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Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2, CH-4002 Basel, Switzerland

Ref: *"*Guidelines for counterparty credit risk management- consultative document"

The Brazilian Federation of Banks (FEBRABAN) appreciates the opportunity to comment on the Basel Committee's Public Consultation on the " Guidelines for counterparty credit risk management - consultative document."

We recognize the importance of managing counterparty credit risk ("CCR") to ensure the safety and soundness of the global banking system, particularly considering the recent bank insolvency and default of Archegos Capital Management and other recent cases of CCR mismanagement.

We also understand that effective risk management must be flexible and compatible with the relevance of operations, sufficient to adapt to changing market conditions and evolving best practices.

Therefore, although we agree with many of the overarching principles provided for in the Consultation, there are concerns that much of the guidance is overly prescriptive and does not leave adequate flexibility for banking organizations to apply their own risk-based approaches commensurate with the relevance of existing exposures.

This could also result in risk transfer to less regulated participants of the financial industry, which would be a counterproductive effect of the guidelines. The main thematic concerns of the consultation and the importance of balancing the new directives are outlined below.

Due Diligence and Monitoring

1. **The scope of any comprehensive information collection and analysis should be tailored to the exposure materiality.**

Applying the same strict information collection requirement to each counterparty may not be feasible in all cases, especially as banking organizations rely on voluntary information disclosure by counterparties.

For example, while information may be readily available for publicly held companies, detailed information may not be available to private or smaller counterparties, may be more expensive to obtain or, even in the case of public companies, may be subject to legal disclosure restrictions.

In other cases, the idiosyncratic nature of the information (e.g., counterparty proposed trading positions and portfolio samples) may make it unfeasible for banking organizations to gather and review all relevant information in a timely manner.

The guidance suggests that credit standards clearly dictate initial and ongoing due diligence expectations for different types of counterparties. The distinction between initial and ongoing counterparty monitoring is important since the latter must be proportional to the risk appetite, the characteristics of the counterparties and the exposures themselves, thus avoiding wasting resources that could be prioritized for more thorough analyses where they can truly add value in risk management.

Currently, credit officers are not required to conduct full counterparty reviews where there is little or no trading activity or exposure. In practice, a higher standard of information gathering and due diligence is used for specific types of counterparties, such as hedge funds, family offices or more sophisticated companies in specific industries, but not for all counterparties. The differentiation makes sense for counterparties with a higher risk profile.

The counterparty due diligence process is significantly more comprehensive than “know your customer” (KYC) procedures and must be more tailored, rather than applying a single standard to all counterparties.

Therefore, we recommend that the Guidelines consider the materiality and risk profile of transactions, rather than applying a single prescriptive model to any institution.

2. Banking organizations must be allowed to reasonably rely on verbal information when making credit risk decisions.

The Consultation states that "banks should also ensure that adequate proof, assurances or verification are applied as part of their due diligence processes."

Although formal written information can be more reliable, traceable and appropriate than verbal information in many cases, credit processes need to use qualitative information or periodic public information, obtained through commercial relationships and credit areas as a priority approach, which can lead to more specific reports if necessary, ensuring agility and resource optimization.

In these and other cases, **we suggest that the BCBS give banking organizations flexibility to determine whether information transmitted verbally is reliable and should not require banking organizations to document verbal interactions when this does not contribute significantly to the credit decision process.**

3. The Consultation should remove or qualify the recommendation to engage in third-party information verification services during onboarding.

The Consultation notes that, to ensure that credit risk decisions are not based on unverified or verbal information, "banks may benefit from engaging third-party information verification services."

While we recognize that third-party providers may be useful in certain cases, mandatory and uniform use of third-party providers to support disclosure verification would be costly and may reduce the timeliness of operation approvals, which may make certain types of transactions unfeasible.

We suggest that the reference to third-party information verification services be optional, limited to counterparties that require specific knowledge or to unusual structures, for which the expertise of the internal credit areas is not sufficient.

4. Intersection between Credit Risk and other secondary risks

The guidelines suggest that banks should adequately address the intersection between CCR and geopolitical or country risk. This includes managing concentration risk by establishing geographic limits, monitoring exposure, and implementing country restrictions and cross-border limits. Country risk is identified and managed within the credit risk management framework.

The guidelines also state that reputational risk can introduce unquantifiable risks that can significantly affect a counterparty's overall risk.

The industry recognizes that capturing these non-quantifiable secondary risks can be challenging, and that analyzing non-financial and reputational risks involves a degree of subjectivity.

Thus, the industry suggests mandatory analysis of other risks only when they are considered relevant.

Credit risk mitigation

5. **The level of customization of margin levels should be based on the size, complexity and exposure of the counterparty.**

The Consultation states that "margins calculated for a specific counterparty should reflect the specific vulnerabilities and exposures of its portfolio and capture material risks at the single name and risk factor level." This level of customization would be unfeasible if mandatory for all counterparties.

For large and complex counterparties or large exposures, the industry agrees that margin requirements should be tailored, as even small market movements can lead to large losses.

The associated banks suggest that the Guidelines observe that the degree of margin customization should be partially based on the nature of the counterparty and the level of exposure of the banking organization, allowing the adoption of a conservative approach as an alternative for less relevant exposures, individually or in a portfolio level.

Exposure measure

6. **Banking organizations should not be required to model wrong way risk ("WWR") independently.**

The Consultation would require banking organizations to have a dedicated WWR modelling framework. While the utility of measuring WWR in comprehensively assessing the risks of certain exposures is recognized, the utility of WWR is context-specific and should not be required as part of the quantification of counterparty exposure, except where relevant.

We suggest that the standard be changed so that institutions contemplate and formalize the criteria and controls relating to WWR as part of their credit analysis policies and guidelines.

7. **Banking organizations should have flexibility in choosing metrics depending on customers/counterparties and should not be required to use Potential Future Exposure ("PFE").**

The Consultation states that banking organizations "should quantify CCR exposure daily, using the PFE to measure future exposure against a given counterparty conditional on its default."

While there is agreement on the use of stress metrics as a guiding principle in assessing CCR, the associated banks believe that mandating the use of PFE does not reflect the full range of best practices that banking organizations currently use to manage counterparty credit risk.

We suggest that the BCBS allow banking organizations to develop appropriate metrics for use in measuring exposure, which may include PFE, but should not require any specific methodology, always conditioned and proportionate to the impact of risk factors on the bank's profitability.

8. **The Guidelines should not retroactively adjust margin period of risk ("MPOR") expectations.**

Under the Basel capital framework, a banking organization is generally required to use an MPOR of at least 10 days. The Consultation's proposed guidance to deviate from the Basel framework to account for "excessive concentration risks, liquidity risks, idiosyncratic risks" could lead to differences between risk management practices and minimum capital requirements.

Both banking organizations and supervisors have other tools to monitor and manage "excessive concentration, liquidity and idiosyncratic risks" without revisiting the highly conservative calibration of the Basel MPOR framework, which represents a multi-year multilateral negotiation and in-depth analysis of industry data.

Therefore, we recommend that the BCBS does not increase the prescribed MPOR requirements, which in turn would lead to higher capital for a highly conservative measure. Instead, this Guideline should indicate the need to assess these risks, but without prescribing the methodology for assessment, which should be organically incorporated into internal risk metrics, in the most efficient manner according to the different models adopted by each entity.

9. Stress testing should only be required for large or complex counterparties and significant risk concentrations.

The Consultation requires banking organizations to conduct a comprehensive set of severe stress tests "at the counterparty and portfolio levels."

Aiming to carry out stress tests considering the particularities of specific counterparties, a set of individual information not available on the market would be necessary, thus making application at this level of granularity unfeasible.

Stress testing is a highly complex and costly requirement, which is generally reserved for macro analysis or analysis of large or complex counterparties and **the industry recommends that this method be applied only where relevant. Moreover, the guidelines should specify that banking organizations can determine which measures to test based on their risk analysis and risk preferences.**

Governance

10. The guidelines should not require a committee dedicated to the topic.

The Consultation appears to call for an independent CCR committee. In practice, the formal collaboration between market risk and credit risk daily varies across banks and specific business models may not require a separate CCR function.
We recommend that there is no preference for autonomous CCR management, incorporating the requirements into the credit and risk committees already established, according to the governance of each institution.

11. The limit framework should be risk-based.

The Consultation requires that banking organizations "implement a transparent and actionable limit governance framework with clear and proper oversight and review." This would include a limit governance framework, including a violation remediation process, a review and challenge process, as well as a formal calibration process through a committee.

It may not be feasible for all limit violations to be subject to a formal committee process, particularly where the limit violations involve a non-material exposure or a single name. **We recommend that banking organizations adapt their limit framework according to the relevance.**

12. Independent risk management should not have exclusive authority to allocate risk-weighted assets ("RWAs").

The Consultation states that "independent risk functions should have sole authority to approve limit exceptions, as well as the authority to allocate the risk appetite – such as PFE, RWAs or stress exposure – across companies and products with the same counterparty."

While we recognize that a core function of independent risk management is to provide independent monitoring and management of risk limits, including exceptions, the allocation of RWAs is generally carried out by a first line of defense function under the supervision of independent risk management.

The Guidelines should be amended to recognize that independent risk management will have an oversight role in the process, including setting risk appetite levels, rather than having sole authority for allocation decisions.

Closeout practices

13. The Guidelines should only require biennial closeout exercises if the institution has no recent similar real-world experience.

The Consultation implies that banking organizations would be required to conduct closeout exercises annually.

Closeout exercises are expensive and time-consuming measures. While there is agreement that a banking organization should be prepared for a closeout scenario, we believe that an annual exercise requirement is unnecessary for most banking organizations and would only lead to costly re-runs rather than producing new insights into gaps in closeout procedures.

Moreover, in certain jurisdictions with more volatile economic scenarios, it is common for banks to have expertise in resolving complex situations, with restructuring, legal, credit and risk areas displaying well-structured associated operational processes, with the ability to anticipate events through watch lists or other mechanisms, making the proposed closeout exercises unnecessary.

We recommended that the requirement be biennial, if the institution's experience in addressing real cases of the same nature is not demonstrated.

Once again, we appreciate the opportunity to comment on the revisions to the "Guidelines for counterparty credit risk management- consultative document." If you have any questions about the topics addressed in this letter, please contact the undersigned at com.gestao.riscos@febraban.org.br.

Sincerely,

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