

Comments
on the EBA Consultation Paper on Guidelines on
Connected Clients under Article 4 (1) (39) of
Regulation (EU) No 575/2013

Cologne/Berlin, 26th October 2016

A. General comments

The Arbeitskreis der Banken und Leasinggesellschaften der Automobilwirtschaft e.V. (AKA), and the Verband der Automobilindustrie e.V. (VDA) represent the companies of the automotive industry including their financial services companies – the so called Captives. The Captives are the link between the car manufacturers, the car dealers and the consumers. They offer wholesale financing and working capital to dealers as well as retail financing and leasing to consumers.

Captives, manufacturers and dealers are part of the same automotive value chain. However, each of them has its specific business model and is subject to different risks. Against this background respective exposures to one of them have never been considered to constitute a single risk for all of them.

We fear that the current legal situation might be changed by the draft “Guidelines on Connected Clients” under Article 4 (1) (39) of Regulation (EU) No 575/2013” as proposed by EBA on 26th July.

The EBA proposes a more extensive interpretation of the concept of group of connected clients which would lead to stricter prudential rules. Some indicators of the proposed approach do not take into account a comprehensive analysis of the idiosyncratic risk of interconnectedness. Such an extensive approach exceeds the economic concept of ‘single idiosyncratic risk’ and thus the purpose of article 4 (1) (39) CRR. It partly requires constituting a group of connected clients without a profound consideration of the actual risk of contagion.

As a consequence this could have adverse economic impacts that even increase risk instead of reducing it. In particular the funding risks for undertakings of the real economy, such as car manufacturers and dealers, would increase, since a too extensive formation of groups of connected clients would limit their funding opportunities. This should be avoided if these undertakings do not constitute a single idiosyncratic risk. Only the fact, that there is an indication that could constitute interconnectedness should not constitute a group of connected clients if such indication is not substantiated by a comprehensive economic analysis of interconnectedness.

Additionally, we would like to point out that all important aspects of the concept of ‘single idiosyncratic risk’ based on economic dependency were intensively deliberated and arguments were balanced against the purpose of Article 4(45) of Directive 2006/48/EC during the consultation of the CEBS Guidelines in 2009. We are neither aware of any shortcomings of the CEBS guidelines from a risk management perspective nor that there was any failure of groups that could have been detected and prevented by a more extensive interpretation of the concept of groups of connected clients.

Against this background we would argue for adopting the content and interpretation of the CEBS guidelines with regard to the specifications and interpretation of economic dependency.

B. Specific comments on the main aspects

1. Only existence-threatening repayment difficulties should be considered to constitute a single risk based on economic dependency

The definition of connected clients in article 4 (1) (39) (b) CRR states that two or more natural or legal persons are to be regarded as constituting a single risk when they are so interconnected that, if one of them were to experience financial problems, in particular funding or repayment difficulties, the other or all of the others would also be likely to encounter funding or repayment difficulties.

The term 'repayment difficulties' should reflect a certain degree of severity corresponding to the purpose of the legal provision. An appropriate interpretation would be that the assumed 'repayment difficulties' need to be substantial and existence-threatening in order to constitute an interconnectedness. This is exactly what CEBS has already stipulated (see paragraph 42 of the CEBS Guidelines). We therefore argue that this interpretation best reflects the purpose of Article 4 (1) (39) (b) CRR and should be retained. Temporary financial difficulties that can be resolved do not justify the constitution of a group of connected clients based on economic dependency since there is no single idiosyncratic risk.

In addition, without a supervisory specification of the vague term 'financial difficulties' there will be a high level of legal uncertainty. A heterogeneous interpretation will lead to inconsistencies in applying the concept of single risk based on economic dependency, though. Thus, we argue that paragraph 23 ("Background and rationale") should specify that 'repayment difficulties' should be substantial and existence-threatening. This ensures a better reflection of the definition of 'group of connected clients' stated in article 4 (1) (39) of Regulation (EU) No 575/2013.

The Basel Committee concurs with this argument in its "Supervisory framework for measuring and controlling large exposures" as it describes the assessment of economic dependence as follows: "Provided that the bank can demonstrate to its supervisor that a counterparty which is economically closely related to another counterparty may overcome financial difficulties, or even the second counterparty's default, by finding alternative business partners or funding sources within an appropriate time period, the bank does not need to combine these counterparties to form a group of connected counterparties" (see paragraph 27).

2. Obligatory constitution of economic dependency based on hard threshold to reject

We are of the opinion that it always depends on the single case whether there exists an economic dependency that constitutes a single idiosyncratic risk. Hard thresholds

can only provide an indication but should never lead to a general obligation to constitute a group of connected clients. Instead, further comprehensive and profound analyses of economic dependencies should always be necessary. Also it should be possible to show with such analyses that there is no single idiosyncratic risk. Again this would be in line with the interpretation of the Basel Committee.

Instead of stipulating that “institutions should deem” the situations listed in par. 23 as constituting economic dependencies the draft guidelines should rather qualify these situations as rule examples which “may” constitute a single risk. Such a solution would require further economic analyses of interconnectedness to come to a final conclusion.

3. No obligatory constitution of economic dependency in case of liquidity facilities in favour of several conduits involved in ABCP programmes due to a potential common source of funding

The question in which circumstances liquidity facilities in favour of several conduits involved in ABCP programmes constitute a group of connected clients through a potential common source of funding has already deliberated intensively during the consultation of the CEBS guidelines released in December 2009. These rules have been introduced in reaction to the financial crisis and have proved to be very efficient since they have led to a market rectification: ABCP structures with structured investment vehicles that caused problems during the last financial crisis have left the market due to their non-sustainable business models.

Meanwhile full support for liquidity facilities has been established as quality feature. The EU-Commission’s draft on a securitisation regulation also requires this in order to obtain the STS label for ABCPs (see article 13 (4) sentence 2 of the STS-Regulation draft). Furthermore, EBA’s report from July 2015 on STS securitisations states that “there should be only one party providing liquidity support to all transactions within a simple ABCP programme. In addition, in order to minimise potential agency problems between the sponsor and liquidity facility provider and thereby further increase simplicity, the two functions should be carried out by the same entity” (criterion 3, see pages 84 and 85).

This means that EBA requires ABCPs to have a common source of funding to obtain the STS label while at the same time punishes ABCPs for having the same funding source since all conduits obligatorily shall constitute a group of connected clients.

We are of the opinion that it depends on the circumstances of the single case whether several conduits constitute a group of connected clients due to a potential

common source of funding through liquidity facilities by the same sponsor. Thus, at least it should remain possible to show that there is no single risk in such a case. Otherwise the ABCP market could be seriously damaged with a profound negative impact on the funding of auto loans and auto leases by means of ABCPs.

4. Possibility of disproving groups of connected clients pursuant to Article 4 (1) (39) (a) CRR

It should be possible to disprove groups of connected clients even if one client controls the other. Particularly in case of securitisations, the very far reaching concept of control under IFRS 10 regarding servicing and retention of a securitisation position to fulfil the risk retention requirements pursuant to Article 405 CRR can constitute control. However, where it can be shown that there is no single idiosyncratic risk between the SPV and the originator, they should not be considered to constitute a group of connected clients.

5. No excessive requirement to identify groups of connected clients

In practice, it can be very difficult to identify economic dependencies between parties if one party is not a customer of the credit institution. This is even more complicated in a supervised group. In order to avoid excessive costs and efforts it should be clarified that in such cases the identification of economic dependency can be based on the present knowledge of the credit institution.

6. Same threshold for a thorough investigation of economic dependency as in the Basel Committee's large exposures framework

The Basel Committee's large exposures framework (paragraph 28) sets a threshold of 5% of eligible capital, defined as Tier 1, in relation to the aggregate exposure to a single borrower for a thorough investigation of economic dependency. The same threshold should be applied in the guidelines.

C. Answers to the boxed questions

Question 1:

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

Answer:

Most significant examples are the following from our point of view:

1. In cases of SPV's involved in the securitisation with an insolvency-remote set up and further features of high quality securitisations warranting that there is no channel of contagion between the SPV and the originator constituting a single idiosyncratic risk

We refer to point 3 of our special remarks. Auditors require with reference to IFRS 10 in many cases the inclusion of SPV's from securitisation in the consolidated financial statements. Often it suffices that the originator has sold its loan or lease receivables to an SPV involved in a securitisation transaction, transfer the servicing and holds a securitisation position. For instance, such securitisation position may exist to fulfil the risk retention requirements pursuant to Article 405 CRR or may stem from overcollateralisation. Through the inclusion of the SPV in the originator's consolidated financial statements, a case of control is assumed based on IFRS 10 in conjunction with Article 4(1) (37) CRR. However, no single idiosyncratic risk exists in many of such cases. This, in particular, applies to SPV's involved in the securitisation with an insolvency-remote set up and further features of high quality securitisations warranting that there is no channel of contagion between the SPV and the originator constituting a single idiosyncratic risk. Without the possibility to rebut the group of connected clients pursuant to Article 4 (1) (39) (a) CRR due to the missing single idiosyncratic risk, a group of connected clients between the originator and the SPV involved in the securitisation would have to be constituted which would impede the funding opportunities of the originator and all the companies including that of the real economy that belong to such a group due to large exposure limitations. This would not be justified.

2. Majority of voting rights with comprehensive minority protection rights of the minority shareholders that prevent control by the majority shareholder.

Pursuant to § 290 (2) of the German Commercial Code, in all case of the enumeration a dominant influence and thus control pursuant to Article 4 (1) (37) CRR is irrefutably presumed. This is notably of relevance in the case of § 290 (2) (1) of the German Commercial Code: Regardless of the actual rights of control, it is irrefutably presumed that one company has a dominant influence over the other company if one company holds the majority of voting rights of the other company. A constitution of a group of connected clients is, however, not appropriate in those cases where there are minority protection rights in favour of the minority shareholder that prevent a dominant influence of the majority shareholder. For instance, in many joint venture agreements, it is stipulated that irrespective of a formal majority of 51% of the voting rights all important matters require the prior consent both of the majority shareholder and the minority shareholder. In such a case, there is no control according to IFRS 10 but control pursuant § 290 (2) (1) of the German Commercial Code. The possibility to rebut the constitution of a group of connected clients allows the formation of a group of connected clients that is aligned with the actually existing control rights that constitute a single idiosyncratic risk and contributes to a more uniform formation of group of connected clients.

Question 2:

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.

This cannot be answered because EBA's understanding of "exceptional case" is unclear. However, if originators were forced by supervisory guidance to constitute a group of connected clients between the originator and the SPV it would have a severely hamper the funding of the originators by means of securitisation. We would like to repeat that there is no single idiosyncratic risk. This is the case for both STS- and Non-STS securitisation.

Question 3:

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

No. We welcome the clarification that the consolidated financial statements prepared in accordance with the provisions of EU law are to be taken as the main indicator of control within the meaning of Article 4 (1) (37) in conjunction with (39) of the CRR.

Question 4:

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

Answer:

No, each case of control depends on the circumstance of the single case. However, there are a number of standard constellations that constitute the rebuttable presumption of control. The list of indicators is useful and helpful and comprises all relevant well-known constellations that may constitute control. A further extension of the list of control indicators is not necessary because EBA already has clarified that it is a "non-exhaustive list of indicators of control". We understand the indicators specified as a list of features that may indicate a control relationship and where the existence of control has to be examined. To clarify that the list of indicators is not only a checklist but that the specific circumstances of each case have to be taken into consideration, we would welcome if sentence 2 of paragraph 13 c of the draft EBA Guidelines would be completed as follows:

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

For instance, a shareholding of more than 50% in another company is specified as indicator of control. 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 is no control by a majority shareholder. In Germany, this notably is of relevance in case of limited partnerships (Kommanditgesellschaften) with majority limited partners (Mehrheitskommandisten) under standard articles of association. In this case, the limited partner, whose personal liability is limited to the amount of capital he has invested, holds the majority of the shares but merely has no right of control, because the company is controlled and dominated by the general partner (Komplementär).

We have reservations about the indicator 'blocking minority' because the ability to effectively block important decisions does not mean control. It is common sense that control typically requires rights to actively participate in decision to steer and control an undertaking. A mere right to block or prevent decisions is usually not sufficient. Hence, IFRS 10 does not presume control due a potential blocking minority.

Question 5:

What would be the cost of the assessment of the existence of control relationship in the case of subsidiaries exempted from accounting consolidation? Please provide an estimation on quantitative costs. In your experience, how significant are these cases?

Answer:

This is difficult to assess and would require a more comprehensive analyses. Yet we feel that the necessary efforts are high and do not outweigh the benefits in most cases. With regard to IFRS in most cases those companies are exempted from the consolidation of the group that are not material for the assessment of the financial situation of the group. In addition, it is often difficult to obtain the documents that are required for an assessment. Against this backdrop, it should be allowed to abstain from further investigations, if there is no clear indication of control such as the majority of voting rights and if the exposure of such company that is not included in the consolidation is not material.

Question 6:

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

In principle, yes.

Question 7:

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.

Answer:

This is very difficult to assess and would depend on the grading of the repayment difficulties. We are of the opinion that the repayment difficulties have to be existence-threatening (refer to our specific remarks to “payment difficulties” above). In case of repayment difficulties that are only temporary the impact could be very high.

Question 8:

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 thresholds of ‘at least 50%’ in points c), d), f) and g)?

Answer:

The situations described in the list are more or less clear. We reject an obligatory constitution of economic dependency based on a hard threshold and refer to our specific remarks.

We appreciate those thresholds as a trigger for intensifying the assessment on economic dependencies.

We therefore suggest amending paragraph 23 of the draft EBA Guidelines as follows:

‘Institutions should **consider**, in particular, the following situations **that may constitute a single risk based** on economic dependency:’

Question 9:

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.

Answer:

No. We believe that not all conceivable cases can be captured. It 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. In addition, paragraph 24 makes clear that the list of indicators in paragraph 23 is non-exhaustive. This is sufficient. As outlined above it is important that these indicators should not automatically entail the requirement to constitute a group of connected clients but trigger a comprehensive and profound analysis of economic dependencies that may constitute a single idiosyncratic risk and thus a group of connected clients.

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.

Answer:

We think that the combination of interconnectedness through control and interconnectedness through economic dependency would lead too far to large groups of connected clients, which is not intended by the legislator.

Arbeitskreis der Banken und Leasinggesellschaften der Automobilwirtschaft (AKA),
Gut Maarhausen, Eiler Straße 3 K1, 51107 Köln, Germany

Verband der Automobilindustrie (VDA), Behrenstrasse 35, 10117 Berlin, Germany

Supported by:

Banque PSA Finance, 75 avenue de la Grande Armée, 75116 Paris, France
BMW Bank GmbH, Heidemannstr. 164, 80939 München, Germany
FCA Bank S.p.A, Corso Agnelli 200, 10135 Torino, Italy
Opel Bank GmbH, Mainzer Straße 190, 65428 Rüsselsheim, Germany
Honda Bank GmbH, Hanauer Landstr. 222-224, 60314 Frankfurt, Germany
MCE Bank GmbH, Schieferstein 5, 65439 Flörsheim, Germany
Mercedes-Benz Bank AG, Siemensstr. 7, 70469 Stuttgart, Germany
RCI Banque, 14 avenue du Pavé Neuf, 93168 Noisy le Grand, France
TOYOTA Financial Services Europe & Africa Region, Toyota Allee 5, 50858 Köln,
Germany
Volkswagen Financial Services AG, Gifhorner Str. 57, 38112 Braunschweig,
Germany