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OGGETTO: COMMISSIONE CREDITI E RISK MANAGEMENT

Draft RTS EBA on technical standards on the identification of a group of connected clients

Cordiali saluti

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Si informa la Commissione in oggetto che l'EBA ha pubblicato il documento per la consultazione in oggetto, recante la bozza di Regulatory Technical Standards in materia di gruppi di clienti connessi. Tale proposta di regolamentazione dà seguito al mandato contenuto nel CRR sul tema e riveduta, sostituendole in parte, le apposite linee guida già emanate da EBA nel 2017.

Il documento, allegato per pronto riferimento, è disponibile al seguente indirizzo:

<https://www.eba.europa.eu/eba-consults-technical-standards-identification-group-connected-clients>

Eventuali osservazioni e commenti possono essere trasmessi ad efact@assifact.it **entro l'8 luglio p.v.**

EBA/CP/2022/07

8 June 2022

Consultation Paper

Draft Regulatory Technical Standards

on the identification of a group of connected clients under Article 4
paragraph 1 number 39 of Regulation (EU) No 575/2013

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1. Responding to this consultation

The EBA invites comments on all proposals put forward in this paper and in particular on the specific questions summarised in 5.2.

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 08.09.2022. 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 (EU) 1725/2018 of the European Parliament and of the Council of 23 October 2018. Further information on data protection can be found under the Legal notice section of the EBA website.

2. Executive Summary

Article 4(4) of Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR) requires the EBA to submit to the Commission, by June 2020, draft regulatory technical standards (RTS) specifying in which circumstances the conditions set out in point (39) of Article 4 paragraph 1 to form a group of connected clients are met.

The EBA has already adopted in November 2017 own-initiative Guidelines on connected clients under Article 4(1)(39) of the CRR ([EBA/GL/2017/15](#)) (GL). These GL have applied since 1 January 2019 to competent authorities and institutions. They elaborate on the concepts of control and economic dependency, which are the backbone of the definition of a group of connected clients. Both concepts remain unaltered in the amended CRR.

These draft RTS revise and partially replace the GL. Sections of the GL related to the circumstances of control, economic dependencies and their interaction, will be repealed and transferred without substantial changes to the RTS. All explanatory examples, as well as further guidance on the alternative approach for exposures to central governments and supervisory expectations with regard to control and management procedures for identifying connected clients, will stay in the GL. While the draft RTS concentrate on a clear and harmonised specification of the circumstances in which the conditions set out in point (39) of Article 4 paragraph 1 of the CRR to form a group of connected clients are met, the GL contain practical examples and provide procedural guidance (i.e., when to increase efforts to identify groups of connected clients). The draft RTS in conjunction with the GL provide the complete framework for the identification of group of connected clients.

The definition of group of connected clients in the CRR allows identifying two or more natural or legal persons who are so closely linked by idiosyncratic risk factors, that it is prudent to treat them as a single risk. Idiosyncratic risk arises where, because of specific circumstances of bilateral interrelationships, financial problems of one entity are transferred to another entity or entities that otherwise would not be concerned directly. Consequently, the purpose of these draft RTS is to set out clear circumstances where interconnections by means of a control and/or an economic dependency relationship lead to a single risk and thus a grouping requirement.

The draft RTS also set out legal provisions for the assessment of situations where control and economic dependencies coexist and thus one overall group of connected clients, as opposed to two or more separate groups of connected clients, needs to be formed.

Nevertheless, the draft RTS make clear that there might be exceptional situations where the institution can demonstrate to its competent authority that circumstances prevail that refute the existence of a single risk.

Next steps

The final draft RTS will be submitted to the Commission for adoption. Following the submission, the RTS will be subject to scrutiny by the European Parliament and the Council before being published in the Official Journal of the European Union.

3. Background and rationale

1. These draft RTS revise and partially replace the EBA Guidelines ([EBA/GL/2017/15](#)) on connected clients under Article 4 paragraph 1 number 39 of the amended Capital Requirements Regulation (Regulation (EU) No 575/2013) (GL) published on 14 November 2017. These GL have been applicable to competent authorities and financial institutions since 1 January 2019.¹ Their objective was to provide clarity on the definition of connected clients as applicable from 2014 onwards. As of 18 March 2021, all EU competent authorities have declared compliance with these GL (see [guidelines compliance table](#)). The draft RTS take into account the experience gained by institutions as well as competent authorities through the application of the GL.
2. These draft RTS focus exclusively on the circumstances in which the conditions set out in Article 4 paragraph 1 number 39 of Regulation (EU) No 575/2013 to form a group of connected clients (GCC) are met. The draft RTS apply to all areas of that Regulation where the concept of a GCC is used – i.e., the large exposures regime (Part Four of that Regulation), the categorisation of clients in the retail exposure class for the purposes of credit risk (Article 123(c) and Article 147(5)(a)(ii)), the development and application of rating systems (Article 172(1)(d)), the criteria for STS securitisations qualifying for differentiated capital treatment (Article 243) and the SME supporting factor (Article 501(1)). The draft RTS also apply to EBA technical standards and EBA guidelines that refer to GCCs as defined in Article 4 paragraph 1 number 39 of Regulation (EU) No 575/2013, namely in the area of liquidity reporting, where this concept is used in the specification of items requiring stable funding that must be reported to the competent authorities (Article 428 paragraph 1 point (g)(ii) of that Regulation), and in the reporting of concentration of funding by counterparty and concentration of counterbalancing capacity by issuer/counterpart.
3. The objective of the definition of a GCC in Regulation (EU) No 575/2013 is to identify two or more natural or legal persons who are 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. Idiosyncratic risk arises where, in a bilateral interrelationship, financial problems of one entity are transferred via this interrelationship to another entity or entities that otherwise would not be concerned directly. Consequently, the purpose of the current GL (and thus also the draft RTS) is to clarify and operationalise the concept of interconnection – i.e., when a control and/or an economic dependency relationship should lead to the grouping of clients because they constitute a single risk in accordance with Article 4 paragraph 1 number 39 of Regulation (EU) No 575/2013.
4. Geographical and sectorial concentration risks fall outside the scope of these draft RTS and are addressed by other means, such as the risk management rules on concentration risk

¹ The GL revised and replaced the 'Guidelines on the implementation of the revised large exposures regime' issued by CEBS on 11 December 2009.

under Pillar 2. Geographical or sectorial risk can be defined as a dependency linked to an external factor (e.g., a certain product market or a specific region) that affects all entities active in the region or sector in the same manner. Institutions that only operate in a well-defined geographical area, or in an area dominated by one specific industry or sector, are not more affected in their conduct of business by the grouping requirement than other institutions.

5. Based on the current GL, the draft RTS shed light on when the criteria for the two types of interconnections – control and economic dependency as defined in Article 4 paragraph 1 number 39 points (a) and (b) respectively – are met. In particular, they provide guidance on how institutions shall identify GCCs following these two types of interconnections separately as well as when both conditions prevail.
6. Furthermore, the GL explain the alternative approach of grouping when the head of the group is the central government, as specified in the second subparagraph of the definition.
7. They also include a section on due diligence/governance expectations (control and management procedures for the identification of GCCs, documentation and review requirements). Clearly defined policies and procedures for determining GCCs and a diligent documentation of compliance with these policies and procedures (including a periodic review) is of crucial importance.
8. The main advantage of the GL is the possibility to have descriptive examples and illustrations of different grouping situations. Given the legal nature and formal requirements of RTS, such examples cannot be part of the legal text. However, for consultation purposes, all examples of the GL (and additional ones) were included in the background of this draft.

3.1 Legal mandate and approach retained

9. The Commission's Risk Reduction Measures Package, amending, inter alia, Regulation (EU) No 575/2013, includes new mandates for the EBA. Paragraph 4 of Article 4 mandates the EBA to:

"[...] develop draft regulatory technical standards specifying in which circumstances the conditions set out in point (39) of paragraph 1 are met.

EBA shall submit those draft regulatory technical standards to the Commission by 28 June 2020."

10. Article 4 paragraph 1 number 39 of Regulation (EU) No 575/2013 defines a GCC for the purposes of Regulation (EU) No 575/2013. The conditions set out therein refer to cases in which two or more natural or legal persons:
 - a. are directly or indirectly interconnected by a control relationship as defined in Article 4 paragraph 1 number 37 of that Regulation;
 - b. are interconnected by some form of economic dependency as set out in Article 4 paragraph 1 number 39 point (b), so that, if one of them were to experience

financial problems, in particular funding or repayment difficulties, the other or all of the others would also be likely to encounter funding or repayment difficulties.²

11. Those two conditions, which were already further elaborated on in the GL, allow identifying natural and/or legal persons so closely linked by idiosyncratic risk factors that it is prudent to treat them as a single risk. It has to be noted that the term “legal person” used in the RTS should be understood and applied to any entity other than a natural person irrespective of its national legal structure (also encompassing e.g. civil law associations). It applies also to cases where two or more natural or legal persons fall under the definition of shadow banking entities. If the reporting institution has exposures to two or more shadow banking entities that are not connected by idiosyncratic risk (i.e., neither by control nor economic dependency) then according to the EBA guidelines on limits on exposures to shadow banking entities ([EBA/GL/2015/15](#)) the institution has still to set an adequate aggregate limit to these exposures.³
12. Article 4 paragraph 1 number 39 of Regulation (EU) No 575/2013 provides two deviations from the grouping requirement: i) cases where the central government is the head of the group of connected clients and ii) cases of direct exposures to a central counterparty (CCP) for clearing activities purposes (the latter introduced by Regulation 2019/876 amending Regulation (EU) No 575/2013). As these are exemptions from the grouping requirement (and conclusively specified in level 1) they are not covered by the draft RTS (their inclusion would only result in a repetition of level 1 text).
13. The deadline included in Regulation (EU) No 575/2013 for the EBA to submit these draft RTS to the Commission was 28 June 2020. As reported in the [EBA Risk Reduction Package Roadmaps](#), published in November 2019, the EBA deemed it beneficial to allow institutions to gain sufficient experience with the application of the GL before their partial integration into the draft RTS. For this reason, the EBA is committed to submit these draft RTS to the Commission by December 2022.
14. The approach taken by the EBA in developing these draft RTS has been to leverage on the existing GL for the parts that fall under the mandate of the RTS, given that it is EBA’s understanding that the approach of the existing GL is not challenged. In this vein, sections 4, 6 and 7 of the GL will be repealed as soon as the RTS will enter into force. The GL will be amended and stay in force, with its remaining content giving guidance on the alternative approach for exposures to central governments (Section 5) and control and management procedures for identifying connected clients (Section 8). In addition, the EBA deems it useful to maintain the illustrative examples that were provided in the GL also for the parts that are now transferred to the draft RTS, as they are deemed crucial for the understanding of the requirements but cannot be part of the legal text (see Section 3.4).

² Instances where economic dependency can be assumed: i) direct economic dependencies such as supply chain links or dependence on large customers; or ii) a common main source of funding in the form of credit support, potential funding or direct, indirect or reciprocal financial assistance.

³ According to the EBA guidelines on limits on exposures to shadow banking entities which carry out banking activities outside a regulated framework under Article 395(2) of Regulation (EU) No 575/2013 ([EBA/GL/2015/20](#)), institutions set limits, as part of their internal processes, on their individual exposures to shadow banking entities and on their aggregate exposure to shadow banking entities.

3.2 Identification of a group of connected clients

3.2.1 Control relationship

15. Section 4 of the GL provides guidance when the circumstances set out in Article 4 paragraph 1 number 39 point (a) of Regulation (EU) No 575/2013 are met. This section of the GL has been transposed into Article 1 of the draft RTS.
16. Where a control relationship as defined in Article 4 paragraph 1 number 37 of Regulation (EU) No 575/2013 exists, the controlling person/entity has legally enforceable rights that establish a strong form of financial dependency on the controlling person/entity by the controlled entity. In case of financial problems of the controlling entity, it can be assumed that it will make use of its rights to extract capital and/or liquidity from the controlled entity, thereby weakening the financial position of the latter. Thus, financial problems can be transferred to the controlled entity, with the result that both the controlling person/entity and the controlled entity would experience financial problems ("domino effect"). From the perspective of prudential risk stemming from exposures to clients, it is therefore appropriate to attach the strong assumption of a single risk to a relationship of control between different natural and/or legal persons.
17. The definition of control in Article 4 paragraph 1 number 37 of Regulation (EU) No 575/2013 points to the definition of the relationship between a parent undertaking and a subsidiary, as defined in the Accounting Directive 2013/34/EU,⁴ or to the accounting standards to which an institution is subject under Regulation (EC) No 1606/2002,⁵ or to a similar relationship between any natural or legal person and an undertaking.
18. Where the Accounting Directive 2013/34/EU is applicable, it has an impact on the way institutions assess control relationships for the purposes of grouping connected clients. Taking into account that Article 22 paragraphs 1 and 2 of [Directive 2013/34/EU](#) establish several options and national discretions for Member States, the notion of a control relationship depends on the national transposition of the Directive.
19. For clients to which the EU accounting rules do not apply (e.g., natural persons, central governments and/or clients that prepare consolidated financial statements in accordance with the accounting rules of a third country), the draft RTS list circumstances that always constitute a control relationship, and additionally provides a non-exhaustive list of indicators that institutions should use when assessing the control relationship.
20. A GCC shall be identified according to Article 4 paragraph 1 number 39 point (a) of Regulation (EU) No 575/2013 when it can be concluded that there is a control relationship

⁴ Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC.

⁵ Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards.

among natural and/or legal persons (“control group”). As the definition of control presupposes a parent-subsidiary relationship, two legal persons that are subsidiaries of the same parent entity do not themselves control each other. However, when these legal persons are part of the same consolidated financial statements, the condition in Article 4 paragraph 1 number 39 point (a) of Regulation (EU) No 575/2013 is still deemed to be met, even in the absence of exposures towards the natural or legal person that controls the group.

21. For cases where no consolidated financial statements have to be prepared, the draft RTS provide a non-exhaustive list of circumstances of control criteria and control indicators for the assessment if there is a parent-subsidiary-similar relationship among natural and/or legal persons. The two-segment-list contains circumstances that always constitute a control relationship among natural and/or legal persons and indicators that should be considered by institutions in their assessment, as any of these circumstances might constitute a control relationship among natural and/or legal persons.
22. The draft RTS also address the case of intragroup exposures – i.e., when the reporting institution is itself part of a control group (in other words: an institution that is owned/controlled by another institution and they are all part of a banking group that holds participations in both financial and non-financial entities). In these cases, the institution shall consider the existence of a single risk because the entities within its own group are again being part of the same consolidated financial statement.⁶
23. It is to be noted that Article 4 paragraph 1 number 39 point (a) of Regulation (EU) No 575/2013 foresees an exception that enables the institution to abstain from forming a group of connected clients when it can demonstrate that, despite the existence of a control relationship, those natural and/or legal persons do not constitute a single risk (see [Scenario C 1](#) in Section 3.4 below).
24. In any case, the assessment of a control relationship is only the first step in the assessment of the connections among natural and/or legal persons, which is done before assessing any potential economic dependency and possible interlinkages between control and economic dependency relationships.

3.2.2 Economic dependency

25. Section 6 of the GL provides guidance when the circumstances set out in Article 4 paragraph 1 number 39 point (b) of Regulation (EU) No 575/2013 are met. This section of the GL has been transposed in Article 2 of the draft RTS.

⁶ Even though such types of exposures are likely to be fully or partially exempted – either via Article 400(1)(f), Article 400(2)(c), or Article 493(3)(c) of Regulation (EU) No 575/2013, and provided the counterparty concerned is covered by the supervision on a consolidated basis to which the institution itself is subject, it is necessary to assess the existence of a GCC in order to calculate the large exposure amount.

26. Even if the issue of control of one natural or legal person over another does not apply, institutions are obliged to assess whether there exists a relationship of economic dependency. If it is likely that the financial difficulties of one natural or legal person would spread to other(s) impacting full and timely repayment of liabilities, there exists an idiosyncratic risk that needs to be addressed by considering the natural and/or legal persons to be connected. An economic dependency among natural and/or legal persons thereby may be mutual or only one way (see Scenarios [E 1](#), [E 2](#), [E 3](#), [E 4](#), [E 6](#), [E 7](#) and [E 8](#) in Section 3.4 below).⁷
27. Dependency might arise in the context of business interconnections (e.g., supply chain links, dependence on large customers or counterparty exposures, financial dependency) that are not linked to sectorial or geographical risks, exposing the natural and/or legal persons involved to the same idiosyncratic risk factor. If this idiosyncratic risk materialises, one or both obligors are likely to experience repayment difficulties. Consequently, interconnections among entities (or persons) due to bilateral business relationships may lead to contagion risk that is independent of sectorial or geographical risks. The fact that the existence of common idiosyncratic risk factors may lead to contagion risk for otherwise unrelated natural and/or legal persons is at the core of the concept of economic interconnection.
28. In analysing economic dependencies, institutions should also consider the non-exhaustive list of situations in Article 2(1) of these draft RTS when assessing connections among shadow banking entities. Institutions should give due consideration to the fact that relationships between legal persons falling under the definition of shadow banking entities will most likely consist not of equity ties but rather of a different type of relationship – i.e., situations of de facto control or relationships characterised by contractual obligations, implicit support or potential reputational risk (e.g., sponsorship or even branding).
29. The rationale for the definition of economic interconnection is to identify channels of contagion stemming from economic dependencies that a natural or legal person cannot overcome without experiencing repayment difficulties. However, even if a natural or legal person is currently economically dependent on another person, it could still be possible for the entity to easily (i.e., in a timely manner without excessively increased costs) find a replacement or to compensate for any losses (or foregone profits) inflicted by the party in financial difficulties without experiencing own repayment difficulties. Coming to this conclusion, the institution does not need to consider these persons as a single risk.
30. Economic dependency may arise where funding problems of one natural or legal person are likely to spread to another on account of the same main funding source. This does not include cases where natural and/or legal persons get funding from the same market (e.g., the market for commercial paper) or where a common source of funding is due solely to

⁷ Dependency might arise in the context of business interconnections (e.g., supply chain links, dependency on large customers or counterparty exposures, financial dependency) that are not linked to sectorial or geographical risks, and it suggests that the natural or legal persons involved are exposed to the same idiosyncratic risk factor.

the geographical location. Small and medium-sized corporates will, in many cases, not have the capacity or commercial incentive to have financial relationships with institutions other than their local bank, and, in addition, for most of them the personal relationship with their bank officer is the key to better financial services. This fact does not in itself justify regarding these natural and/or legal persons as interconnected, even though they have a common source of funding (potentially even the reporting institution itself). Such funding dependencies can normally be replaced (see Scenario E 5 in Section 3.4 below). In the same vein, natural and/or legal persons that depend on their existing source of funding because of their poor creditworthiness also do not belong to this category.

31. Institutions should also consider cases where the common source of funding is provided by the institution itself, its financial group or its connected parties⁸ (see Scenarios [E 4](#) and [E 5](#) and [E 6](#) in Section 3.4 below) and cannot be replaced in a timely manner without excessively increased costs. Institutions should also assess any contagion or idiosyncratic risk that could emerge from the following situations:
 - a. use of one funding entity (e.g., the same entity or conduit that cannot be easily replaced);
 - b. use of similar structures (e.g., where the entity has some liquidity support mechanisms provided by a sponsor and is allowed to draw on these when experiencing financial difficulties);
 - c. reliance on commitments from one source (e.g., guarantees or other potential fundings; credit support in structured transactions or non-committed liquidity facilities, including direct, indirect or reciprocal financial assistance), taking into account its solvency, especially where there are maturity mismatches between the maturity of the underlying assets and the frequency of the refinancing needs.
32. Institutions are not required to actively collect information about whether their clients share an external common source of funding. However, institutions do need to take into account available information in this regard.
33. It shall be underlined that according to the GL institutions are expected to strengthen their investigation of economic dependencies among their clients in all cases where the sum of all exposures to one individual client exceeds 5% of Tier 1 capital. Therefore, institutions should perform an extensive research of any type of “soft information” (e.g. other public or private information available) that typically exists at the level of individual loan officers and relationship managers, even though such information goes beyond the institutions’ clients.

⁸ Recital 54 to Regulation (EU) No 575/2013 sets out that “In determining the existence of a group of connected clients and thus exposures constituting a single risk, it is also important to take into account risks arising from a common source of significant funding provided by the institution itself, its financial group or its connected parties.”

3.2.3 Interrelation between control relationship and economic dependency

34. Article 3 of the draft RTS incorporates section 7 of the GL and specifies the grouping requirement when both circumstances set out in Article 4 paragraph 1 number 39 points (a) and (b) of Regulation (EU) No 575/2013 are met; in particular, when a single risk between two or more natural and/or legal persons would lead to a chain of contagion (“domino effect”). The concepts of control and economic dependency are based on two different kinds of interconnection to be assessed separately. However, there are situations where these two types of dependencies are interlinked and could therefore co-exist within one GCC in such a way that all relevant natural and/or legal persons constitute a single risk. This happens when a GCC is first established based on a control relationship according to the legal provisions set out in Article 4 paragraph 1 number 39 point (a) of Regulation (EU) No 575/2013 and successively extended by another natural and/or legal person or a second GCC because of some form of economic dependency as set out in Article 4 paragraph 1 number 39 point (b) of Regulation (EU) No 575/2013. In their assessment, institutions should consider each case separately, i.e. identify the possible “domino effect” based on the individual circumstances (see Scenarios [C/E 1](#) to [C/E 4](#) as well as the “comprehensive group” of Scenario E 7 in Section 3.4 below).
35. The introductory wording in point (b) of Article 4 paragraph 1 number 39 of Regulation (EU) No 575/2013, “any of the following”, does not necessarily lead to two mutually exclusive grouping requirements. A control relationship establishes a very strong form of dependency between entities (control as legal dependency). Thus, it is also a manifestation of economic dependency and not a separate alternative. In addition, the wording “between whom there is no relationship of control” cannot be interpreted in a way that precludes the establishment of an overall GCC that includes both, economically dependent entities as well as controlled entities.
36. The chain of contagion leading to the possible default of some or all entities concerned is the relevant factor for the grouping and needs to be assessed in each individual case.
37. Downstream contagion should be assumed when an entity is economically dependent on another client and is itself the head of a “control group” – i.e., a GCC formed on account of the existence of a control relationship in accordance with Article 4 paragraph 1 number 39 point (a) of Regulation (EU) No 575/2013. If the other client is part of a GCC, the control group of the economically dependent entity should then be included in the GCC to which the economic dependency relationship exists. The reason for this is that, to overcome its own pending payment difficulties, the economically dependent entity will most likely withdraw resources from controlled entities, thus extending the risk of contagion downstream (see [Scenario C/E 3](#) in Section 3.4 below).
38. On the other hand, upstream contagion of entities that control the economically dependent entity should be assumed only when the controlling entity is also economically

dependent on the entity that constitutes the economic link between the two controlling groups (see [Scenario C/E 4](#) in Section 3.4 below).

3.3 Feedback from stock-take amongst competent authorities and industry representatives

39. To develop these draft RTS, the EBA conducted a stock-take amongst competent authorities (CAs) and industry representatives to gather information on past experiences, practical challenges and possible issues regarding the identification of GCCs based on the GL.
40. Overall, both the CAs and the industry representatives perceive that the GL are clear enough to allow their implementation by RTS. No significant changes or burdensome procedures related to the mapping and management of GCCs are expected. In contrast, both the CAs and the industry representatives are expecting a proportionate effort to integrate the RTS requirements in the institutions' internal systems. Most of the respondents recognized also that forming a GCC based on the application of control criteria is easier than establishing interconnectedness based on economic dependencies, as the latter is a more complex area which often depends on expert judgement and thus hampers the use of automated procedures.
41. Some respondents pointed out that more guidance is required for cases in which the reporting institution itself belongs to a GCC and cases in which for a given reporting reference date, the reporting institution does not have exposures to the head of a group, but has exposures to two or more of its subsidiaries. These two issues are currently addressed by the proposed paragraph 1 of Article 1, which sets out the legal provision for cases where the parent of a group prepares a consolidated financial statement, thus including all subsidiaries in a GCC. Another point raised was related to clarifications on the concept of "control relationship" when two or more natural persons are involved – i.e., family members, spouses or where other family ties prevail. Currently, these draft RTS set out legal provisions that apply also to natural persons, including those cases of family ties where these natural persons are legally or economically interlinked. Institutions should assess whether such ties may require forming a GCC. Therefore, these RTS cannot include a specific requirement for family ties as the case needs to be assessed individually.
42. More examples were asked also on how to manage situations of "joint control" – i.e., cases of partners owning 50% or 1/3 each. It has to be highlighted that following the feedback on the GL, it was already clarified that "joint control" does not constitute control within the meaning of Article 4(1)(37) of Regulation (EU) No 575/2013 but a form of economic dependency. [Scenario E 7](#) in Section 3.4 below provides more guidance in the case of two partners owning the same amount of shares, which could lead to a GCC because of economic dependencies. Similarly, clarifications were asked also on how to form a GCC when indirect control is performed through natural persons, concerted actions of minority shareholders, other major investors that are sleeping partners, typically passive investors or empty shell companies. The EBA notes that, in these cases, institutions shall assess the

GCC by considering the ultimate beneficiary owner of the control relationship through the circumstances listed in paragraphs 2 and 3 of Article 1.

43. In both the GL and these draft RTS, the term “significant part” is used in relation to a client’s gross receipts, expenditures, production-output, receivables and liabilities. In the stocktake it was pointed out that the inclusion of this term in the draft RTS could lead to different assessments by institutions. In LEX paragraph 10.16 a quantitative threshold of 50% or more is used instead. The EBA notes that following the consultation feedback received for the GL in 2017, most respondents rejected such a quantitative threshold. It was argued that the interpretation of a “significant part” depends on the specific situation and might involve different percentages. However, since this issue has been raised by some respondents, a question for consultation has been added in order to understand whether the introduction of such a quantitative threshold would now be deemed beneficial by the industry (after some years of practical experience with the qualitative definition).
44. More guidance was required for mixed groups, which can include firms operating in several sectors (not only the banking sector). In this case, some respondents argued that the existence of a single risk, especially when the controlling entity is non-EU, might be challenged despite the existence of a chain of control. These draft RTS set out legal provisions that, when met, require forming a GCC. For example, if the parent undertaking consolidates the non-EU subsidiaries, the GCC shall include them; or, if the parent undertaking is established in a third country (i.e., non-EU), Article 1(2) and (3) requires forming a GCC when EU accounting rules do not apply to all entities, but a control relationship exists. Moreover, economic dependencies need to be always considered. This implies that where one natural or legal person experiences financial problems, in particular funding or repayment difficulties that could spill over to the other entities, a GCC shall be formed.
45. Respondents welcomed the provision in paragraph 37 of Section 8 of the GL, which requires institutions to strengthen their investigation on GCCs based on economic dependencies when exposures are above 5% of their Tier 1 Capital. This provision will remain within the GL as guidance for institutions and in order to facilitate the procedures of assessment and management of GCCs based on economic dependencies.
46. While [Scenario C 1](#) in Section 3.4 already provides an example for situations where a single risk does not exist, further guidance was suggested for situations where ring-fencing or bankruptcy remoteness for all borrowers would not result in a GCC. The EBA notes that in these cases institutions shall assess the necessity to form a GCC based on a case-by-case analysis. Situations where a single risk does not exist may also depend on the respective insolvency law of the Member State concerned.
47. Moreover, respondents asked for clarifications around the term “not easily replaceable”, which is used in Section 6 of the GL and is related to interconnectedness based on economic dependency. The draft RTS specify that an economic dependency should be considered when a relationship with a natural or legal person cannot be replaced in a timely manner

without excessively increased costs, thus having the potential to trigger funding or repayment difficulties.

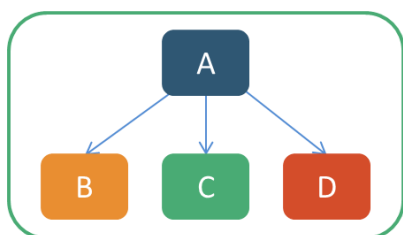
3.4 Illustration of scenarios in which the conditions set out in Article 4 paragraph 1 number 39 of Regulation (EU) No 575/2013 are met

48. The scenarios included in this section illustrate circumstances in which the conditions for GCCs set out in Article 4 paragraph 1 number 39 of Regulation (EU) No 575/2013 are (or are not) met, from the perspective of the reporting institution, for the provisions of the GL that were transferred to the RTS. The examples are unchanged compared to the ones of the existing GL. Three new examples have been added, one with regard to a simple control relationship (baseline scenario), a second with regard to the case of common ownership by two shareholders of three companies that both hold equally 50% of the shares in the respective companies, and a third with regard to the case of a horizontal group (Article 22 paragraph 7 of Directive 2013/34/EU). As the definition of a control relationship in Article 4 paragraph 1 number 39 point (a) relies on a parent-subsidary-relationship, the example of a horizontal group is discussed under the heading of economic dependencies.

3.4.1 Groups of connected clients based on a control relationship

Scenario C 0: Baseline scenario “Control relationship”

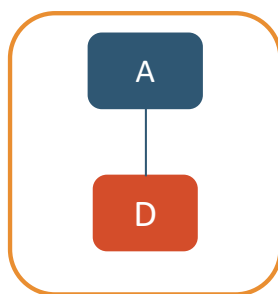
49. In the baseline scenario, the reporting institution has exposures to all entities shown below (A, B, C and D). The parent entity A prepares and publishes the consolidated financial statements according to IFRS, as legally required, including all three subsidiaries. The GCC thus encompasses all entities.



Scenario C 1: Exceptional case where no single risk exists despite the existence of a control relationship

50. The reporting institution has exposures to all entities as described in the baseline scenario C 0. Entity A has control over entities B, C and D. The subsidiaries B, C and D are special purpose entities/ special purpose vehicles (SPEs/SPVs).
51. To assess whether the assumption of a single risk can be refuted despite the existence of a control relationship, the reporting institution should assess at least all of the following elements in relation to each of the SPEs/SPVs (entities B, C and D in this scenario):

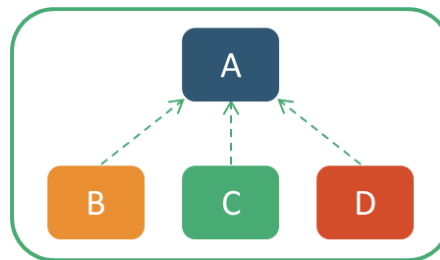
- i) The absence of economic interdependence or any other factors that could be indicative of a material positive correlation between the credit quality of the parent undertaking A and the credit quality of the SPE/SPV (B, C or D). Among other factors, the absence of a potential reliance on parent undertaking A for funding sources and circumstances of deconsolidation of the SPE/SPV under the applicable accounting rules have to be assessed as potential signs of economic independency.
 - ii) The specific nature of the SPE/SPV, especially its bankruptcy remoteness (based on Article 300 paragraph 1 of Regulation (EU) No 575/2013) – in the sense that effective arrangements exist that ensure that the assets of the SPE/SPV will not be available to the creditors of parent undertaking A in the event of its insolvency – and whether the debt securities issued by the SPE/SPV normally reference assets that are third parties' liabilities.
 - iii) The structural enhancement in a securitisation, and the de-linkage of the obligations of the SPE/SPV from those of parent undertaking A, such as the existence of provisions, in the transactions' documentation, ensuring servicing and operational continuity.
 - iv) The compliance with the provisions under Article 248 of Regulation (EU) No 575/2013 regarding arm's length conditions.
52. Having assessed all of these elements, the reporting institution could conclude that, for example, subsidiaries B and C do not constitute a single risk with parent undertaking A. As a result, the reporting institution would need to consider a GCC composed only of clients A and D. The institution should document these assessments and its findings in a conclusive way.



3.4.2 Establishing interconnectedness based on economic dependency

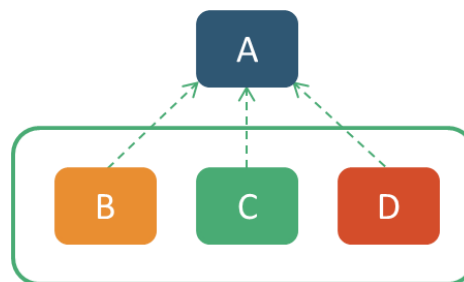
Scenario E 1: Baseline scenario “Economic dependency”

53. The reporting institution has exposures to all entities shown below (A, B, C and D). B, C and D rely economically on A. Hence, the underlying risk factor for the institution is in all cases A. The institution has to form one comprehensive group of connected clients, not three individual ones. It is irrelevant that there is no dependency among B, C and D.



Scenario E 2: Variation on baseline scenario (no direct exposure to source of risk)

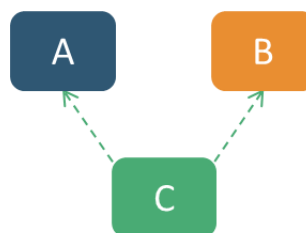
54. There is a grouping requirement even if the reporting institution does not have a direct exposure to A but is aware of the economic dependency of each client (B, C and D) on A. Potential payment difficulties of A would be contagious to B, C and D, i.e. they would all experience payment difficulties, if A gets into financial trouble. Therefore, they need to be treated as a single risk.



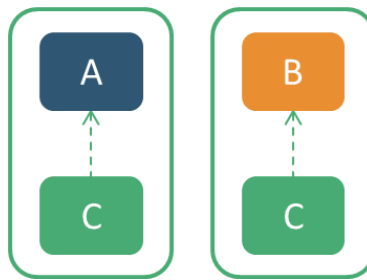
55. As in scenario E 1, it does not matter that there is no dependency among B, C and D. A causes the grouping requirement, although it is not a client of the reporting institution.

Scenario E 3: Overlapping groups of connected clients

56. If an entity is economically dependent on two (or more) other entities, it has to be included in the GCCs of both (all such) entities. Note that the payment difficulties of one of the other entities (A or B) might be sufficient to result in C being in difficulty. Also, given that neither A nor B are economically dependent on C, any difficulties of A will not be passed on to B and vice-versa, C has to be included in the GCCs of both (all such) entities:



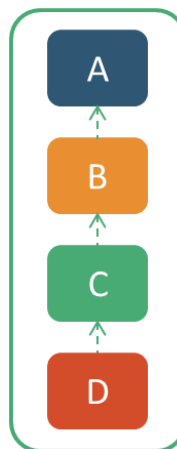
Grouping requirements:



57. The argument that the exposure to C will be counted twice is not relevant under the large exposure regime, because the exposure to C is considered a single risk in two separate groups. The large exposure limit applies separately (i.e. the limit applies once to exposures to group A/C and once to exposures to group B/C). As there is no dependency between A and B, no comprehensive group (A + B + C) needs to be formed in this example.

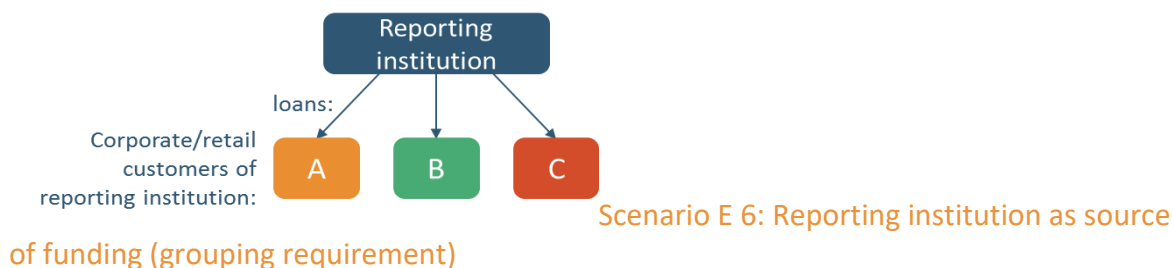
Scenario E 4: Chain of dependency

58. In the case of a “chain of dependency”, all entities that are economically dependent (even if the dependency is only one way) need to be treated as one single risk. It would not be appropriate to form three individual groups (A + B, B + C, C + D).

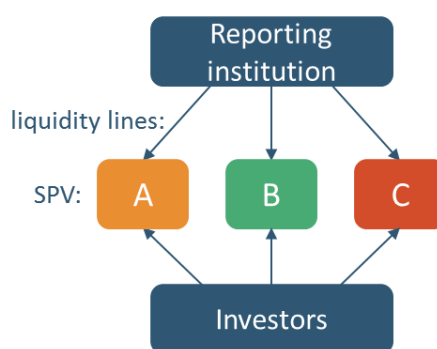


Scenario E 5: Reporting institution as source of funding (no grouping requirement)

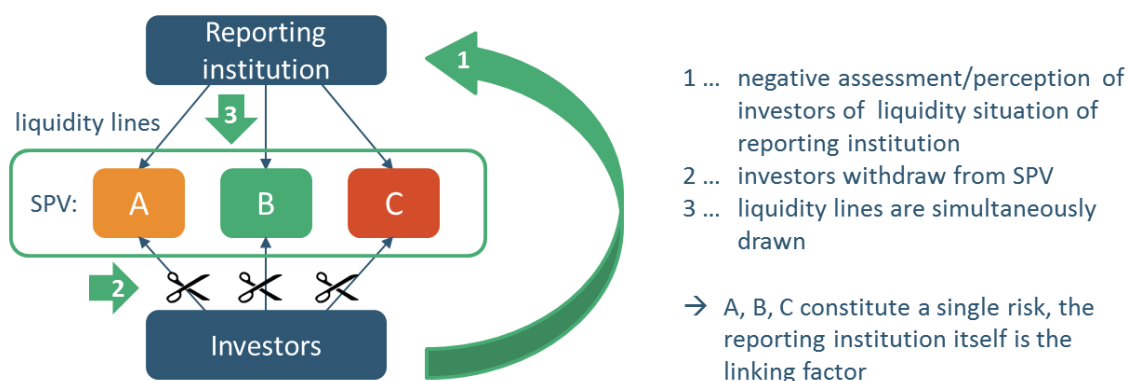
59. In the following scenario, the reporting institution is the sole provider of funds for three customers. It is not an “external funding source” that connects the three clients and it is a funding source that can be replaced in a timely manner without excessively increased costs. Thus, no GCC needs to be formed.



60. In the following scenario, the reporting institution is the liquidity provider of three SPVs or conduits (similar structures):



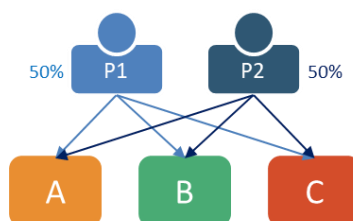
61. In such a case, the reporting institution itself can constitute the source of risk (the underlying risk factor) as recognised in recital 54 to Regulation (EU) No 575/2013 leading to a concerted action of investors:



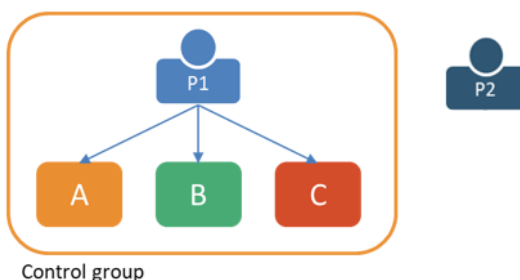
62. In the scenario above, it does not make a difference whether the liquidity lines are directly to the SPV or to the underlying assets within the SPV; what matters is the fact that liquidity lines are likely to be drawn on simultaneously. Diversification and quality of the assets are also not considered in this scenario, nor is the reliance on investors in the same sector (e.g. investors in the ABCP market), as the single risk is created by the use of similar structures and the reliance on commitments from one source (i.e., the reporting institution as the originator and sponsor of the SPVs).

Scenario E 7: Case of common ownership by two shareholders of three companies that both hold equally 50% of the shares in the respective companies

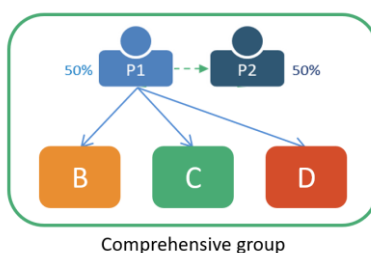
63. In the following scenario, the reporting institution has exposures to three entities (A, B and C) and to their two shareholders (P1 and P2), who own the same amount of shares (i.e., 50/50) of each of the entities.



64. In such a situation, institutions should first assess if one of the two shareholders can exercise a significant influence on the entities concerned. If this is the case (for example P1), a single group comprising of the shareholder that exercises a dominant influence and the entities concerned needs to be formed (in this case, P1 + A + B + C). This would be a case of a control group and the only grouping requirement provided there are no other connections leading to a single risk (e.g. adequate ring-fencing for P2).⁹

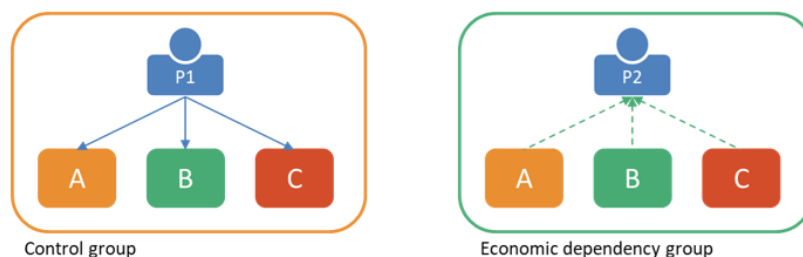


65. Secondly, the reporting institution needs to assess any economic dependencies between the persons concerned. If it cannot be ruled out that there is an economic dependency between P1 and P2, as pictured in the chart, in this case with financial difficulties that could spread from P2 to P1, a single comprehensive group (A + B + C + P1 + P2) needs to be formed (with no separate control or economic dependency groups), as also foreseen in Article 2(1)(j) of these draft RTS.



⁹ Where a shareholder owns less than 50% but still holds a significant stake and has the ability to exercise a dominant influence, institutions need to assess the grouping requirements on the basis of a case-by-case analysis.

66. In contrast, if it can be demonstrated that P1 and P2 are adequately ring-fenced and/or independent, after forming the control group, the reporting institution has still to assess whether other economic dependencies could prevail, e.g. whether financial difficulties of the other shareholder (P2) could spread to A, B and C. If this is the case, an economic dependency group comprising of the shareholder that could trigger funding or repayment difficulties and the entities concerned needs to be formed (in this case, P2 + A + B + C) in addition to the control group of P1. There may be also other cases of economic dependencies that would require other grouping solutions.



Scenario E 8: Case of horizontal group by means of economic dependencies according to paragraph 7 of Article 22 of Directive 2013/34/EU

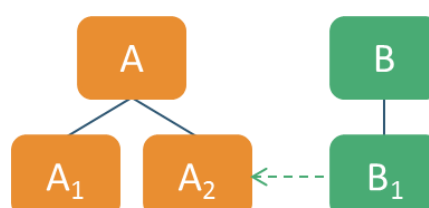
67. In the following scenario, the reporting institution has exposures to three entities (A, B and C), which are managed on a unified basis in accordance with paragraph 7 of Article 22 of Directive 2013/34/EU. In such a case a single group comprising of the entities concerned needs to be formed (in this case, A + B + C).



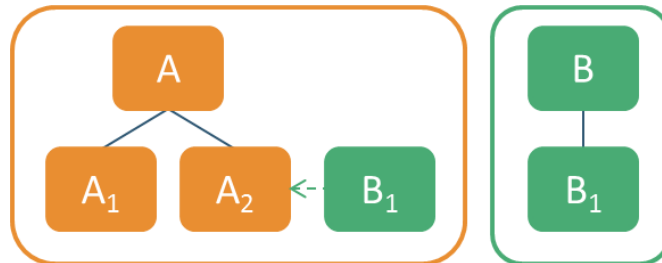
3.4.3 Relation between interconnectedness through control and interconnectedness through economic dependency

Scenario C/E 1: Combined occurrence of control and economic dependency (one-way dependency)

68. In the following scenario, the reporting institution has exposures to all entities shown in the diagram below. A controls A₁ and A₂, B controls B₁. Furthermore, B₁ is economically dependent on A₂ (one-way dependency):



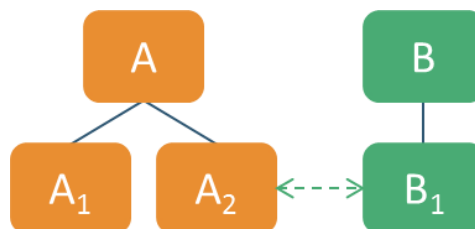
69. In this scenario, the reporting institution should come to the conclusion that B_1 is in any case to be included in the group of connected clients of A (the group thus consisting of A, A_1 , A_2 and B_1) as well as of B (the group thus consisting of B and B_1):



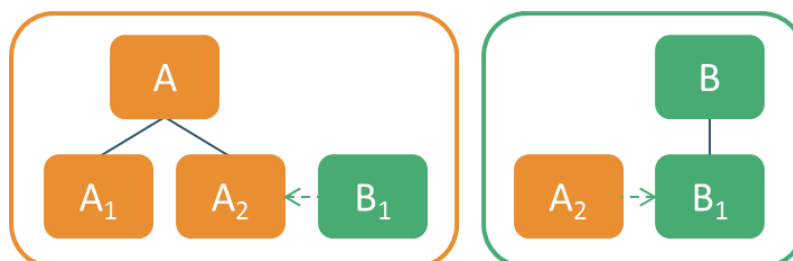
70. In case of financial problems of A, A_2 and ultimately B_1 will also experience financial difficulties on account of their legal (A_2) and economic (B_1) dependency respectively. The forming of three different groups (A + A_1 + A_2 , A_2 + B_1 , B + B_1) would not be sufficient to capture the risk stemming from A, because B_1 , although dependent on A_2 and thus on A itself, would be carved out of the single risk of group A.

Scenario C/E 2: Combined occurrence of control and economic dependency (two-way dependency)

71. In this scenario, the economic dependency of A_2 and B_1 is not only one way but mutual:

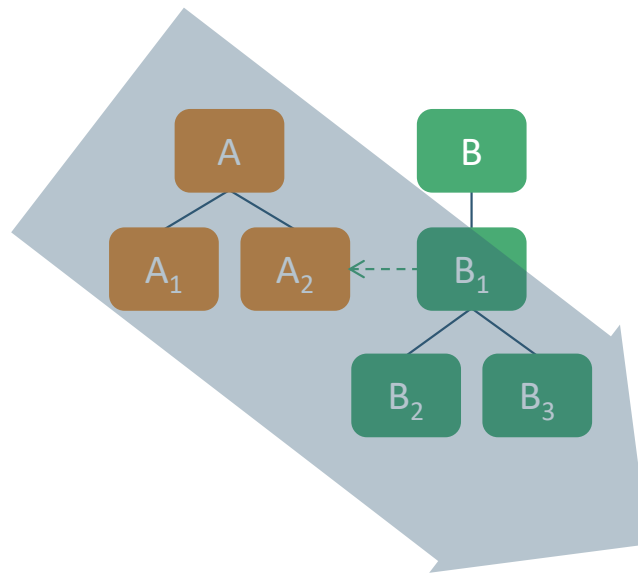


72. A_2 would need to be included additionally in group B, and B_1 would need to be included additionally in group A:

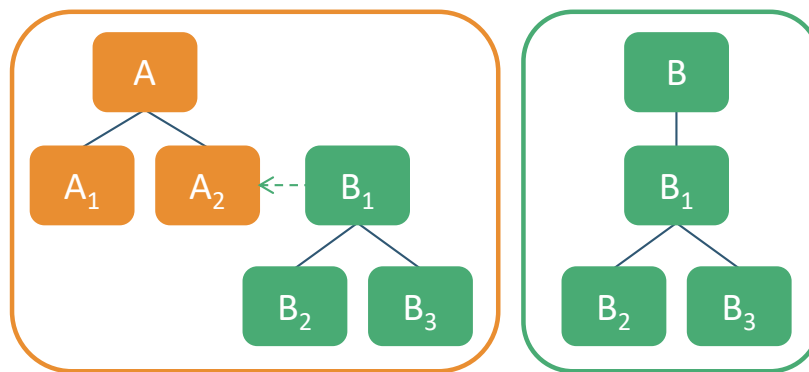


Scenario C/E 3: Downstream contagion

73. In a variation on scenario C/E 1 above, B_1 also controls two entities (B_2 and B_3). In this case, the financial difficulties of A will pass through A_2 and B_1 down to the two subsidiaries of B_1 ("downstream contagion").

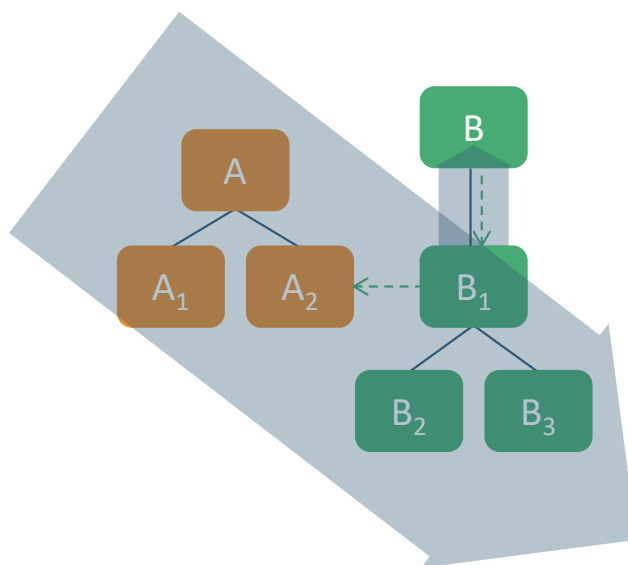


74. In this scenario, the grouping requirement shall be as illustrated below:

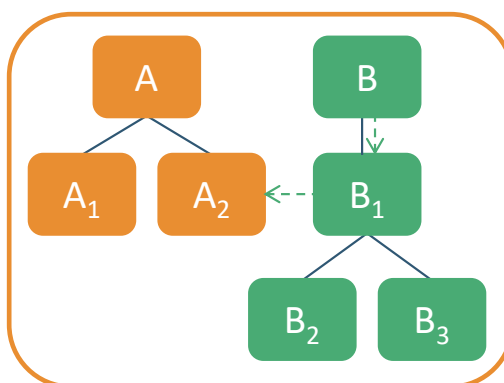


Scenario C/E 4: Upstream contagion

75. The control relationship between B and B₁ does not automatically lead to including B in the group of connected clients of A, as financial problems for A might not necessarily result in financial difficulties for B. However, the controlling entity B needs to be included in the group of A, if B₁ forms such an important part of group B that B is economically dependent on B₁. In this case, the financial difficulties of A will proceed not only downwards but also upwards to B, causing payment difficulties for B (i.e., all entities now form a single risk).



76. In this scenario, the grouping requirement shall be as illustrated below:



Questions for consultation:

- Question 1.** Could you please indicate, if the approach of sections 4, 6 and 7 of the existing EBA guidelines, now transposed in the Articles of the draft RTS, remains sound and is implementable with no major challenge or unduly high costs. Please elaborate.
- Question 2.** Have you identified any additional aspect(s) that would require clarification? In this vein, would you see the need for further illustrative examples (and if yes, on which precise situation or specific case)? Please elaborate.

4. Draft regulatory technical standards

COMMISSION DELEGATED REGULATION (EU) .../...

of XXX

supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for specifying in which circumstances the conditions set out in Article 4 paragraph 1 point (39) of Regulation (EU) No 575/2013 are met

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to 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 648/2012,¹⁰ and in particular Article 4 paragraph 4 thereof,

Whereas:

- (1) Under the large exposures framework quantitative limits are established to limit the maximum loss an institution can incur from the failure of a client or a group of connected clients. When a number of natural or legal persons are connected with specific relationships and dependencies in a way that a failure of one of the connected persons could lead to cascading failures of the rest they need to be treated as a single risk. This Regulation specifies in which circumstances the conditions set out in Article 4, paragraph 1, point (39) of Regulation (EU) No 575/2013 are met.
- (2) Identifying ‘groups of connected clients’ as per Regulation (EU) No 575/2013 should lead to identify natural or legal persons so closely linked by idiosyncratic risk factors that it is prudent to treat them as a single risk. When it is unclear under which specific category of connections under this Regulation the interconnection between different persons should be classified, a general principle of prudence should prevail leading to the assumption of the existence of a single risk and, accordingly, the circumstances listed under Articles 1 and 2 of this Regulation should be understood as non-exhaustive lists. This does not include cases where natural and/or legal persons are only linked through their dependance to common geographical or sectoral external factors.
- (3) To clarify the circumstances under which the condition of control is met for the purposes of identifying the existence of a single risk, it should be set out in this Regulation that, when two or more legal persons are part of the same financial consolidated statement, the condition of control should be deemed as met, even in the absence of exposures towards the natural or legal person that controls the group.

¹⁰ OJ L 176 27.6.2013, p. 1.

- (4) There is a need to lay down in this Regulation the circumstances, in which a single risk among one or more natural or legal persons on the basis of control exists even when consolidated financial statements are not being prepared, either because natural persons are involved, or because the legal persons are established in a third country or the legal regime applicable to these persons does not require financial consolidation. In particular, when the natural or legal person holds the majority of voting rights, or has the ability to appoint or remove the majority of the management body or exercises a dominant influence over another person, the conditions of control should be deemed as met.
- (5) In addition, this Regulation should also specify further circumstances in which two or more natural or legal persons may constitute a single risk because one of them, directly or indirectly, has control over the other or others. In particular, where the natural or legal person decides on the strategy or on important transactions of another person, or has the right or ability to coordinate the management of a person with that of other persons, these circumstances could be seen as having a dominant influence and thus meeting the conditions for a single risk on the basis of control.
- (6) This Regulation should specify those circumstances that at least should be considered when assessing economic dependency for the purpose of determining a single risk. This should not prevent institutions and competent authorities to consider further circumstances, not specifically foreseen by this Regulation. To that end, this Regulation sets out a non-exhaustive list of such circumstances. Economic dependency requires that the relationship with a natural or legal person has the potential to trigger funding or repayment difficulties and cannot be replaced in a timely manner without excessively increased costs – i.e., costs or reduced revenues that could trigger repayment difficulties.
- (7) Furthermore, this Regulation lays down the circumstances in which the conditions of control and economic dependency coexist. For this purpose, when two or more natural or legal persons constitute a single risk on the basis of control and one or more of them are so closely interlinked and interdependent with another natural or legal person or persons that they are economically dependent, all these persons constitute an overall single risk. When assessing the coexistence of control and economic dependency, institutions should consider each case separately, considering the possible connections based on individual circumstances. Where persons that are part of different control groups are also interconnected via economic dependency, all of these persons need to be grouped into one overall group of connected clients (encompassing the control group, any economically dependent person or persons and any person or persons being controlled by the latter).
- (8) This Regulation takes the possibility into account that exceptional circumstances prevail that preclude the existence of a single risk. To that end, an institution should be in a position to present adequate evidence, despite conditions of this Regulation being met among two or more natural or legal persons, that these persons need not be treated as a group of connected clients.
- (9) This Regulation is based on the draft regulatory technical standards submitted to the Commission by the European Banking Authority and builds upon the consistent

approaches already developed in the EBA Guidelines 2017/15 of 14 November 2017 as regards the implementation of Article 4(1)(39) of Regulation (EU) No 575/2013. Together with the guidance for the alternative approach for exposures to central governments and for the control and management procedures for identifying clients that constitute a single risk included in these Guidelines, it provides the complete framework for the identification of groups of connected clients.

- (10) The European Banking Authority has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the advice of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010 of the European Parliament and of the Council,¹¹

HAS ADOPTED THIS REGULATION:

Article 1

Control relationship

1. Two or more natural or legal persons shall constitute a single risk because one of them, directly or indirectly, has control over the other or others, and one of them is required to prepare consolidated financial statements including the other or others in accordance with paragraphs 1 and 2 of Article 22 of Directive 2013/34/EU or the International Financial Reporting Standard (IFRS) 10, as laid down in the national law of the respective Member State.
2. When paragraph 1 does not apply, two or more natural or legal persons shall constitute a single risk because one of them, directly or indirectly, has control over the other or others, in the following circumstances:
 - (a) the natural or legal person holds the majority of the voting rights in another person or persons;
 - (b) the natural or legal person has the right or the ability to appoint or remove the majority of the members of the administrative, management or supervisory body of another person or persons;
 - (c) the natural or legal person is in a position to exercise dominant influence over another person or persons pursuant to a law or contract, or provisions in memoranda or articles of association;
3. When paragraphs 1 or 2 do not apply, two or more natural or legal persons may be deemed to constitute a single risk because one of them, directly or indirectly, has control over the other or others, in any of, but not limited to, the following circumstances:

¹¹ Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

- (a) the natural or legal person decides on the strategy or directs the activities of another person or persons;
 - (b) the natural or legal person decides on important transactions, such as the transfer of profits or losses of another person or persons;
 - (c) the natural or legal person has the right or ability to coordinate the management of one or more natural or legal persons.
4. Paragraph 1 shall apply also where no consolidated financial statements are prepared due to exemptions or derogations set out in the Directive 2013/34/EU or the IFRS, as laid down in the national law of the respective Member State.
5. In exceptional cases, where an institution is able to demonstrate that no single risk prevails despite the circumstances of paragraphs 1, 2 or 4 of this Article being met with regard to two or more natural or legal persons, these persons need not be treated as a group of connected clients.

Explanatory box

Article 1 of these draft RTS sets out the circumstances where a single risk is deemed existing because of control, as in Section 4 of the GL. This shall be the case where two or more natural and/or legal persons constitute a single risk because one of them is required to prepare consolidated financial statements in accordance with national GAAP or IFRS. Moreover, a GCC shall be formed even when the consolidated financial statements are not prepared due to exemptions or derogations. Furthermore, paragraphs 2 and 3 of Article 1 set out circumstances that lead or may lead to a control relationship in the case no (European) consolidation requirements prevail (e.g. central governments, natural persons, third country entities or in cases of dominant influence). This article fully incorporates Section 4 of the GL on GCC based on control, with no changes.

Questions for consultation:

- Question 3.** After considering the circumstances set out in Article 1 that constitute a single risk by means of control, could you please indicate if the described circumstances are sufficiently clear? Please elaborate.
- Question 4.** Is the additional [Scenario C 0](#) related to the determination of a group of connected clients by means of control, listed in Section 3.4.1 (Groups of connected clients based on a control relationship), sufficiently clear? Would you see need for further illustrative examples of a control relationship?

Article 2
Economic dependency

1. Two or more natural or legal persons constitute a single risk because they are interconnected in a way that, where one of them were to experience financial problems, in particular funding or repayment difficulties, the other, or the others would also be likely to encounter financial problems, in at least the following circumstances:
 - (a) where the insolvency or default of a natural or legal person is likely to result in the insolvency or default of another natural or legal person or persons;
 - (b) where a natural or legal person has fully or partly guaranteed the exposure of another natural or legal person and the exposure is so significant for the guarantor that the guarantor is likely to experience financial problems if a claim occurs;
 - (c) where a significant part of a natural or legal person's gross receipts or gross expenditures is derived from transactions with another natural or legal person that cannot be replaced in a timely manner without excessively increased costs;
 - (d) where a significant part of the goods produced or services offered by a natural or legal person is sold or supplied to another natural or legal person and that relationship cannot be replaced in a timely manner without excessively increased costs;
 - (e) where a significant part of the receivables or liabilities of a natural or legal person is to another natural or legal person;
 - (f) where the expected source of funds to repay the loans of two or more natural or legal persons is the same and none of these persons has another independent source of income from which the loan may be serviced and fully repaid, and the expected source of funds cannot be replaced in a timely manner without excessively increased costs;
 - (g) where it is expected that the financial problems of one natural or legal person would cause difficulties for another natural or legal person to fully and timely repay its liabilities, because the persons are legally or contractually jointly liable to the institution;
 - (h) where two or more natural or legal persons rely on the same source for the majority of their funding and, in the event of insolvency or default of that source of funding, that source of funding cannot be replaced in a timely manner without excessively increased costs;
 - (i) where two or more natural or legal persons are managed on a unified basis according to point (a) of paragraph 7 of Article 22 of Directive 2013/34/EU;

- (j) where the administrative management or supervisory bodies of two or more legal persons consist for a major part of the same persons, common owners, managers or shareholders.
- 2. In exceptional cases, where an institution is able to demonstrate that no single risk prevails despite one or more of the circumstances of this Article being met with regard to two or more natural or legal persons, these persons need not be treated as a group of connected clients.

Explanatory box

Article 2 specifies the circumstances where a GCC shall be formed because it is expected that the financial problems of one natural or legal person would cause difficulties for the other natural or legal person. It fully incorporates Section 6 of the GL and is also complemented by the requirements in LEX 10.16 (6) and (7).

Questions for consultation:

- Question 5.** After considering the circumstances set out in Article 2 that constitute a single risk by means of economic dependency, could you please indicate if the described circumstances are sufficiently clear? Please elaborate.
- Question 6.** In point (c) of Article 2(1), would you prefer following a quantitative approach by replacing the term “significant part” with a threshold of “50% or more” as envisaged in point 1 of LEX 10.16? What would be the advantages or disadvantages? Please elaborate.
- Question 7.** What is your view on the wording “*that cannot be replaced in a timely manner without excessively increased costs*” compared to the wording used in the GL “*that cannot be easily replaced*”? What do you think about this change, is it more comprehensible? Please elaborate.
- Question 8.** Is the additional [Scenario E 8](#) related to the determination of a group of connected clients by means of economic dependencies, listed in Section 3.4.2 (Establishing interconnectedness based on economic dependency), sufficiently clear? Would you see need for further illustrative examples of an economic dependency relationship? Please elaborate.

Article 3

Combined existence of control relationships and economic dependencies

- 1. Without prejudice to Article 1 paragraph 5 and Article 2 paragraph 2, three or more natural or legal persons shall constitute a single risk, when two or more of these

persons constitute a single risk by means of control in accordance with Article 1 (control group) and one or more natural or legal persons are connected to one or more of the persons being part of the control group by means of economic dependency in accordance with Article 2.

2. Where the person that is connected by means of economic dependency as referred to in paragraph 1 is part of another group of connected clients, all persons, either being controlled by that economically dependent person or being themselves economically dependent on that person, shall also constitute a single risk with the persons of the control group as referred to in paragraph 1.
3. In exceptional cases, where an institution is able to demonstrate that no single risk prevails despite the circumstances of this Article being met with regard to three or more natural or legal persons, these persons need not be treated as a group of connected clients.

Explanatory box:

Article 3 specifies the circumstances where a GCC shall be formed because persons are interconnected through control and economic dependencies. It fully incorporates Section 7 of the GL.

Questions for consultation:

Question 9. After considering the circumstances set out in Article 3 that constitute a single risk by means of the combined existence of control and economic dependencies, could you please indicate if the described circumstances are sufficiently clear? Please elaborate.

Question 10. Is the additional [Scenario E 7](#) related to the determination of a group of connected clients by means of the combined existence of control and economic dependencies, listed in Section 3.4.3 (Relation between interconnectedness through control and interconnectedness through economic dependency), sufficiently clear? Please elaborate.

Article 4

Entry into force

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the Commission
The President

[For the Commission
On behalf of the President
[Position]

5. Accompanying documents

5.1 Draft cost-benefit analysis / impact assessment

1. These draft RTS revise and partially replace the EBA GL ([EBA/GL/2017/15](#)) on the identification of GCCs under Article 4 paragraph 1 number 39 of amended Regulation (EU) No 575/2013. These GL have been applicable to competent authorities and financial institutions since 1 January 2019. The draft RTS take into account the experience gained by institutions as well as competent authorities through the application of the GL.
2. To develop these draft RTS, the EBA conducted a stock-take amongst NCAs and industry representatives to gather information on past experiences, practical challenges and possible issues regarding the identification of GCC based on the GL. Overall, both the NCAs and the industry representatives perceive that the GL are clear enough to allow their implementation in form of RTS.
3. The present analysis provides the reader with an overview of the findings as regards problem identification, possible options to address them and their potential impacts. Given the nature and the scope of the RTS, and pursuant to the principle of proportionality, this analysis is high-level and qualitative in nature. Only a qualitative analysis is provided with regard to the potential impact of the options; a quantitative analysis is presented with the aim to provide information on the materiality of the phenomena discussed.
4. The qualitative analysis presents the advantages and disadvantages of different options. Moreover, the quantitative analysis relies on information available through the Supervisory Reporting Templates (i.e., COREP). This way, it was not necessary to collect information from NCAs or directly from the institutions.¹²

A. Problem identification and baseline scenario

5. The Large Exposures framework acts as a backstop to limit: i) institution's losses; and ii), the impact that the default of a substantial exposure could have on the stability of an institution and the banking sector in the Union. With the aim to mitigate contagion effects due to persons so interconnected that the financial difficulties of one of them could translate in funding or payment problems for the others, the Large Exposures limits apply not only to single clients, but also to groups of connected clients, which need to be formed in case of a control or economic dependency relationships or when both grouping requirements prevail.
6. According to Article 4 paragraph 1 number 39 of Regulation (EU) No 575/2013, two or more natural or legal persons constitute a single risk because of connections between them based

¹² Making ad hoc data collections is a costly and time-consuming process. For this reason, it is preferable, whenever it is possible to exploit data that are readily available from statistical agencies and databases.

on a control or an economic dependency relationship. Institutions are required to identify such connections when assessing their clients for the application of the Large Exposures framework. However, this definition needs to be complemented with the draft RTS that defines the circumstances in which two or more natural or legal persons shall constitute a single risk.

B. Policy objectives

7. The concept of a GCC is relevant not only for the application of the Large Exposures regime but also to other areas of that Regulation, namely the categorisation of clients in the retail exposure class for the purposes of credit risk (Articles 123 first subparagraph point (c) and 147 paragraph 5 point (a)(ii)), the development and application of rating systems (Article 172 paragraph 1 point (d)), the criteria for STS securitisations qualifying for differentiated capital treatment (Article 243), the specification of items requiring stable funding for reporting purposes (Article 428 paragraph 1 point (g)(ii)) and the SME supporting factor (Article 501 paragraph 1). Moreover, the concept of GCCs is also referred to in the area of liquidity reporting.
8. To ensure a prudent and harmonized application by institutions in the Union of all requirements of the Prudential Regulation referring to GCCs, an “operational” definition of the circumstances where a GCC shall be formed appears necessary.

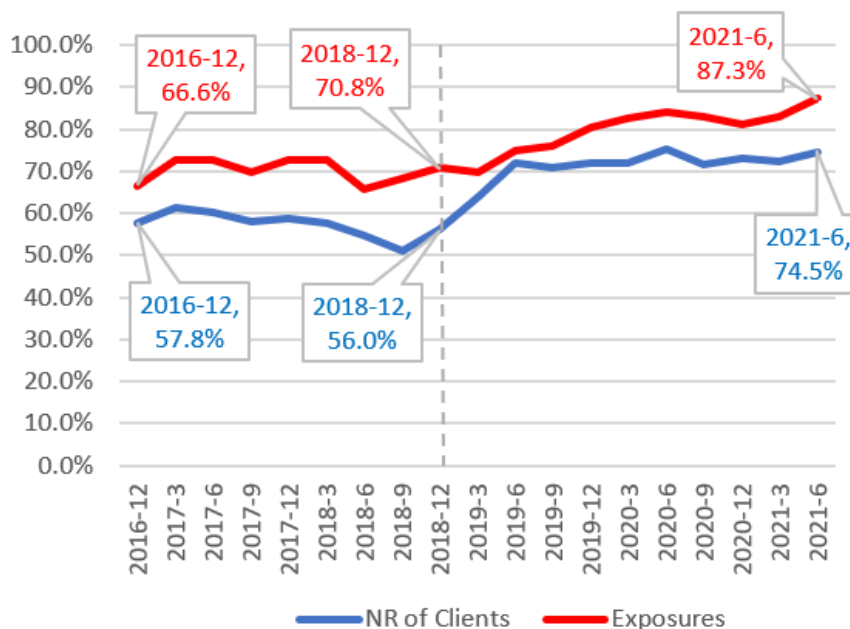
Qualitative Analysis

9. These RTS have been preceded by the publication of GL, which allowed to leverage on the experiences accumulated by institutions so far. On the basis of the stock-take conducted by the EBA, it emerged that both the NCAs and the industry representatives perceive the GL as sufficiently clear to allow their implementation by RTS. No significant changes of the procedures related to the mapping and management of GCCs are expected as a consequence.

Quantitative Analysis

10. According to Article 394 of Regulation (EU) No 575/2013, institutions are required to report on a quarterly basis detailed information about their large exposures.
11. Figure 1 shows the share of clients reported as GCCs, and the relative share of total exposures stemming from them. This figure is based on data from over 200 banks reporting at the highest level of consolidation. Until end-2018, the relative importance of GCCs was constant as % of total reported clients and as % of total exposures. From 2019 (year of entering into force of the GL), an increasing trend can be observed for both ratios. This could be justified by the increased commitment by the institutions to identify interconnected clients.

Figure 1: Relative share of reported clients with economic connections and relative total exposures associated with these clients.



Source: COREP C.28 and C.29.

Scope of application

12. The main options considered regarding the scope of application are the following:
 - (a) No action;
 - (b) Development and publication of a list of GCCs; and
 - (c) Development of RTS for the identification of the GCCs (complemented by GL).
13. As regard the first point – i.e. the typical “zero” option; it should be taken into consideration whenever the costs of the proposed regulation is deemed higher than its benefits. In this specific case, the correct and homogeneous identification of GCCs appears as key element of the application of several provisions in Regulation (EU) No 575/2013.
14. The definition and maintenance of a list of GCCs at the European level could shape considerable costs for both the Regulator and the institutions. Indeed, a detailed data collection at client level would be needed. In any case, the identification of the economic connections between the customers of a bank when made by a party external to the bank would hardly be complete given the importance of soft information that are not generally available.
15. Conversely, the GL and the draft RTS do not impose structural costs, like additional reporting requirements, but set some common principles that help to increase the harmonization among EU institutions.

Preferred option

Considering both the possible materiality of losses stemming from large exposures and the need to ensure a harmonized application of the Regulation across EU institutions, it is deemed that the benefits of the RTS outweigh the costs. Furthermore, in this specific circumstance, the fact that the RTS have been preceded by the publication of GL, enables to verify ex-post the effectiveness of this initiative, with Figure 1 showing that after the publication of the GL, intuitions started to pay more attention to the identification of GCCs.

5.2 Overview of questions for consultation

- Question 1.** Could you please indicate, if the approach of sections 4, 6 and 7 of the existing EBA guidelines, now transposed in the Articles of the draft RTS, remains sound and is implementable with no major challenge or unduly high costs. Please elaborate.
- Question 2.** Have you identified any additional aspect(s) that would require clarification? In this vein, would you see the need for further illustrative examples (and if yes, on which precise situation or specific case)? Please elaborate.
- Question 3.** After considering the circumstances set out in Article 1 that constitute a single risk by means of control, could you please indicate if the described circumstances are sufficiently clear? Please elaborate.
- Question 4.** Is the additional Scenario C 0 related to the determination of a group of connected clients by means of control, listed in Section 3.4.1 (Groups of connected clients based on a control relationship), sufficiently clear? Would you see need for further illustrative examples of a control relationship?
- Question 5.** After considering the circumstances set out in Article 2 that constitute a single risk by means of economic dependency, could you please indicate if the described circumstances are sufficiently clear? Please elaborate.
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- Question 7.** What is your view on the wording “that cannot be replaced in a timely manner without excessively increased costs” compared to the wording used in the GL “that cannot be easily replaced”? What do you think about this change, is it more comprehensible? Please elaborate.
- Question 8.** Is the additional Scenario E 8 related to the determination of a group of connected clients by means of economic dependencies, listed in Section 3.4.2 (Establishing interconnectedness based on economic dependency), sufficiently clear? Would you see need for further illustrative examples of an economic dependency relationship? Please elaborate.
- Question 9.** After considering the circumstances set out in Article 3 that constitute a single risk by means of the combined existence of control and economic dependencies, could you please indicate if the described circumstances are sufficiently clear? Please elaborate.
- Question 10.** Is the additional Scenario E 7 related to the determination of a group of connected clients by means of the combined existence of control and economic dependencies, listed in Section 3.4.3 (Relation between interconnectedness through control and interconnectedness through economic dependency), sufficiently clear? Please elaborate.