THE BANKING ASSOCIATION SOUTH AFRICA

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Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

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Dear Sir / Madam

**Comments on SA-CCR – Hedging of counterparty credit risk exposures**

We thank you for allowing our members the opportunity to comment on matters relating to the hedging of counterparty credit risk exposures.

We have captured the South African banking industry's response as contained in the attached Annexure A.

We look forward to your consideration and any further engagement on the issues raised by our member banks.

Sincerely

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**Stephen Letsoenya**
**General Manager – Prudential**

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**ANNEXURE A**

**NAME OF PERSON COMPILING SUBMISSION:** **Stephen Letsoenya**
**ORGANISATION:** **The Banking Association South Africa**
**SUBMISSION DESCRIPTION** **BCBS - Hedging of counterparty credit risk exposures**

| NR | REFERENCE IN ACT/BILL/DOCUMENT | COMMENT (Why is it a problem?) | PROPOSED WORDING/COMMENT |
|---|---|---|---|
| 1. | Annex 2: Illustrative numerical example - Case 2 – page 5 | In this example, the EAD of $14 into two components - $6.9 being the protected EAD and $7.1 being the unprotected EAD. So, when CVA refers to counterparty c, is just the $7.1 unprotected EAD the EAD for counterparty c or would we still combine the total EAD at the netting set level and say the EAD of counterparty c is the $14? | Clarity on this point requested. |
| 2. | Annex 2: Illustrative numerical example - Case 2 – page 5 | It is a bit strange to recognise residual exposure to the derivative counterparty. Under current regulations the EAD would be $14 using the first example and yet based on the proposed change the EAD is 6.9 + 7.1 which is still $14.<br><br>The proposed change is understood to require to reflect residual exposure to the counterparty, however this is not achieved by changing the EAD but rather by using the RWA% of the derivative counterparty against a subset of the EAD. It just seems strange that the EAD remains the same but the | Clarity on this point requested. |

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| | | use of two different RWA% (potentially) assists in recognising some residual exposure. | |
| 3. | Annex 1: proposed amendments to the Basel Framework – page 3 | Under the revised wording for CRE51.16 (1), the retained wording implies that the counterparty credit risk charge facing the protection provider for the derivative exposure of the credit protection remains exempt.<br><br>Would this not fair reflection of the counterparty credit risk to the protection provider rather than the protected portion of the exposure to the derivative counterparty?<br><br>In other words, if the exception in CRE51.16 (1) were to be removed so that the credit protection is included in the EAD calculation facing the protection provider, while the unprotected portion is charged to the derivative counterparty. | Proposal to remove the exception of CRE51.16 (1), while also removing the wording in CRE22.79 (1) where “The protection portion is assigned to the risk weight of the protection provider.”<br><br>This would still retain the unprotected portion to be charged using the risk weight of the underlying counterparty, as outlined in the remainder of CRE22.79 (1). |
| 4. | Annex 1: proposed amendments to the Basel Framework – page 4 | Under the proposed section CRE51.19 there is reference to when a bank uses a guarantee or credit protection consistent with CRE22.80 **and** when the protection amount is fixed or capped. Given CRE22.80 refers to protection on a pro rata basis, the guarantee and credit protection can be both pro rata and fixed. | “When a bank uses a guarantee or credit derivative that is consistent with CRE22.80 to hedge against a counterparty credit risk exposure that is subject to the SA-CCR (CRE52) or IMM (CRE53) **<u>or</u>** when the protection amount is either fixed or capped … “ |

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|---|---|---|---|
| | | Is the expectation that the revised approach should be applied when a guarantee/credit protection is on a pro rata basis or when it is fixed/capped? | |
| 5. | **General** | • We believe that the SA-CCR, especially given it forms the basis of CVA, is already conservatively calibrated for the impact of collateral. Similarly, the restriction to not apply double default thinking to guarantees and credit derivatives is a conservative calibration. While ensuring that the treatment of cash collateral and guarantees is consistent is achieved through this, a simultaneous reduction of some of the conservatism that builds up to this would be sensible to ensure the cumulative conservatism isn't problematic.<br><br>• We believe that the easiest way to achieve this would be to simultaneously re-calibrate SA-CCR based on the approach in the BIS working paper no 26 (foundations of the SA-CCR), specifically the use of the exponential multiplier in the recognition of collateral. If this were moved back to the modelled multiplier, perhaps still with some level of floor (though we question why infinite collateral can't allow a transaction to reflect a 0 EAD), this would offset some of the additional | |

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| | | conservatism being brought through with this recognition of a guarantee.<br>• Considering the developing regulatory landscape in the US and the UK, any additional conservatism is likely to add to the schism between the few (smaller) jurisdictions actually adhering to Basel and the larger ones who feel they have the freedom to apply more flexibility. | |