

EBA/CP/2017/07

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# Consultation Paper

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

# 1. Responding to this consultation

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The EBA invites comments on the proposals put forward in this paper and in particular on the specific questions listed in section 2 of this paper.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed/ rationale proposed; and
- describe any alternative regulatory choices the EBA should consider.

## Submission of responses

To submit your comments, click on the 'send your comments' button on the consultation page by 26.06.2017. Please note that comments submitted after this deadline, or submitted via other means may not be processed.

## Publication of responses

Please clearly indicate in the consultation form if you wish your comments to be disclosed or to be treated as confidential. A confidential response may be requested from us in accordance with the EBA's rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

## Data protection

The protection of individuals with regard to the processing of personal data by the EBA is based on Regulation (EC) No 45/2001 of the European Parliament and of the Council of 18 December 2000 as implemented by the EBA in its implementing rules adopted by its Management Board. Further information on data protection can be found under the Legal notice section of the EBA website.

## 2. Consultation on the extension of the scope of the draft guidelines on connected clients

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### 2.1 Background and rationale

1. The objective of the definition of ‘group of connected clients’ in Article 4(1)(39) of Regulation (EU) No 575/2013<sup>1</sup> (i.e. Capital Requirements Regulation – ‘CRR’) is to identify clients so closely linked by idiosyncratic risk factors that it is prudent to treat them as a single risk. Idiosyncratic risk represents the effect of risks that are specific to individual clients and arises where, in a bilateral interrelationship, financial problems of one entity are transferred via this interrelationship to another entity which otherwise would not be concerned.
2. The EBA has revised the ‘Guidelines on the implementation of the revised large exposures regime’ issued by CEBS on 11 December 2009, focusing exclusively on the issue of ‘groups of connected clients’. As a result, the EBA has publicly consulted on a draft proposal of guidelines on connected clients under Article 4(1)(39) of the CRR.<sup>2</sup> The consultation period lasted for 3 months and ended on 26 October 2016. 23 responses were received, of which 18 are available on the EBA website.<sup>3</sup>
3. The proposed draft guidelines aim at clarifying and operationalising the concept of interconnection, in particular when control or economic dependency should lead to the grouping of clients because they constitute a single risk in accordance with Article 4(1)(39) of the CRR. Therefore, both types of interconnection considered in the definition of connected clients are covered in the draft guidelines, namely:
  - i) the clients are directly or indirectly interconnected by a control relationship as defined in Article 4(1)(37) of the CRR;
  - ii) the clients are interconnected by some form of economic dependency as set out in Article 4(1)(39)(b) of the CRR, as for instance:
    - direct economic dependencies such as supply chain links or dependence on large customers, or
    - the clients have a main common source of funding in the form of credit support, potential funding or direct, indirect or reciprocal financial assistance.

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<sup>1</sup> Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 321, 30.11.2013, p. 6).

<sup>2</sup> The consultation paper is available at: <https://www.eba.europa.eu/regulation-and-policy/large-exposures/guidelines-on-connected-clients>

<sup>3</sup> The non-confidential responses are published at: <https://www.eba.europa.eu/regulation-and-policy/large-exposures/guidelines-on-connected-clients>

4. The consultation paper proposed that the guidelines apply only to the large exposures regime (part Four of the CRR). However, the concept of ‘group of connected clients’ is also used in other areas of the CRR, i.e. in the categorisation of clients in the retail exposure class for the purposes of credit risk (Article 123(c) and Article 147(5)(a)(ii)), in the development and application of rating systems (Article 172(1)(d)), in the specification of items requiring stable funding for the purposes of reporting (Article 428(1)(g)(ii)), and in the application of the SME supporting factor (Article 501(2)(c)), and also in the EBA technical standards and the EBA guidelines that refer to ‘groups of connected clients’.
5. The fact that the proposed scope of the draft guidelines was restricted to the large exposures regime has raised questions and comments among respondents to the public consultation. **Therefore the EBA is considering extending the scope of the draft guidelines on connected clients under Article 4(1)(39) of the CRR to the remaining aspects of the CRR, the EBA technical standards, and the EBA guidelines where the concept of group of connected client is relevant (see paragraph above).**
6. The extension of the scope of the draft guidelines beyond the large exposures regime would ensure the consistency in the application of the concept of connected clients across the CRR and the harmonisation of institutions’ practices. In this context it is noted that the CRR specifies a definition of ‘group of connected clients’ in Article 4(1)(39), which is applied consistently throughout the CRR. Therefore, the draft guidelines should likewise apply consistently where the CRR, the EBA technical standards, or the EBA guidelines make reference to that definition. Given that this is a material change to the draft guidelines that have been consulted upon during the summer, the EBA is now seeking feedback from stakeholders on the possible impact of this change, e.g. in their practices and capital requirements.

## 2.2 Amended scope of the draft guidelines on connected clients

7. The provisions on the subject matter and scope of application of the draft guidelines is intended to be amended as follows:

### **Subject matter and scope of application**

5. These guidelines specify the approach institutions, **as defined under point (3) of Article 4(1) of Regulation (EU) No 575/2013**, should take when applying the requirement to group two or more clients in a 'group of connected clients', ~~for the purposes of Part Four of Regulation (EU) No 575/2013 (Large Exposures)~~, because they constitute a single risk in accordance with Article 4(1)(39) of that Regulation.

### **~~Scope of application~~**

~~6. These guidelines apply to institutions to which Part Four of Regulation (EU) No 575/2013 (Large Exposures) applies, in accordance with the level of application set out in Part One, Title II, of the same Regulation.~~

#### **Question 1:**

Do you agree with this approach? Please explain how the application of the draft guidelines with the above amended scope would possibly affect current practices.

Please specify what overall impact the extended scope would have. If relevant, please differentiate between the impact of considering connected clients due to control or connected clients due to economic dependencies.

## 2.3 Specific questions on the extended scope

### **2.3.1 Retail exposure class**

8. It is likely that for retail exposures under Article 123(c) or Article 147(5)(a)(ii) of the CRR, groups of connected clients also include clients assigned to exposures classes other than the retail exposure class. It is also reasonable to assume that institutions' exposures to clients other than retail (e.g. sovereigns, large corporates) are higher, which may lead to the EUR 1 Million threshold in Article 123(c) and in Article 147(5)(a)(ii) of the CRR being exceeded. This would make clients which would have otherwise be classified as retail, but which are connected clients to those other non-retail clients, ineligible for the retail exposure class. In the EBA's view this treatment is appropriate, since in case of interconnectedness the various clients would represent a single risk for the institution, and if the exposure against them is large, then the retail treatment should not be applied.

**Question 2:**

Please explain how the application of the draft guidelines on connected clients would possibly change current practices regarding the categorisation of retail exposures?

What is the likely impact of applying the draft guidelines on connected clients to the categorisation of clients in the retail exposure class (Article 123(c) and Article 147(5)(a)(ii) of the CRR)? If there is an impact, please provide concrete examples and both qualitative and quantitative information, specifying whether the impact is related to the Standardised Approach or the IRB Approach for credit risk.

**2.3.2 Rating systems**

9. With regard to the development and application of the rating systems, it is the EBA's view that there would be no direct impact of the application of the draft guidelines on the rating systems, as Article 172(1)(d) of the CRR clearly requires that a separate rating shall be provided to each separate legal entity and that institutions shall have appropriate policies regarding the treatment of groups of connected clients.
10. Similar approach has been reflected in paragraph 61 of the EBA Guidelines on the application of the definition of default published in January 2017<sup>4</sup> where it was specified that default is identified individually with regard to each obligor, but institutions should specify policies with regard to how and when default of one entity could affect other entities within the group of connected clients.

**Question 3:**

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)?

**2.3.3 SME supporting factor**

11. In several instances, SMEs are expected to fall within a group of connected clients for which the EUR 1.5 Million threshold in Article 501(2)(c) of the CRR would be exceeded, and in such cases the SME supporting factor would not be applicable.

**Question 4:**

Please explain how the application of the draft guidelines on connected clients would possibly change current practices regarding the use of the SME supporting factor?

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<sup>4</sup> The guidelines are available at: <https://www.eba.europa.eu/regulation-and-policy/credit-risk/guidelines-on-the-application-of-the-definition-of-default>

What is the likely impact of applying the draft guidelines on connected clients to the SME supporting factor (Article 501(2)(c) of the CRR)? If there is an impact, please provide concrete examples and both qualitative and quantitative information.

#### 2.3.4 Specification of reporting requirements

12. The concept of groups of connected clients is also relevant in the specification of reporting requirements. For instance, in the area of liquidity this concept is used in the specification of items requiring stable funding that shall be reported to the competent authorities (Article 428(1)(g)(ii) of the CRR), in the reporting of concentration of funding by counterparty and concentration of counterbalancing capacity by issuer/counterparty (respectively templates C 67.00 and C 71.00 of the Commission Implementing Regulation (EU) 2016/313 of 1 March 2016 amending Implementing Regulation (EU) No 680/2014 with regard to additional monitoring metrics for liquidity reporting<sup>5</sup>).

##### Question 5:

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.

## 2.4 Next steps

13. Responses received in the context of this consultation will be considered in the finalisation of the guidelines on connected clients along with the answers received during the previous consultation on these guidelines.

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<sup>5</sup> Available at: [http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L\\_.2016.060.01.0005.01.ENG&toc=OJ:L:2016:060:TOC](http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2016.060.01.0005.01.ENG&toc=OJ:L:2016:060:TOC)