Response to the BCBS 574 consultation on CCR management

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GENERAL REMARKS

We would like to begin by recognising BCBS's efforts to harmonise practices in CCR management at an international level. We agree that the importance of CCR has generally been underestimated and that there is room for improvement. In terms of the presented guidelines, we agree with most of them. In the following, we make some remarks and raise minor concerns regarding individual points.

FOCUS ON NBFIS

In general, many practices seem to be tailored specifically towards NBFI counterparties, either fully or to a certain extent. We believe that it could be beneficial for readability and comprehensibility of the guidelines to separate practices that aim towards NBFI or risky/complex counterparties from more general practices that also apply to banks without exposure to these kinds of counterparties.

DUE DILIGENCE AND MONITORING

1 UNDERSTANDING A COUNTERPARTY'S RISK PROFILE

Practice 1 describes due diligence and monitoring expectations for counterparties, with the aim of understanding their risk profiles. While this aim is certainly desirable for all banks and their counterparties, we believe, however, that it can only be achieved on a reasonable effort basis, particularly for the ongoing monitoring.

ONBOARDING

8 UNDERSTANDING OF CLIENT'S OVERALL RISK PROFILE

Practice 8 states that banks should collect additional disclosures and risk reports from risky and complex counterparties. We recommend stating that there are limits to the capabilities of information gathering, particularly with regard to fraud prevention for received documents. Moreover, we recommend stating that the exchange of said documents would call for sound legal frameworks, and that it could be facilitated via an incentivisation of counterparties, as explained in Practice 9.

CREDIT RISK MITIGATION

MARGINING

17 MARGIN LEVELS

Practice 17 addresses margin requirements tailored towards specific properties of portfolios and counterparties. While it is indeed desirable to have bespoke margin requirements in place, e.g., for NBFI counterparties, it could be noteworthy that, as of today, many counterparty portfolios are still unmargined in the first place and that CCR mitigation overall would benefit from introducing margining based on standard terms for those.

22 RISK APPETITE FOR MARGIN FRAMEWORK

Practice 22 demands establishing a risk appetite for deviations from margin terms. We believe that this is an unrealistic demand for many institutions, as many banks, particularly smaller ones, would first need to develop a specific risk appetite framework for CCR.

26 BASING MARGIN ON RISKS AND VULNERABILITIES

Practice 26 describes how margin requirement should be based on risks and vulnerabilities of the traded positions. It uses the terms “estimated margin” and “required margin”, which we believe are not standard terms and should be defined.

28 HAIRCUTS ON SFTS

Practice 28 states, among other things, that SFT haircuts should depend both on the riskiness of the security and the riskiness of the counterparty. We believe this statement can be misleading and that one should differentiate between contractual haircuts and haircuts applied in exposure calculations.

EXPOSURE MEASUREMENT

EXPOSURE METRICS

39 RESIDUAL TAIL RISKS

Practice 39 states that residual tail risks should also be covered to obtain a holistic view on CCR. However, it is not clearly stated what is meant by this. Can we assume that this recommendation aims at an expected shortfall metric?

POTENTIAL FUTURE EXPOSURE

51 POTENTIAL FUTURE EXPOSURE MEASUREMENT

Practice 51 requests a degree of conservatism in PFE for BAU risk limits based on the choice of risk scenarios for portfolio dynamics and collateral as well as in the treatment of excess collateral. Yet, limit management is part of pillar II, which is usually more designed towards modelling economic realities in contrast to prudent requirements from pillar I. We believe that excess conservatism could possibly undermine trust in the PFE metric.

52 ILLIQUIDITY IN EXPOSURE CALCULATION

Practice 52 describes how to deal with excessive risk from concentrated and illiquid positions / collateral. Firstly, the term “illiquid counterparties” is used, which we believe should be changed for greater clarity.

Secondly, we believe that an extension of the MPoR should only account for the expected delays in closeout, as described in the practice, and that additional measures to account for illiquidity should avoid any double counting regarding the MPoR extension.

Thirdly, the practice states that the portfolio dynamics should be simulated with stochastic models calibrated to a level of distress. It should be clarified whether this means adjusting the entire exposure simulation (i.e., a stress calibration), or rather to put an overlay of illiquid-portfolio-dynamics on top, to take effect during the MPoR.

53 INCORPORATING WWR IN PFE

Practice 53 states that PFE should be calibrated to historical and idiosyncratic scenarios to incorporate WWR, particularly for NBFIs. We think it should be further explained what is actually meant by calibrating PFE: for example, should the Archegos/Viacom market scenario be transferred to other relevant stocks, and the market model be calibrated to such “historically inspired” scenarios? Or should the mentioned overlay be calibrated to historical scenarios, and if yes, how?

56 BACKTESTING OF PFE

Practice 56 states that banks should benchmark their PFE models versus realised dynamics of publicised defaults. However, if a bank’s portfolio does not contain relevant risk factors of these incidents, it is rather difficult to map such scenarios in a meaningful way.

CCR STRESS TESTING AND SCENARIOS ANALYSIS

59 CCR STRESS TESTING ON PORTFOLIO LEVEL

Practice 59 calls for comparing stress exposures with risk limits also at aggregated portfolio level. We believe that this should include default clustering, in the sense of considering quantiles of exposures aggregated across counterparties (instead of summing over counterparty PFEs). This point could be clarified.

LIMITS

67 RISK LIMITS

The practice 67 states that risk limits should be granular enough to monitor key risks such as dispersion. It is not obvious to us what exactly is meant by the term dispersion; hence we believe it should be clarified.

69 LIMIT CALIBRATION

Practice 69 states that there are events potentially requiring a recalibration of the limit framework. We think it could be beneficial to further clarify at which level limits might change:

From our point of view, anything affecting the bank's risk appetite should trigger an overhaul of all limits, including top level limits. Likewise, changes to individual counterparties, such as rating migrations, should trigger a change of individual counterparty limits.

Counterparty limits and other types of sub-limits usually behave sub-additively towards the portfolio limit, and could, for instance, be calibrated through a credit portfolio model. Thus, changes in general market conditions and changes in methodology could require an overhaul of sub-limits, while the portfolio limit would stay aligned to the bank's risk appetite.

GOVERNANCE

MANAGEMENT REPORTING

87 PRODUCTION AND ANALYSIS OF REPORTS

Practice 87 states: "Furthermore, a bank should be able to produce and analyse reports in both normal and stressed market conditions". From our point of view, it should be clarified whether this is meant in the sense that the bank should be able to produce and analyse reports in stressed market situations, or whether the reports should be created for two different scenarios (normal and stressed). Both would be valid.

LIMIT GOVERNANCE AND EXCEPTION MANAGEMENT

94 TECHNICAL LIMIT BREACHES

Practice 94 states that technical limit breaches should "be subject to exception approvals that are sized appropriately to allow for remediation of the root cause of the breach". Strictly speaking, such a temporary and exceptional limit increase does not help in fixing the root cause of the breach; it rather allows for continued and meaningful limit monitoring while the root cause is being remediated. We believe the practice should be reformulated accordingly.

97 LIMIT SETTING

Practice 97 states that risk limits should be set in a way that is consistent with the outcome of the assessment of the counterparty, but also consistent with the ability to effectively unwind the counterparty's portfolio. However, the conditions for effective winddown are more dependent on individual deals than on the counterparty itself. Perhaps, appropriate sub-limits on product level would be helpful to take unwinding into account.

98 INTRADAY

Practice 98 encourages banks to establish ad hoc intraday exposure monitoring for assessing impacts of large intraday market moves on risk limits. In our experience, intraday capabilities pose quite some challenges for CCR / exposure systems, not just in terms of performance. Indeed, it can already be challenging to track intraday portfolio changes and their (incremental) impact on exposures, even without taking into account the processing of consistent intraday market data and the recalibration of the models.

In addition, we think that one should differentiate for which portfolios and circumstances it would be beneficial to have intraday information on limit consumption available, depending on an institution's ability to take intraday action.

INFRASTRUCTURE, DATA AND RISK SYSTEMS

102 CAPABILITIES OF SYSTEMS

Practice 102 states that systems, models, and data management capabilities should be sound and sufficiently sophisticated to support CCR measurement under BAU and stress conditions. Here, we assume this means that reports need to be successfully generated even in case a stressed market condition is experienced, e.g., that technically the process still works, models are calibrated successfully, metrics are calculated, etc. The point should be clarified.

CLOSEOUT PRACTICES

WATCH LIST PRACTICES AND DEFAULT MANAGEMENT PROTOCOL

118 BACKUPS FOR CRUCIAL VENDORS AND THIRD-PARTY RELATIONSHIPS

Practice 118 states, among other things, that banks should take special care that crucial vendors and third-party relationships have secondary providers in place as a backup strategy. Commenting solely on CCR calculations, a large majority of banks use third-party solutions for exposure calculation, and many do so as well for aggregation, monitoring, and reporting. Having a fully configured, operational, and equally sophisticated secondary exposure system ready at-hand is a rather infeasible demand to most of these banks, both in terms of administrative overhead and costs. We think that the level of sophistication of a secondary system should be clarified; for example, would a system based on SA-CCR or a more risk sensitive version of SA-CCR provide an acceptable temporary backup solution?