German Banking Industry Committee

Die Deutsche Kreditwirtschaft

Comments

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

EBA/CP/2017/07

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Berlin, 26 June 2017

The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent more than 1,700 banks.

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Comments

I. General Statements

In the response by the German Banking Industry Committee (GBIC), dated 26 October 2016, on the first consultation paper of the draft guidelines on connected clients under Article 4 (1) (39) of Regulation (EU) No 575/2013our suggestion was to examine broadening the scope of application of the guidelines. Hence, we welcome the submission of the second consultation paper on the scope of the draft guidelines on connected clients as defined by Article 4 (1) (39) of the CRR.

In principle, extending the concept of groups of connected clients – originally conceived in connection with large exposures – to other areas of regulation is appropriate, provided that such areas are from their content closely related to the back-stop regime for large exposures. Preventing excessive credit risk concentrations (and hence, potential losses) justifies applying strict standards for the grouping of borrowers for large exposures' purpose.

Over and above the regulation of large exposures, extending the scope of the guidelines' application would only be appropriate – for reasons of principle, and especially for consistency reasons – for those areas where groups of connected clients are established in the lending business (Retail Exposure Class / SME Supporting Factor). The examples provided in the first consultation paper are in line with this understanding, as is section 34 of the draft guidelines according to the first consultation paper ("Identification of possible connections among clients should be an integral part of the institution's **credit** granting and surveillance process.").

In Germany, the scope of application of groups of connected clients has already been extended, for reasons of consistency, to other lending-related regulations, by virtue of sections 15 and 18 (1) of the German Banking Act (Loans to managers etc and Borrower documentation).

Ultimately, the second consultation paper does not provide any further guidance on whether the liquidity regime is set to be based upon existing groups of connected clients (i.e. formed by those clients against which the institution has a risk exposure), or whether the proposed extension to cover this area will also involve the broadening of groups of connected clients to include or use as a starting point clients who are purely or predominantly depositors (i.e. clients without borrowings). We strongly reject the latter, particularly given the problems this would pose in terms of capturing and processing data. More detailed information required to establish groups of connected clients is generally only available for borrowers, based on the credit granting and surveillance process and the reporting system. Whilst the requirement of collating, maintaining and documenting extensive sets of data already involves significant administrative efforts, this can be

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explained to borrowers. In contrast, if the scope of data collection was extended to include depositor clients, for whom such data is not yet available, institutions would face extreme expenses for capturing such data – at the same time, it would be impossible to justify procuring such data from clients who are (predominantly) depositors. Moreover, such an extended data collection exercise would raise the question of whether this is permissible under data protection laws – requiring, for example, a client to disclose his corporate structure prior to being able to make a deposit (see also our special comments on Question 5).

In addition, we propose the introduction of a *de minimis* threshold, in order to provide some relief to institutions: the requirement to examine whether to establish a group of connected clients should be waived for individual borrowers with exposures below €500,000.In this context and as already pointed out in our statement on the first consultation paper, given the Draft Regulation to amend the CRR in which the European Commission suggests to align the with the Basel Committees' Framework on Large Exposures, we believe that EBA should also set the threshold for a thorough investigation of economic dependency at 5% of eligible capital, defined as Tier 1, in relation to the aggregate exposure to a single borrower as being done by the Basel Committee.

Referring to our letter dated 17 March 2017, we would like to reiterate our request that ongoing work on the guidelines should not be concluded in the near future (2017/2018). Instead, given the mandate provided in Article 4 (4) of the Draft Regulation to amend the CRR, the EBA should wait for further developments at a European level, and the work submitted to date should be used as input for a Regulatory Technical Standard (RTS), then to be prepared by the EBA.

II. Special comments

Q3: Do you agree with the EBA´s assessment that there would be no impact of applying the draft guidelines on connected clients to development and application of the rating systems (Article 172 (1)(d) of the CRR)?

In our opinion, extending the scope of application to include rating procedures would bring about significant changes for institutions. We believe that, depending on the specifications, process-related and administrative efforts would increase significantly, and would represent a disproportionate burden for smaller institutions in particular. Even though section 9 tends to negate any direct impact related to Article 172 (1) d of the CRR, this provision only applies to the IRBA. Given the outstanding importance of rating systems for the risk management of each institution, we believe that a clarification is required that the requirements for establishing groups of connected clients have no influence upon development and calibration of rating systems for risk management purposes (Pillar II).

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Q5: Please explain how the application of the draft guidelines on connected clients would possibly change current practices regarding the reporting to competent authorities, for instance in the area of liquidity? What is the likely impact of applying the draft guidelines on connected clients to reporting requirements, where relevant? If there is an impact, please provide concrete examples and both qualitative and quantitative information.

Assuming that it is EBA's understanding, concerning the area of liquidity management, that clients exclusively (or predominantly) making deposits also need to be examined regarding the establishment of connected-client groups, we anticipate serious problems concerning the availability of data required to assess the establishment of clients to groups of connected clients, in accordance with the extensive criteria set out in EBA's draft guidelines on connected clients.

To date, the concept of connected-client groups has been exclusively applied in the context of large exposures, thus targeting banks' borrowing clients. Grouping clients is only required if several members of a group of connected clients have actually taken out loans from the institution concerned.

Extending the scope of application of EBA's guidelines on connected clients to depositor clients, or to introduce a notional analysis of grouping, would require a significant amount of additional information. Such information is not currently available with the level of detail required by the draft guidelines. Besides causing immense process-related and organisational efforts for data collection and processing, such extended requirements for disclosure of financial or economic circumstances – which significantly exceed those required for know your customers (KYC) purposes and the prevention of money laundering and financing of terrorism– are likely to meet resistance from clients, and threaten to negatively affect the business relationships.

For instance, an individual holding a share in a small business, who wishes to make a deposit from his private assets, is unlikely to agree disclosing the financial circumstances of that small business to an extent that economic dependencies with other companies can be checked.

Moreover, individual clients may need to be assigned to different groups of connected clients. Whilst such multiple assignments might be unproblematic for the purposes of large exposure limits (at least given the absence of any aggregate limit for all large exposures), they might pose problems for liquidity reporting purposes, and/or would require further regulation. Taking ALMM as an example, the multiple assignment of individual clients would exaggerate concentration risk on the funding side (C67.00).

Extending the guidelines' scope of application onto the liquidity regime would only be acceptable if no new requirements were introduced regarding the examination and

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potential establishment of groups of connected clients and using existing groups established on the basis of lending relationships only in liquidity regime. We reject any more extensive requirements.