Nederlandse
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Subject: NVB Reaction to bcbs 246 on the supervisory framework for measuring and controlling large exposures

Dear Sir, Madam,

On behalf of the Dutch Banking Association[1] (NVB), I would like to thank you for giving us the opportunity to provide you with our feedback on consultation paper 246 regarding the supervisory framework for measuring and controlling large exposures. The large exposure (LE) regime is a risk management tool, which is particularly geared towards monitoring single name concentrations, allowing both institutions and competent authorities to assess the impact of a potential default of the largest clients on that institution. As such, the LE regime acts as an important backstop measure. Next to the response provided by the European Banking Federation, we would like to share the following areas of concern:

*The large exposure regime should remain a backstop measure*
Managing concentration risks is an important area of risk management, as concentration risks are not included in the scope of pillar one, but pose a real threat on the stability of banks if these risks are improperly managed. Out of all the tools used by banks to monitor and manage concentration risks, the LE regime acts as a failsafe for single name concentrations. It complements other focus areas such as concentrations by industry, product, and geography. Some of the proposals raised by the Basel Committee do not match with the intention of the LE to be a backstop, for instance the capital definition. This should be changed to include all tiers of capital.

*The large exposure regime should reflect internal risk management processes*
To a large extent, banks use internal models to assess the credit risk on their books. In order for the LE regime to align as much as possible with risk management practices, the results of internal models should be used as much as possible. The models used for the capital calculations are extensively reviewed – both internally and by competent authorities – and back tested. They provide the best combination of sophistication and reliability that is available under the current regulatory framework. If a higher level of conservatism is required, this can be achieved more easily by setting a lower reporting threshold than by applying specific tweaks.
Creating deviations from current methodologies would introduce additional operational requirements and would reduce the mutual comparability of the results. For instance, the suggested CCF factors

[1] The Nederlandse Vereniging van Banken (NVB) is the representative voice of the Dutch banking community with over 90 member firms, large and small, domestic and international, carrying out business in the Dutch market and overseas. The NVB strives towards a strong, healthy and internationally competitive banking industry in the Netherlands, whilst working towards wider single market aims in Europe.

to be used for LE reporting differ from the CCFs required to be used for risk mitigants. Another example is the suggested requirement for IMM banks to calculate the LE numbers using CEM. Hedges with a remaining maturity of less than three months are to be excluded according to the proposal. This will lead to shocks in the results. Secondary exposures, such as exposures to issuers of securities that are used as collateral, should not be treated in the same way as a direct exposure to the issuer; they should be processed separately.

*The impact of possible and proposed changes to the exposure measure*
The Basel Committee is investigating a number of potential changes to the exposure measure, which could have a significant impact and might deviate from the intended scope of the LE regime.

In particular, we would like to highlight three types of exposures:

1. Intercompany exposures
2. Exposures to Systemically Important Financial Institutions
3. Exposures to CCPs

Ad 1 – Intercompany exposures:
The free flow of capital and liquidity within banking groups is essential when it comes to the economic effectiveness of the banking system. Ensuring capital and liquidity are deployed where they add the most value, is one of the basic principles of an efficient market. The large exposure regime should not be used to constrict intragroup flows. To the extent these flows pose a risk to a banking group, the risks are best addressed as part of the on going work regarding recovery and resolution planning.

Ad 2 – Systemically Important Financial Institutions (SIFIs):
Next to the free flow of capital and liquidity, the LE regime should not be mixed with initiatives to manage systemic relevance of institutions. As such, we advocate maintaining the LE regime as a pure backstop, addressing issues regarding systemic relevance both via the already introduced specific buffer requirements and via recovery and resolution planning. Allowing a maximum exposure of 10% for SIFIs would not only increase the administrative burden, it would also require additional diversification, which might not always be available. In this context, we would also like to highlight the reporting templates for G SIFI's introduced by the FSB in 2012. These templates enhance the regulatory abilities to monitor major interbank exposures. Related initiatives, such as the introduction of a Legal Entity Identifier, are work in progress. It would be good to align the various initiatives as much as possible, as this could limit the already strongly increasing reporting burden.
Looking at the methodological side of things again, a deviation from the general LE rules for SIFIs does not match with the underlying issue regarding systemic relevance. The LE regime pertains to concentrations on the asset side of banks' balance sheets. The proposed special regime for SIFIs would effectively apply to other banks, requiring them to diversify the liabilities on their balance sheets. The 10% maximum exposure on SIFIs would require banks to continuously monitor their exposures against those counterparties. Given all the policy developments that are being worked on, such a requirement does not seem appropriate. We therefore recommend not introducing a special LE regime for exposures to SIFI banks.

Ad 3 - Exposures to CCPs:
In principle, exposures to CCPs should be subject to the same principles as exposures to other financial counterparties. Since the financial crisis, however, the regulatory requirements have changed significantly. As a consequence, the CCP landscape is in a transitional phase. It is unclear what the landscape will look like in the near future, how many alternatives there will be per market, how large the exposures will be, etc. The steady state characteristics will become much clearer in the coming years, as the clearing obligation enters into force for new trades, existing trades are novated to CCPs and CCPs are set up and/or will enter new markets. During this transitional phase,

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no hard limit should be set allowing for an efficient migration to the new situation. A soft limit will help to understand and monitor the developments of exposures against CCPs.

Contrary to other financial counterparties, banks cannot always *choose* if they want to do business with a CCP, as the regulation requires banks to use these CCPs. It is not efficient to force banks to use CCPs on the one hand and to limit their use on the other; such a policy would not be consistent. Also, exposures resulting from transactions done by banks that do not have direct access to Q-CCPs, should be treated as an exposure to the Q-CCP instead of exposures to the clearing member, if this bank is protected against losses in case the clearing member defaults.

The regulatory changes that are underway are all designed to increase the use of CCPs. Consequently, the concentration risks on CCPs are expected to increase. Central counterparties should therefore be well capitalised and subjected to top notch supervision. The LE regime should not constrain the migration of trades to CCPs.

*The effects of the suggested treatment of CIUs and securitisations*
The approach described for CIUs and securitisations is generally suitable. Nevertheless the LE calculation should only focus on *large* exposures. The decision tree as it is currently described does not sufficiently separate small from large exposures. In case a large bank invests an insignificant amount in a non-granular fund, this bank will be required to include this amount in the LE analysis and to add insignificant amounts to the LER results.

Example: a bank with EUR 20 billion of capital holds a EUR 400 million loan to a large corporate, and invests EUR 1 million in a non-granular fund with 50 underlying exposures. This bank should than add EUR 20 thousand to the LER reporting. The LER amount would than be EUR 400.020.000. In order to avoid adding immaterial positions, a threshold regarding the exposures invested into funds and securitisations should be set before the decision tree should be used. The suggestion made in point 111, to add an unknown exposure to existing large exposures, might be a possibility. It would avoid a lot of work for larger banks while smaller banks with larger individual positions could choose to calculate individual positions.

*Intraday exposures should be excluded from the LE regime*
Section 101 creates the impression that intraday exposures might have to be included in the LE calculations. As intraday positions are typically managed from a settlement risk perspective and fluctuate tremendously, we recommend not including them in the scope of LE. Given the reporting frequency of LE, the reported intraday exposures will have matured by the time the results are submitted to the competent authority.

*Creating logical unknown counterparties*
We agree with the principle that reporting should take place as much as possible on the basis of a look through approach. However, the simple aggregation of all unknown exposures to a single unknown counterparty will not produce a realistic view of concentration risks. The information required might be penalising for banks in case of data quality challenges, but it will not provide usable information to the competent authority. For instance, there are cases where the exact underlying exposure is not known, but it can still be ascertained that the exposures do not overlap, for instance as a result of disjoint regions or sectors. An institution should report unknown counterparties based on sensible categories of the underlying exposures it has on its books.

*Closing remark regarding the transitional arrangements*
Regarding the transitional arrangements, it should be noted that the proposed phase in as per 2019 will likely take place earlier due to market discipline. Changes could interact with the phasing in of Basel 3.

This concludes our feedback to the consultation paper. In case you have any questions or remarks, please feel free to contact me at your convenience.

Kind regards,

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