

An update on large exposures – PRiM seminar

Margaret Ferns

Steve Eastwood

On Thursday 13th November PRiM (the association of risk management professionals in Luxembourg) organised an evening seminar which sought to provide, "An update on large exposures" an issue that has leapt up manager's agendas in recent months thanks to the likes of Lehman Brothers, Société Générale and Bear Stearns (to name but a few) The guest speaker was Michel Dorval of Thomson Reuters Risk Management.

"Regulators are currently working on guidelines governing large exposures," he began, "But there is some concern that these new rules could increase complexity for banks, already laden with regulation." Under current guidelines, a large exposure is considered to be where exposure to an individual counterparty of group of related companies exceeds 10% of the bank's own funds. The rules lay down that the bank is not permitted to have to a single counterparty that exceeds 25% of its funds, with an additional 800% aggregate limit on large exposures.



Michel Dorval

Since these rules were set down in the 1990s and were based on the Basel I framework, the European Commission was concerned that they no longer reflected market practices and, therefore, called for a review. To this end the CEBS (the Committee of European Banking Supervisors) carried out a survey of current supervisory practices in 2006, finally sending its findings and advice to the EC in November last year. The heart of the CEBS technical advice to the Commission was two-fold; first covering the objective and purposes of large exposures and the second addressing the questions of credit risk mitigation; intra-group exposures and clear definitions.

The highlights of the CEBS' advice on large exposures were as follows...

- Large exposures are not adequately addressed by any of Basel II's three pillars, and regulatory intervention is therefore justified.
- An amended limits-based backstop regime is proposed. The current rule that a bank cannot incur an exposure to a client or group of connected clients that exceeds 25% of its own initial funds is maintained, as is an 800% aggregate limit on large exposures.
- Large and sophisticated insti-

tutions should not be exempted from large exposure limits.

- The concept of 'connected client' is clarified and broadened to include a common source of funding between counterparties as an indicator of economic interconnectedness. The publication of further detailed guidelines is recommended.
- All inter-bank exposures should be subject to a 25% of own funds limit. As a concession to smaller banks, exposures will be limited to the higher of a euro threshold amount or 25% of their own funds. The euro threshold amount will be €50 million (or €150 million if the exposures have a maturity of less than three months).
- The Committee of European Banking Supervisors proposes to maintain current national discretion on the issue of intra-group exposures. Further cost/benefit analysis is recommended.
- Credit mitigation techniques should be accorded the same treatment for large exposure purposes, as for solvency purposes, but only if the associated instruments are sufficiently liquid. Physical collateral other than real estate will not be considered eligible for large exposure purposes.

PRiM on Personal Insurance Fraud

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"Personal Insurance fraud," was the topic of the latest PRiM evening seminar, held on Monday 24th November at the Luxembourg Hilton. Gérard Voilque, who has worked for both the French police and public security services, as well as having been a police attaché to the French embassies in Cameroon, Niger and Morocco, was the invited speaker, who began by explaining.

"Personal insurance fraud is a deliberate act designed to make illegal profit from insurance," adding that, "unfortunately making a precise evaluation of it is very difficult, yet the phenomenon is vast; and ever on the up." Voilque reported that in Europe more than 8 billion euro is lost to personal insurance fraud each year and that in France alone in 2007; 18,662 frauds were detected, adding up to a total of 134.5 million euro. Personal insurance fraud, then, appears to be a lucrative business that is becoming more and more appealing to many; but why?

Greed at heart

According to Voilque, "What motivates the fraudster is mostly greed and the idea of making easy money. Perhaps they want to get back what they see as money wasted in premiums paid over the years from, what they view as, a big anonymous institution with limitless means."

However, the issue goes beyond what motivates a person to commit insurance fraud, to society itself.

"Insurers are often not popular institutions and as a result we have a permissive social context, where a blind-eye is turned to insurance fraud. Not only that, but the judicial environment and public authorities do not give the issue priority, their time and resource usually tied up in dealing with criminal activities."

Striking back

Taking this lack of legislative support and the fact that insurance fraud can take many forms, how can insurers arm themselves? "By prevention, detection, investigations and follow-up action," said Voilque. "Insurers must have a balanced anti-fraud policy that allows them to see where a fraud is most likely to happen – in other words sound risk management practices." He warned, however,



Gérard Voilque

that there is no "one size fits all" solution to insurance fraud. "Each company must find a solution that matches its commercial policy and then get measures and controls set up."

Fraud not fatal

Voilque's conclusions were as follows, "Fraud need not be fatal and it can be eradicated;

appropriate internal anti-fraud measures added to well-trained personnel will go a long way in this direction. Enlisting the help of professional associations with specific expertise (investigators for example) and making public authorities and the general public more aware of the scale of the problem should increase the will to see it eradicated."

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