

## ***Comments on the non-internal model method for capitalising counterparty credit risk exposures – 27 September 2013***

**Submitted by:** Standard Bank Group (SBG)

Reference to paper	Comment
<b>Introductory remarks</b>	
General	<ul style="list-style-type: none"> <li>In the absence of an impact analysis it is difficult to access and comment on the overall capital requirement</li> <li>The methodology seems to be very complex with too many steps and segmentations although not detailed enough to fit every portfolio perfectly, but if it was any more complex the IMM approach may as well apply</li> </ul>
<b>Proposed revisions</b>	
Alpha	
<ul style="list-style-type: none"> <li>Alpha equals 1.4, which is carried over from the multiplier set by the Basel Committee under the IMM</li> </ul>	<ul style="list-style-type: none"> <li>The use of a scalar reverses the benefit of a more complex methodology</li> <li>It would be preferable to change the calculations / add-ons for various categories of exposures</li> <li>It would be counterintuitive to use this for CCPs as it would make bilateral trades more attractive than central clearing</li> </ul>
Replacement cost and NICA	
<ul style="list-style-type: none"> <li>Replacement cost if floored at zero</li> </ul>	<ul style="list-style-type: none"> <li>We do not believe that the replacement cost should be floored at zero (Refer to PPE add-ons below)</li> </ul>
<ul style="list-style-type: none"> <li>Margined and un-margined transactions</li> <li>For margined trades, the replacement cost is:  <math>RC = \max(V - C; TH + MTA - NICA; 0)</math>  where V and C are defined as in the un-margined formulation, except that C includes the collateral balance due to past VM payments, TH is the positive threshold before the counterparty must send the bank collateral, and MTA is the</li> </ul>	<ul style="list-style-type: none"> <li>There is inconsistency in the calculation of margined and un-margined transactions and we recommend that the formulae for margined trades should be reconsidered</li> <li>The high threshold applied to margined trades should result in the outcome being economically the same as un-margined trades, although this is not the case</li> </ul>

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minimum transfer amount applicable to the counterparty	
PFE add-ons	
<ul style="list-style-type: none"> <li>Definition of notional exposure</li> </ul>	<ul style="list-style-type: none"> <li>The notional exposure has not been clearly defined in the proposed NIMM framework</li> <li>Clarity around the notional is vital due to the increase in the number of categories from CEM to NIMM</li> <li>There is still ambiguity as to which notional to apply when considering different currencies</li> </ul>
<ul style="list-style-type: none"> <li>The PFE add-on consists of (i) an aggregate add-on component, which consists of add-ons calculated for each asset class and (ii) a multiplier that allows for the recognition of excess collateral or negative mark-to-market value for the transactions</li> </ul>	<ul style="list-style-type: none"> <li>We believe that a similar multiplier should be applied to Replacement Cost, alternatively, the Replacement Cost should not be floored at zero as highlighted above</li> </ul>
<ul style="list-style-type: none"> <li>Supervisory delta adjustment is made to this trade-level adjusted notional amount based on the position (long or short) and linearity or non-linearity of the trade, resulting in an effective notional amount which is aggregated at the hedging set level</li> </ul>	<ul style="list-style-type: none"> <li>The proposed deltas are too simplistic to reflect the true delta position, however rather than adding complexity to the NIMM approach, the IMM approach could be used</li> </ul>
<ul style="list-style-type: none"> <li>Add-on for interest rate and foreign exchange derivatives</li> </ul>	<ul style="list-style-type: none"> <li>The netting rules under NIMM seem to be more stringent than CEM. Under the CEM approach, partial netting is applied across the portfolio</li> <li>We perceive that the NIMM approach to netting may harm banks with high trading volumes</li> <li>It is proposed to triangulate fx positions, although this again will increase the complexity of the calculation</li> </ul>
<ul style="list-style-type: none"> <li>An adjusted notional amount based on maturity or price is calculated at the trade level</li> </ul>	<ul style="list-style-type: none"> <li>The adjustment applied to the notional based on maturity is similar to the standardized approach. Given the markets we trade in, using outright maturity is going to be punitive. The duration approach is proposed</li> </ul>
<ul style="list-style-type: none"> <li>PPE Calculation</li> </ul>	<ul style="list-style-type: none"> <li>When considering transactions for which all future cash flows to be received are known in advance, a cap should be</li> </ul>

Reference to paper	Comment
	applied to the PFE so that the EAD is always lower than the sum of cash flows to be received
<b>Time Risk Horizon</b>	
<ul style="list-style-type: none"> <li>The Basel Committee proposes to keep the minimum time risk horizons for the NIMM consistent with the time horizons used for the IMM.</li> </ul>	<ul style="list-style-type: none"> <li>A 3/2 multiplier has been applied here. We do not believe it to be appropriate to apply a multiplier over such a comprehensive framework</li> </ul>
<b>Other</b>	
Exposure to corporates	<ul style="list-style-type: none"> <li>The NIMM methodology will result in corporate derivatives being very expensive</li> <li>With Corporate trades typically being un-margined, the impact of the NIMM methodology will be severe</li> <li>Any further granularity applied to NIMM will place it on the same level of complexity as the IMM approach</li> </ul>
<b>Reference to other areas of Basel Framework in NIMM paper</b>	
<ul style="list-style-type: none"> <li>The new proposal on the non-internal model method for capitalising counterparty credit risk exposures proposes that the leverage ratio will be calculated using the non-internal model method (NIMM) for counterparty credit risk going forward.</li> </ul>	<ul style="list-style-type: none"> <li>This will in effect result in the leverage ratio moving towards a regulatory quasi-risk metric and moves even further away from the accounting measure. This is not aligned with the original intention of the leverage ratio being a simple backstop measure. In addition to this, for an IMM (internal model method) bank, calculating the NIMM for the leverage ratio would result in a potential burden</li> </ul>
<ul style="list-style-type: none"> <li>The Basel Committee is considering replacing the CEM and SM with the NIMM in other areas of the capital framework as well. The additional areas where the NIMM could be used include the leverage ratio, large exposures, and exposures to central counterparties (CCPs).</li> </ul>	<ul style="list-style-type: none"> <li>If the bank is using the IMM approach, applying the NIMM to other areas of the Basel framework will be overly onerous</li> </ul>