlling entity to the detriment of a lending institution's recoverable assets are, for example, conceivable. This risk is to be cushioned through the formation of groups of connected clients. In contrast, economic dependency involves mainly risk-related interconnectedness resulting from bilateral business relationships and business orientation. Any general reframing of the relationship between control and economic dependency goes beyond the EBA's mandate to ensure harmonised supervisory practice in Europe. In our view, such a basic policy decision would be up to EU legislators by amending Article 4 (1) (39) of the CRR accordingly.
- As an outset when assessing economic dependency, it will be very challenging both conceptually and technically to connect only part (e.g. one single entity) of another group of connected client to the other group of connected client´s single entity because when forming a single risk the credit assessment is typically assessed in the interconnectedness of the groups' financial robustness due to potential parent´s implicit or explicit support or collateral arrangements. This could create a situation where the same single entity will de facto need to be managed outside its´ natural controlling group and then again within its´ natural controlling group and hence causing double counting of credit risk and unnecessary credit risk assessment.

Answers to Questions

Question 01: Are you aware of any situations where the existence of a control relationship among clients does not lead to a 'single risk'?

In most cases a control relationship triggers 'single risk' and hence if financial distress occurs, the controlling entity will intervene to support the troubled subsidiary and vice versa. This being said, it might be the case in situations where another party has such control as described in guideline No. 13 c), such as management rights based on contractual conditions, clauses, etc. Such types of control do not necessarily have any impact on financial difficulties, etc.

Another situation where interconnectedness through control does not necessarily lead to a "single risk", which is not very likely but deserves to be mentioned, occurs when a parent holding controls several sub-holdings but explicitly states that it leaves to one or more of them a high degree of autonomy without exercising managing and controlling activities. In this situation, if it is also likely that possible financial difficulties would not generate a domino effect, then the autonomous sub-holding should constitute a separate group of connected clients.

A very typical feature of many SPV types (basically those established for undertaking business initiatives, like project finance and real estate) in practice is their bankruptcy-remote style set-up. Such ring-fencing design typically results in most SPVs being economically independent from other parties´ (such as the originator´s) economic fate even if accounting rules require the relationship to be deemed a controlling one.

Please note that for securitisation purposes SPVs, if there is a risk relationship, it would be with the debtor(s) of the underlying assets, but this relationship exists regardless of the SPV holding the assets technically.

In this respect it is worth mentioning that there could not be single risk with SPVs which are consolidated under the IFRS 10 accounting principle, whose risk of repayment difficulties has been already internalised by the consolidating bank. Such accounting-based consolidation is often based on *deemed* control only (rather than factual control). Moreover, "control" is typically derived from limited functions only, such as servicing, asset management etc. which does not necessarily result in controlling the SPV as a legal entity.

Question 02: What is the likely impact of the clarification of having an exceptional case when the existence of a control relationship does not lead to a 'single risk'? Please provide an estimation of the associated quantitative costs.

As we are dealing with information contained in the official documentation (e.g. annual reports, local registries), which is collected from group clients, it would be sufficient to document the lack of single risk in a detailed and comprehensive manner. Hence, we estimated that the impact would be overall null or low in line with the current operating practices. It is expected that no further information/analyses will be required in addition to the documents already set used by mapping functions in risk management. Otherwise, the impact will be relevant.

Question 03: Do you see a need for further clarification of the accounting provisions which are relevant for large exposures purposes? If yes, please point out the exact indicator of control according to the Directive 2013/34/EU or Regulation (EC) No 1606/2002 which should be clarified with respect to the large exposures regime.

We take a critical view of the reference to IFRS 11 (Joint Arrangements). The term 'joint control' does not constitute control within the meaning of Article 4 (1) (37) of the CRR and is therefore unsuitable as an indicator of control. Irrespective of this, joint control would not constitute a single risk either, as joint arrangements do not allow any joint shifts of assets ('stripping') to the detriment of the joint undertaking. We therefore request deletion of the reference to IFRS 11. The same goes for the reference to IFRS 12. A shareholding in an unconsolidated, structured entity does not constitute control within the meaning of Article 4 (1) (37) of the CRR, nor does it constitute a single risk, as no shifts of assets ('stripping') to the detriment of the investor or the structured entity are possible.

Question 04: Are there any other indicators of control in the case of a similar relationship which are useful to add to this list of indicators?

We understand the indicators specified in paragraph 13 c) as a list of features that may indicate a control relationship; we do not believe that they should automatically be applied. To make clear that each individual case must be viewed separately, we recommend wording paragraph 13 c), sentence 2 of the draft EBA Guidelines as follows:

"When conducting this assessment, institutions should consider the following non-exhaustive list of indicators of control ***and take into account the specific circumstances of each case."***

For example, a shareholding of more than 50% in another entity is specified as an indicator. Holding a majority of shares in itself only leads to control, however, if it is accompanied by a similar majority of voting rights or by other rights ensuring a dominant influence. Where, for instance, majorities in terms of shares and voting rights diverge, there might not be controlled by the majority shareholder in our view.

The bullet point i) at page 31 might be amended as follows:

> *"…control of more than half of the voting rights by virtue of a shareholders' agreement or other act of empowerment by the stockholders, at shareholders' meetings, at meetings of the board of directors or equivalent body for corporate governance virtue of a shareholders' agreement or other act of Other indicators that might be added are related to."*

In addition, a further indicator that might be added is:

> *"…control stakes over several firms owned by one single entity but registered under a trustee or other entities acting on behalf of the same counterpart, without the latter being formally involved."*

Question 05: What would be the cost of the assessment of the existence of control relationships in the case of subsidiaries exempted from accounting consolidation? Please provide an estimation of quantitative costs.

In your experience, how significant are these cases?

It is our assessment that this is not a significant problem as far as this information can be retrieved from official documentation (e.g. financial statements, public registries). Additional costs may arise in countries where centralised databases on control relationships among companies are not available.

Question 06: Is the guidance provided in section 5. 'Alternative approach for exposures to central governments' clear? If not, please provide concrete suggestions.

Mostly yes, as long as there are no conditions in the regulations in order to apply this alternative approach and, above all, as long as the actual exemption for exposures to Central Governments is maintained pursuant to Art.400(1) of CRR. In the unwanted and disagreeable case of withdrawal of the exemption, the approach should be modified, since it would make the reporting unduly burdensome and redundant.

Implementation of the envisaged measures is an issue that should be carefully taken into account. The outlined structures determine multiple counting of risk positions to both central governments and controlled entities, since they can be included in different groups of connected clients.

As a general matter, double counting (due to entities being included in different groups of connected clients) is not desirable, since it heavily impacts on a bank's operations, affecting the supervisory reporting procedures as well as the credit risk management practices (see also the response to question 10). The occurrences of multiple counting should therefore be limited as much as possible, i.e. they should be limited to the cases explicitly addressed in the CRR.

Therefore, financial institutions should be granted full flexibility in choosing the approach - full approach, alternative approach and partial alternative - to be applied to central governments, on a case by case basis, in order to limit the operating burdens and to facilitate compliance with both the present guidelines and other overlapping rules, in force in different countries (e.g. discipline of related parties transactions).

More detailed prescriptive guidance would be helpful to determine what falls within the categories. Can Local Authority A, Local Authority B and Local Authority C can all be assessed separately? The EBA should make clear that institutions can choose the approach for the assessment of local authorities within the same jurisdiction, despite the approach adopted for the central government.

Question 07: What is the likely impact of considering that clients are connected as soon as the failure of a client would lead to 'repayment difficulties' of another client? Please provide an estimation of any associated quantitative costs.

The 2009 CEBS Guidelines established that there was no requirement to consider clients to be interconnected as long as an institution concluded that the failure of a client would not lead to "**substantial, existence-threatening** repayment difficulties" of another client. However, the draft guidelines propose to delete the expression "'substantial, existence-threatening" and leave just "repayment difficulties". We understand EBA's effort on achieving a more prudential approach on this aspect; nevertheless, repayment difficulties should always be assessed taking into consideration the materiality of the impact on the level of credit risk for the bank as a result of the repayment problem.

Also, since the identification and grouping based on economic dependency typically is manual the new and more strict formulation will increase the manual routines in order to identify "groups of connected client" based on economic dependency.

Moreover, a broader definition of entities constituting groups of connected clients would determine greater volatility in the composition of groups, with unintended effects in terms of operating costs and impact on credit risk management practices.

In any case, a more precise definition of "repayment difficulties" would help, in order to specify that client likeliness to repay should be seriously impaired and lead to the event of default of the counterparty. We therefore ask EBA to maintain the existing reference to substantial, existence-threatening repayment difficulties. Whilst the document specifies "repayment difficulties" rather than "substantial existence threatening repayment difficulties", it does allow a loan from not being classified as "connected" when it is demonstrated that the entity can overcome the issue / demonstrates that the borrower can survive.

In addition, we take a critical view of the requirements in paragraph 27 ff. on economic dependency through a main source of funding and thus emphatically reject these. More pronouncedly than the 2009 CEBS Guidelines, the EBA now implies that loans granted by the reporting institution itself can be regarded as such a common source of funding (see paragraph 28 of the draft EBA Guidelines). In this context, the EBA lists a number of indicative factors that may lead to the assumption of contagion or idiosyncratic risk (see paragraph 29 of the draft EBA Guidelines). In application of these factors, the EBA concludes in example E6 that an institution providing liquidity lines to several SPVs 'can constitute the source of risk (the underlying risk factor) as recognised in recital 54 of Regulation (EU) No. 575/2013'. We believe that the approach taken in paragraphs 28 and 29 of the draft EBA Guidelines (and the conclusion drawn therefrom in the example) is not justified.

On the one hand, liquidity risk resulting from securitisation programmes is, in our view, addressed here inappropriately in the large exposures regime, applying provisions of the 2009 CEBS Guidelines which were designed at the time to draw lessons from the sub-prime mortgage crisis. These provisions however cannot automatically be applied to the situation today. The adoption of these provisions would, in particular, fail to take into account that through changes to capital requirements for securitisations and the introduction of a short-term liquidity coverage ratio (LCR) rules addressing the undesirable developments in the subprime mortgage crisis have been introduced in the meantime. We share the EBA's view that the liquidity lines to A, B and C in example E6 could be drawn on simultaneously because the event triggering such drawing (general market disruption) is ultimately identical or at least similar. However, we believe this is exclusively a liquidity management issue and should therefore also be treated as such.

On the other hand, the interpretation of example E6 ignores the fact that credit risk resulting from securitisation transactions is captured very effectively via the look-through rules (EU Regulation 1187/2014). Under the look-though approach, the underlying assets are taken into account, whereas in example E6 there is a look back at the liquidity provider. The provisions of the EU Regulation also set a materiality threshold of 0.25% of eligible capital. Any aggregation of SPV exposures at the level of an artificially formed group of connected clients would undermine application of the materiality threshold.

Question 08: Are the situations described in the list in paragraph 23 as constituting economic dependency clear? If not, provide concrete suggestions. In particular, do you have any comments regarding the introduction of the threshold of 'at least 50%' in points c), d), f) and g)?

In line with our comment on Question 7, economic interdependencies should be established, in any case, considering the materiality of the impact in the levels of credit risk for the bank due to the repayment difficulties of the connected counterparty. The examples provided in the draft guidelines help to identify circumstances where economic interconnectedness may be established; however, the guidelines should clarify that these examples do not automatically lead to an economic interdependence and therefore, these clients may not be automatically considered as a group of connected clients.

In the assessments of situations where control may exist and grouping must be done, except for companies included in the consolidation for accounting purposes, it is indicated that the listed criteria should be considered in the assessment process. Regarding economic dependency it is however written in the proposed guidelines that a dependency shall be deemed to exist ("deem") if the criteria are met. In such cases it becomes particularly important that the conditions actually are believed to lead to default or non-payment issues. For many of the criteria such a condition is described as a prerequisite («… so significant for the … is likely to default or experience financial difficulties…»). For the second criterion this condition is not included. These are criteria for a possible grouping where it may be more likely than not that this will be the consequence, but not necessarily. It will, inter alia, depend on the relevant customer's relative debt burden, cost structure, general adaptability, etc. Also for criteria c (income / expense), d (production), f (assets / liabilities), h (customer base), i (ownership structure) and j (relations to co-borrowers) this should be included as a condition.

The existence of such criteria should not automatically lead to the conclusion that a grouping must be done. The expert judgement of the bank, based on credit experience and knowledge of its customers, should necessarily play a role in the decision about the existence of interconnectedness through economic dependency. Consistently, the 50% threshold should not represent a mandatory threshold that triggers the existence of such connection, but rather a warning, prompting the bank to further analysing the clients.

It follows from the introductory comments in the consultation document that the grouping should not be based on risk concentrations as a result of industry or geography. Meanwhile, criterion 23 e) could be read as that such a common source of income can be a geographical region or a sector (what you produce / sell). Thus, it would be beneficial if the guidelines, in the introduction to chapter 6, indicate that the risk concentrations as a result of industry or geography matter shall not give rise to demands for grouping.

Criterion j ("The relationship between a debtor and his / her co-borrowers") appears in any case not as a sufficiently precise indication of a situation that necessarily describe economic dependence as this among other things will have to depend on the relative importance of the loan they are co-borrowers for compared to their total economic and financial situations.

Furthermore, along with the size of the economic relationship, other aspects should be taken into account for the purpose of identifying genuine economic dependency, such as the stability of the interconnection. For example, the bank could deem that the clients should be regarded as connected only after a permanence of the link for a predefined period of time. This would help in reducing volatility in the composition of the groups of connected clients (see also the answer to question 7) and would affect the magnitude of the single risk (i.e. if a counterparty's repayment difficulties affect temporarily or permanently the likeliness of repayment of another counterparty, the risk for the bank is different).

Question 09: Are you aware of any other situations that should be added to the list of situations that constitute economic dependency? In relation to the situation described above, would you treat these exposures as connected? Please explain.

No, as not all conceivable cases can be captured and economic dependency always depends on the specific circumstances of each case. However, the principle leading to identification of a single risk based on economic dependency is clear. We therefore agree with paragraph 22 in section 6 of the draft EBA Guidelines where it says that, when assessing the existence of a group of connected clients based on economic dependency, the specific circumstances of each case should always be taken into account. In keeping with this principle, it should be made clear in paragraph 23 of the draft EBA Guidelines that the situations listed therein may constitute a single risk based on economic dependency.

In addition, we would highlight that the example reported in the Explanatory Box on page 35 does not fit the definition of single risk as the individual exposures are not significant for the guarantor and therefore he/she would not experience financial troubles due to that.

Examples in Paragraph 29 c, d, f and g would be considered good examples of situations where there is an economic dependence. Whether they are connected or not would depend on whether replacement tenants/customers could be sourced.

Question 10: Is the guidance in section 7. 'Relation between interconnectedness through control and interconnectedness through economic dependency' clear? If not, please provide concrete suggestions.

What is the likely impact of this guidance? Please provide an estimation of the associated quantitative costs.

Interconnectedness through control differs fundamentally from interconnectedness through economic dependency. Any obligation to link these may lead to far-reaching requirements for the formation of groups of connected clients. We are opposed to such an approach, as this would go beyond the requirements set in Article 4 (1) (39) b) of the CRR (see also our general remarks). The extent to which this would lead to restricted lending is something that cannot be reliably assessed at the moment. This depends to a large extent on further decisions at European level on implementation of the Basel Committee's large exposures framework, particularly whether the definition of 'eligible capital' is tightened further and how far existing exemptions from the definition of "exposure" and from the application of the large exposure limit are dropped in future.

The implementation of the envisaged measures is likely to determine in many cases multiple counting of risk positions to clients that should be included in different groups of connected clients. As stated before (see the answer to question 6), we deem that double counting of exposures (due to entities being included in different groups of connected clients) is not desirable. In fact, this would lead to the double counting of the bank exposure to the client in the bank records aimed at supervisory reporting. Consequently (unless the bank creates a double-track management system detaching the credit risk management from supervisory evidences), the double counting would affect the monitoring of bank exposure to the client for risk management purposes, in terms of determination of credit limits and allocation of credit decisions. Potential consequences could also arise with respect to the identification of the actual parent company for the purpose of the attribution of the credit rating to the client.

The occurrences of this situation should therefore be limited to the cases explicitly addressed in the CRR (that seems not to be the case with the simultaneous presence of interconnectedness through control and interconnectedness through economic dependency with different entities addressed in Section 7 of the proposed Guidelines).

In any case, the EBA proposal is quite clear, even if its application is not straightforward, for the considerations explained above but also because the assessment of the economic dependency is not always easy. In fact, the concept of "Economic dependency" and its relationship with the concept of "control" raises several doubts. Please consider the following example:

Entity A controls 3 other entities, B, C and D. If entity B's sales are exclusively billed to company E, but has little relevance in terms of the controlling entity A and has support from the holding company, does it make any sense to associate it to company E? And how could the relevance of an entity be explained in respect to the group? The same issue arises in terms of commercial management.

We highlight that more of these issues will appear as concrete situations are analysed. The set-up of a dedicated communication channel between banks and EBA is of the utmost importance, not only for questions that might arise, but also to harmonise the interpretations between banks.

Moreover, the concept application is not straightforward as the assessment of the economic dependency is not always easy because of the high degree of subjectivity and the lack of relevant information; furthermore the reporting of groups' exposures in the LE framework would be more 'volatile' due to the changes in the groups perimeter.

Regarding extending to interconnectedness by economic value, if one takes the following example: one might find that it becomes vulnerable to another counter-party who fails, which the topco bank doesn't know anything about, and brings them all down? Alternatively, how does one have a conversation with a customer one wants to lend to but the linkages may mean that you are putting aside more capital and decide that you will not lend to them on these grounds - how does one explain the linkage when it is using privileged information about an interconnected party by economic value?

Question 11: What is the likely impact of this guidance? Please provide an estimation of the associated quantitative costs.

As in most cases the information about the economic dependency is not available in official documents there might be also relevant impacts on:

- clients relationship
- processes update
- IT tools (data storage and information sharing)
- privacy and banking secrecy

Question 12: What is your view of the proposed Control and Management procedures in order to identify connected clients?

The practicalities of linking together numerous businesses where economic dependencies exist in a global economy for exposure reporting purposes would create significant issues when banks look beyond the immediate known connections.

For example, Connection 1 which the bank risk assesses in the usual way, and the bank has another customer (Connection 2) who happens to be a customer of a party in Connection 1 and reliant on Connection 1 for over 50% of their annual receipts then the bank needs to show an economic dependency between Connection 1 and Connection 2. This means that somehow the bank needs to record total exposure across different customer connections which would otherwise be considered unrelated to be able to report where this total exposure exceeds 2% of the bank's Tier 1 capital.

Following this on, if there is a manufacturer of widgets and the bank also have a number of customers who were retailers of widgets (supplied by our manufacturer, accounting for over 50% of each retailers receivables) all the retailers would be economically dependent on the manufacturer so the bank would need to understand the domino effect, of the manufacturer going bankrupt across all its customers and being able to sum the limits of the manufacturer and the retailers to see if it exceeds 2% capital. Customers may also appear in multiple groupings if they have multiple dependencies on other customers.

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