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EBA's Final Report on Draft Technical Standards on the Identification of a Group of Connected Clients



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On 20 December 2022, the European Banking Authority (“EBA”) published the final report on its draft Regulatory Technical Standards on the identification of a group of “connected clients” under Article 4(4) of the Capital Requirements Regulation (Regulation (EU) No 575/2013) (“the RTS”).

The RTS transfers sections of existing own-initiative EBA Guidelines (“GL”) (in force since January 2019) into technical standard format. Those transferred sections essentially discuss the conditions required to form a group of connected clients, which concept is used in: the large exposures regime; categorisation of clients in the retail exposure class for the purposes of assessing credit risks; rating systems (development and application); criteria for STS securitisations qualifying for differentiated capital treatment; the SME supporting factor; and liquidity reporting in the context of stable funding. The GL will continue to provide guidance in its existing form on due diligence and governance expectations and the alternative approach to be used when the head of the group in question is a central government, as well as the descriptive examples currently used to assist in determining whether a connected group has been formed.

This means that the RTS sets out the elements that go towards creating the interrelationships that lead to the transfer of financial problems among a group of two or more natural or legal persons closely linked by idiosyncratic risk factors – that is, when a group of connected clients is created. In the face of an absence of industry push-back, these elements are being transferred without amendment from the GL. They cover how the two types of interconnectedness – control and economic dependency – arise and how they can interact. Control continues to arise when the would-be controller has legally enforceable rights that lead to a “strong form of financial dependency” which can lead to a domino effect should the controller encounter financial problems. Parent-subsidary relationships and being members of the same accounting group continue to be strong indicators of the

existence of a connected group. The RTS also provides a non-exhaustive list of circumstances when control criteria arise and of indicators of a parent-subsiidiary or analogous relationship.

The RTS also sets out circumstances when economic dependency can connect a group, leading to a significant uptick in the likelihood of financial difficulties spreading. Economic dependency can be mutual or one-way and should be looked at from the perspective of business interconnections in the round. The RTS sets out a non-exhaustive list of situations in which the spread of financial difficulties within a connected group can prove problematic for the full and timely repayment of liabilities. Note that the GL continue to advise that institutions should investigate the economic dependencies of particular clients when exposure to an individual client amounts to more than 5% of Tier 1 Capital.

The next stage for the draft RTS is adoption by the European Commission, followed by scrutiny from the EU Parliament and Council and publication in the EU's Official Journal.
