BANK · VERSICHERUNG

baselcommittee@bis.org

Division Bank and Insurance
Austrian Federal Economic Chamber
Wiedner Hauptstraße 63 | P.O. Box 320
1045 Vienna
T +43 (0)5 90 900-ext | F +43 (0)5 90 900-272
E bsbv@wko.at
W http://wko.at/bsbv

Your reference, Your message of	Our reference, contact person	Extension	Date
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Consultation Large Exposure

The Division Bank and Insurance of the Austrian Federal Economic Chamber, as representative of the entire Austrian banking industry, appreciates the possibility to comment on the Consultation Large Exposure and would like to submit the following position:

Question 1. Proposed definition of a large exposures and proposal for reporting
The Committee's proposal to reduce the threshold defining a large exposure from 10% to 5% would have a strong negative effect on banks. The lowering of the threshold would lead to a progressive increase in the number of large exposures, which would not only increase the cost of reporting but also the time and effort for all other activities necessary for large exposures, such as monitoring or internal assessment. Especially, in combination with the other proposal of the Committee, to use for some types of exposure a calculation method different from the one used for the risk-based capital regime, the cost would increase disproportionately.

EU banks already report the exposures both before and after applying credit risk mitigation techniques (CRM) and exemptions. The large exposure 10% threshold applies to the exposure value before applying CRM and exemptions. In contrast, the largest 20 exposures shall include only non-exempted exposures, as specified in footnote 9 on page 5, which means exposures after CRM and exemptions. Therefore, the report of the large exposures is a different requirement than the report of the 20 largest exposures, and it is not logic to interconnect these two requirements as it is done in paragraph 24. For example if the bank has only 12 large exposures based on the value before applying CRM and exemptions, and where the value after CRM and exemtions might be zero, it will report these 12 large exposures and 8 exposures with the largest value after CRM and exemptions.

Question 2. Proposed criteria for the identification of connected counterparties
The proposal described in paragraph 36 does not ease the burden to identify all economic interdependencies because it means banks would have first to investigate the economic interdependence and combine the exposure, and only then compare the combined exposure with the threshold. So the investigation has to be done in any case. In order to really ease the burden of intensive investigation, the obligation to investigate economic interconnection should be linked to the size of the exposure of one client, e.g. investigation is obligatory if the exposure of one client exceeds 5% of the bank's eligible capital.

Question 3. Definition of eligible capital - CET 1 or Tier 1
By applying Basel III the qualitative requirements for capital instruments have increased. Keeping this in mind we strongly recommend not to consider only CET 1 but Tier 1 as the eligible capital, and we suggest to include also Tier 2 capital, at least some part of it.

Under the Basel III regime the basis of eligible capital will be reduced steadily and end up in 2017 with 33% of tier 2 capital as a maximum anyway. Therefore it would be too rigorous to reduce this percentage to 0% by 01.01.2019.

Question 4. Use of internal models to measure large exposures
We recommend to use the same methods, including internal models, for calculating capital requirement and large exposures. Consistency in this respect is an important issue. The divergence between exposures for the capital requirement regime and exposures for the large exposure regime, caused by using different methods, will lead to permanent reconciliation tasks, and will have negative effects on the usability of the large exposure regime for purposes other than the simple backstop measure.
The model risk inherent to internal model-based approaches is minimised by extensive revisions by supervisors.

Question 5. Exposure value of OTC derivatives
We generally welcome the idea of using the same approach to measure exposures of OTC derivates.
Nevertheless an adoption of CEM or a successor method should be exactly examined by the Comittee. Regarding OTC derivates our point of view is that the usage of the standardised method or CEM is sufficient. Internal model methods bear the risk of diminishing the exposure of a counterparty.

For banks which do not use the Current Exposure Method (CEM) for capital requirement calculation the obligation to use the CEM would mean additional burdensome calculations. Further comments please see question 4 above.

Question 6. Exposure value of securities financing transactions
Please see comments to questions 4 and 5 above.

Question 7. Exposure measure - banking book "traditional" off balance sheet commitment calculation of CCFs
We vote for the option described in (64) to align the calculation with the Solvency Regime. At least a lower (than 100%) CCF should be considered for exposures linked to trade finance activities (66).

Question 8. Definition of large exposure (25) and CRM
The new Basel III regime (Article 392 CRR - Substitution Approach) should be respected, we suggest not to change it.

Question 11. Interbank exposures - specific exemptions
It is appropiate to consider exemptions that fulfil the conditions described in paragraph 102. However, these exemptions should not apply only to interbank exposures but also to exposures with other counterparties. The reasoning for such exemptions is applicable to any counterparty.

Moreover, in addition to the exemptions listed under this chapter, the CRR-exemptions for interbank exposures have to be respected, particularly the following ones:

(1) Article 384: Where the amount of EUR 150 million is higher than 25 % of the institution's eligible capital the value of the exposure, after taking into account the effect of credit risk mitigation in accordance with Articles 388 to 392 shall not exceed a reasonable limit in terms of

the institution's eligible capital. That limit shall be determined by the institution in accordance with the policies and procedures referred to in Article 79 of Directive (inserted by OP], to address and control concentration risk. This limit shall not exceed 100 % of the institution's eligible capital.

With regard to the proportionality principle it is appropriate to not only adhere to the 25% threshold of eligible capital but to have an alternative threshold of EUR 150 Mio (limited to 100% of the institution's eligible capital anyway).
With regard to the proportionality it would moreover be appropriate to have a minimum threshold of EUR 500.000 (equals 10% of the required initial capital of EUR 5 Mio) for the classification of an exposure as large exposure. This would be in line with Art. 88/2 CRR allowing institutions that were already in existence on 1 January 1993 and which do not attain the amount of initial capital required (EUR 5 Mio) to continue to carry on their activities.

(2) - Art 389/1/f CRR: exposures to counterparties referred to in Article 108(6) or Article 108(7) if they would be assigned a 0 % risk weight under Part Three, Title II, Chapter 2.;
- Art 389/2/c CRR: exposures, including participations or other kinds of holdings, incurred by an institution to its parent undertaking, to other subsidiaries of that parent undertaking or to its own subsidiaries, in so far as those undertakings are covered by the supervision on a consolidated basis to which the institution itself is subject, in accordance with this Regulation, Directive 2002/87/EC or with equivalent standards in force in a third country; exposures that do not meet these criteria, whether or not exempted from Article 384(1),shall be treated as exposures to a third party;
- Art 389/2/d CRR: asset items constituting claims on and other exposures, including participations or other kinds of holdings, to regional or central credit institutions with which the credit institution is associated in a network in accordance with legal or statutory provisions and which are responsible, under those provisions, for cash-clearing operations within the network;

Large exposure provisions are dedicated to provide diversification and to avoid risk concentration. Saying that it must not be forgotten, that cooperation within groups and decentralized networks of banks would be burdened in an absurd manner if there would be that necessity for diversification. This would result in a massive disadvantage for groups or networks of banks operating under the same trademark. Moreover a group, an institutional protection scheme and a network of credit institutions with legal or statutory provisions provide for a high degree of safety. Therefore it is appropriate to particularly exempt the above mentioned exposures from the large exposures regime.

(3) Moreover all exemptions listed in Art 389/1 and 2 CRR should be respected as a whole.

<u>Question 12. Calibration of granularity threshold for transactions with underlying assets</u>
A granularity threshold of 1% is too low. The cost of identifying such relatively small underlying exposures is much higher than the financial stability achieved by the identification of the underlying. We propose to set the granularity threshold to 5%. The 5% threshold is currently used by banks applying EBA guidelines and has been proven to serve the need to identify significant underlyings.

Besides the look through approach described in the consultative document, an alternative approach should be applicable if the structure of the transaction (fund, vehicle) ensures that the underlyings are not connected with any other direct or indirect exposure in the bank's portfolio that is higher than 2% of the bank's eligible capital. In this case the transaction should be treated as if it were granular. This structure based approach is part of the current EBA guidelines.

We agree that the most conservative treatment of adding unknown exposure to each of its existing large exposures is too strict and agree with the proposal to sum up unknown exposures

as "unknown client" (= the existing treatment of unknown exposures)

Question 14. Options for the treatment of banks' exposures to CCPs
The second option, i.e. no hard limit, is the preferred option.

Kindly give our remarks due consideration.

Yours sincerely,

Dr. Franz Rudorfer
Managing Director
Division Bank & Insurance
Austrian Federal Economic Chamber