Deutsche Börse Group

Comments on

“Basel Committee on Banking Supervision Consultation Paper on Guidelines for Counterparties Credit Risk Management”

Frankfurt, 28 August 2024

Introduction

Deutsche Börse Group (DBG) **welcomes the efforts undertaken by the Basel Committee on Banking Supervision** to develop guidelines on the effective management of counterparty credit risk (CCR) and what constitutes a robust CCR management framework. Through the implementation of **global regulatory standards and robust risk management practices**, the market can mitigate shocks and ensure a more stable financial environment.

DBG, through its affiliate Eurex Clearing AG, offers services applying mechanisms that, amongst others, effectively manage CCR – i.e., the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flow. This would cause an economic loss where the transactions or portfolios of transactions with the counterparty have a positive economic value at the time of default.

Managing CCR is a raison d'être of a Central Counterparty (CCP). Eurex Clearing is a CCP and a clearing house, qualified in accordance with the European Market Infrastructure Regulation (EMIR) that provides appropriate risk management for, e.g., banks. Eurex Clearing also enables banks with high-risk exposures to their non-bank financial intermediary (NBFI) counterparties to make their own assessment of adequate margin levels for their counterparties.

The way central clearing operates, several elements are incorporated, i.e., not only limited to the risk measurement and mitigation through collateralization, but also pro-active credit risk management, default management, and liquidation of defaulted portfolios as well as mutualization layers aiming to contain the adverse effects that may arise from CCR.

Furthermore, and as mentioned in the BCBS guidelines, we acknowledge that 'strong governance practices are grounded in sound **preventative, detective and corrective technology and data quality controls** that facilitate the identification, monitoring, escalation and remediation of system, data and model issues. Banks with stronger practices maintain a suite of controls to support counterparty risk data aggregation and measurement.'

To this end, DBG is also well suited to offer **DLT-based solutions** that can help banks in fulfilling the requests put forward by the guidelines. **Through our partner HQLA^x**, we developed DLT solutions that may help to manage and mitigate settlement risk, including Herstatt risk. HQLA^X and DBG have formed a strategic partnership to create, operate, and develop the HQLA^X Platform, whose joint operating model provides financial market participants (notably banks) with improved collateral mobility across the traditionally fragmented securities settlement ecosystem.

Leveraging R3's Corda DLT, the HQLA^X Platform uses Digital Collateral Records ("DCRs") to evidence ownership of securities held with a third-party custodian. Using its Delivery vs. Delivery mechanism, HQLA^X enables market participants to manage securities financing transactions (SFT) efficiently from a capital perspective. The HQLA^X platform can also be leveraged for further use cases, including the management of bilateral or centrally cleared margin exposures as well as for repos. For the latter, transactions are settled on a Delivery vs. Payment basis (DvP) across two different platforms.

DBG and HQLAx are of the opinion that digital transformation, and DLT in particular, **should be closely analysed to help mitigate potential risks and to derive benefits** within the banking system as well as the financial system as a whole.

It should also be taken into account that any open SFTs like repo transactions or open derivative transactions will continue to bear the CCR. While DLT can plausibly shorten the time interval between transaction conclusion and final settlement to reduce the time gap that the counterparties are facing CCR of pending securities and cash settlements, CCR faced in open SFTs or derivatives is neither addressed nor resolved by technology yet.

CCPs continue to guarantee this by ensuring the safety and integrity of markets, especially under stressed market conditions. Moreover, the on-boarding of clients to a CCP undergoes the CCR due diligence as a crucial precondition to participation. Meanwhile, **new technologies offer complementary mechanisms to mitigate some of the risks.**

DLT-enabled collateral management to minimize intraday counterparty credit risk

DLT-based solutions can complementarily contribute to enhanced collateral mobility, improved liquidity, and reduce settlement friction, all of which will offer certainty of settlement and a mitigation of CCR – this is particularly crucial in times of stress. Given that DLT-based solutions are real-time, precise, and synchronized across multiple use cases, whether it is DvD, DvP, or real-time margining, confidence in the system consequently increases, keeping the financial markets moving through liquidity-scarce events.

With DLT solutions like HQLA^{X}, market participants can settle securities lending trades exchanging individual loan securities for collateral provisioned in triparty simultaneously. Transfer of ownership of loaned securities and collateral can take place instantaneously and in real-time, thus eliminating credit risk in the settlement cycle. The benefits of this process for credit risk mitigation are best highlighted where collateral is provisioned in one time-zone and loaned securities settle in another.

By decoupling ownership transfer from the physical movement of assets, platforms like HQLA^{x} can enable real-time margining whereby counterparty credit exposures are dynamically collateralized throughout the entire trading day, or even after market closing times, and not only at the end of a trading day. This is particularly relevant for banks with non-bank exposures, where the posting of sufficient collateral is critical for mitigating counterparty credit risks that may build up during the day. Acute intraday market volatility can lead to sudden and significant changes in counterparty credit exposure and collateral valuations, increasing the risk that the posted margin may become insufficient to cover exposures. Real-time margining, on the other hand, enables market participants to avoid outsized intraday counterparty credit exposures resulting from large intraday price swings, particularly during periods of pronounced market stress and high volatility.

Real-time data on DLT allows for accurate and timely exposure management

We acknowledge the call for banks to **create a robust Management Information System**, to **deliver timely reporting**, and to **compute CCR metrics frequently**. In particular, we understand the need for:

- Banks to regularly assess the relevance, timeliness and quality of CCR reporting. This should include, but not be limited to, an assessment of input data quality, analysis of comments on potential data anomalies, assessment of the frequency of reporting and ensuring adequate socialisation of reports within key business and oversight functions.
- Exposure metrics to be produced frequently and in a timely manner, and include all trades giving rise to CCR, across product types (e.g. bilateral, centrally cleared and exchange traded derivatives and SFTs), as well as across business lines and legal entities.
- Management reports to be comprehensive, accurate, consistent & actionable. A bank should be able to produce and analyse reports in both normal and stressed market conditions.

Benefits that DLT-based solutions offer include accurate and timely counterparty and collateral tracking across banks and non-bank institutions. As a first step, all transactions are recorded on a DLT ledger across a network of nodes, and any updates can be broadcasted to all nodes in real time. Then, DLT can integrate with various data sources and systems, allowing seamless data flow across different platforms. We consider the functionalities of DLT, especially the feature of providing real-time, accurate, accessible data across various systems and across a whole range of counterparties, which can provide reliable real-time reporting to facilitate decision-making, a strong fit with a bank's task to support a comprehensive credit risk mitigation strategy.

Looking ahead

While we would not expect regulators to directly mandate DLT as the solution for CCR, we see DLT-based solutions as appropriate tools for enabling banks to mitigate intraday counterparty credit exposures. What began as a targeted solution for particular problems, DLT-based collateral platforms are now poised to help in addressing a wide array of regulatory standards in managing counterparty and collateral exposures.

We stress the integral role of CCPs in managing and mitigating CCR. Looking into the future, DLT could support CCR risk mitigation techniques.

In this context, effective collaboration between regulators, financial institutions, and technology providers is crucial for creating robust and resilient solutions that ensure a stable financial environment.