



**Large Exposure**

1 September 2009

# Background

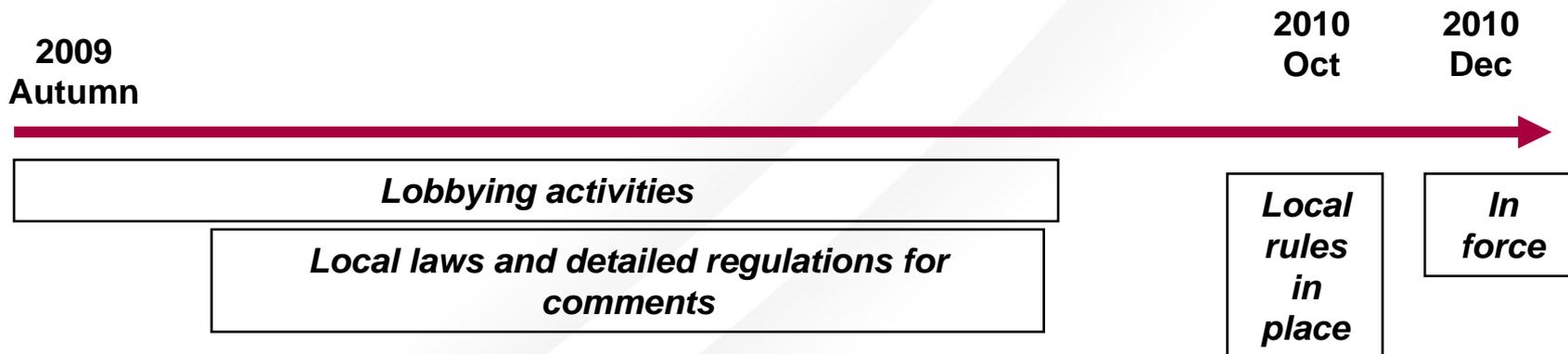
Large exposures limits prevent a bank from incurring disproportionately large losses as a result of the failure of an individual customer (or a group of connected customers) due to the occurrence of unforeseen events.

The European Parliament has recently adopted several changes in the large exposure legislation in order to;

- *harmonizing* the treatment in Europe by deleting many of national options and require common reporting principles,
- *aligning* the large exposure calculations with the methods applied for capital adequacy purposes and
- *adjusting* the treatment of certain types of exposures (e.g. exposures to banks).

*A major change is that banks will be restricted from lending beyond a certain limit (25% of the capital base) to other banks, with an exception for over night transactions in small currencies such as SEK.*

## Timeline for implementation



## Background: The main issues

- **The following new requirements in the CRD and supporting guidelines issued by CEBS are considered to have most significant impact to Nordea:**
  - Interbank exposures
  - Cross border intra group exposures
  - Extended scope in the definition of “Group of connected clients”
- **These changes will affect internal process, require pro-activity and could affect the structure in the funding procedures.**

## Regulatory changes: Interbank

- Banks will be restricted from holding aggregated exposures beyond a certain limit (25% of the capital base) to other banks *regardless of the remaining maturity*, with an exception for over night transactions in small currencies.
- The impact of this new rule might be that many banks will face problems with large exposures in the normal interbank activity. Subsequently this will lead to funding inefficiency on the market.
- This is also of highest importance when considering intra-group exposures and internal funding structure.

## Regulatory changes: Intra-group

- Member States may exempt exposures within a group from the large exposure limit. Under the current regime, all Nordic countries have implemented this rule, but only for companies within their own country.
- Sweden, has in current rules implemented the rule to accept exemption of cross-border entities within a Group.
- This option is remained unchanged in the amended CRD.
- Exposures to companies within the same group which are not subject to other deductions are in some countries limited to 20%. This limitation is removed and the limit of 25% will apply.

## Regulatory changes: Overview

- **The following new requirements in the CRD and supporting guidelines issued by CEBS are considered to have most significant impact:**
  - Interbank exposures
  - Cross border intra group exposures
  - Extended scope in the definition of “Group of connected clients”
- **These changes will affect internal process, require pro-activity and could affect the structure in the funding procedures.**

## Implications for the market/Financial institutions

Interbank implications:

- The proposed changes to large exposure regulation are likely to increase systemic risk (specifically that of liquidity) rather than reduce it. By taking away the right to make large exposure deductions on short maturity interbank assets they will reduce the liquidity of money markets and increase the risk of markets drying up when hit by an exogenous negative event. From this perspective, systemic risk is increased by the proposed changes. This regulation - with its implications to money creation that are deflationary by nature - should also be evaluated from price stability perspective, including implications to economic growth prospects. (Key point)

Treatment of cross-border intragroup units:

- This regulation also threatens the idea of single European market. It forces cross-border banks to reconsider viability of their business models as banks are forced to consider their subsidiaries practically as no longer part of the same group. From the market perspective this is likely to result in balkanisation and major loss of efficiency, both of which are unlikely to improve financial stability, nor to improve consumer access to fairly priced financial services in EU.
- As for all banks the situation will be more complicated and limited. Especially two major concerns should be noted.
  - The first is how the internal funding via a centralised function is deemed to work under the new regime if not reductions in intra-group cross border exposures will be allowed. This is highly dependent on local implementation.
  - The second concern is that room for exposures to other banks are limited to 25%, no matter if the maturity time is very short. Accordingly, there is a need for closely reviewing the impact on the business as well as the internal monitoring and follow-up processes.
- The new requirements following CEBS guideline for connected clients is challenging internal procedures and requires further focus.
- Technical implications