August 28, 2024

Submitted via BIS Comments Portal

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

Re: Guidelines for Counterparty Credit Risk Management

To Whom It May Concern:

The Global Financial Markets Association ("GFMA")[1] on behalf of its members welcomes the opportunity to submit comments on the Basel Committee on Banking Supervision's ("BCBS") consultation on Guidelines for Counterparty Credit Risk Management (the "Guidelines" or the "Consultation").[2] GFMA is also aware that the International Swaps and Derivatives Association ("ISDA") and Institute of International Finance are submitting a comment on the Consultation and support the recommendations in the that Letter.

The GFMA appreciates the importance of managing counterparty credit risk ("CCR") in ensuring the safety and soundness of the global banking system, especially in light of the default of Archegos Capital Management and other recent instances of CCR mismanagement. GFMA also understands that effective risk management must be flexible enough to adapt to changing market conditions, evolving best practices, and the specific characteristics of the risks being managed. Thus, while we agree with many of the overarching principles set forth in the Consultation, GFMA is concerned that many of the guidelines are overly prescriptive and leave little room for a nuanced, risk-based determinations when dealing with counterparties. The result is a framework that emphasizes risk-avoidance, rather than risk management. The ability for our members to

[1] The GFMA represents the common interests of the world's leading financial and capital market participants, to provide a collective voice on matters that support global capital markets. We advocate on policies to address risks that have no borders, regional market developments that impact global capital markets, and policies that promote efficient cross-border capital flows, benefiting broader global economic growth. GFMA brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. The Association for Financial Markets in Europe (AFME) in London, Brussels and Frankfurt, the Asia Securities Industry & Financial Markets Association (ASIFMA) in Hong Kong and Singapore, and the Securities Industry and Financial Markets Association (SIFMA) in New York and Washington are, respectively, the European, Asian and North American members of GFMA.

[2] Basel Committee on Banking Supervision, Guidelines for Counterparty Credit Risk Management (April 30, 2024), https://www.bis.org/bcbs/publ/d574.pdf.

provide critical capital markets services depends on their ability to balance the risks and rewards of their activities. A framework that incentivizes risk avoidance would increase the cost and decrease the availability of those services to the marketplace and drive growth of the unregulated sector.

In Section I of this Letter, we outline the core thematic concerns of this Letter and the importance of balancing consistency and comparability against adaptability and nuance. In Section II, we provide specific recommendations that we believe would improve the risk-sensitivity and flexibility of the Guidelines.

I. General Comments Regarding Prescriptiveness

According to the BCBS, the Consultation is "designed to be broadly applicable," and "[b]anks and supervisors are encouraged to take a risk-based and proportional approach in the application of the guidelines, taking into account the degree of CCR generated by banks' lines of business, and their trading and financing activities, as well as the complexity of such CCR exposure."[3] We agree with these objectives, and would support Guidelines that not only provide clear and instructive guidance, but that are also flexible enough to adapt to changing market conditions, evolving best practices and specific risks being managed. In this regard, we believe that in many places, the Guidelines leave little room for banking organizations to make nuanced, risk-based determinations.

Consistent with its stated objectives, it is critical that banking organizations be allowed to apply a risk-based, proportional and tailored approach to their CCR management and that the Guidelines do not result in a mere tick-box exercise by regulators and banking organizations. Over-prescription of risk management practices not only makes it more difficult and less efficient for banking organizations to continue providing critical capital markets services, but also risks incentivizing risk "monoculture" that ultimately creates fragility in the financial system. An overly prescriptive approach that does not leave appropriate flexibility for banking organizations to apply their own risked-based approaches could also result in risk transfer to less-regulated parts of the financial sector, which would be a counterproductive effect of the guidelines.

For example, in many places, the Consultation does not permit banking organizations to consider exposure or counterparty size, exposure type, or client segment when designing CCR measures. In other cases, otherwise valuable tools, such as stress testing, would be applied beyond the point of feasibility or utility. Similarly, in many places, the Consultation's burdensome information gathering requirements would outweigh any benefits, which would not uniformly or meaningfully improve banking organizations' risk management. These include a requirement to "track non-standard contractual terms," and to include in any CCR due diligence an initial "comprehensive collection and

[3] Consultation at 2

review of financial and non-financial information"[4] as well as ongoing monitoring of "updated information…[including] significant changes to how the counterparty measures and manages their risks."[5] In each case, the Consultation does not weigh whether the minimal material or useful benefit to a banking organization's assessment or management of risks is commensurate with the associated cost.

We reiterate that the GFMA supports the goals of the Consultation, but believes that the guidelines could be amended to more effectively achieve those goals. Certainly, many of the most granular and prescriptive proposed guidelines are relevant in many cases for large or significant counterparties, or material exposures. But for large categories of counterparties and exposures, imposing such requirements would make it prohibitively difficult or costly for banking organizations to provide critical services to entire market segments. The recommendations set out immediately below seek to address areas in the Consultation where these concerns are most pronounced.

II. Specific Comments

A. Due Diligence and Monitoring

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

The Consultation would require "comprehensive collection and review of financial and non-financial information – including legal, regulatory, reputational and operational risks, as well as other relevant risks" for each counterparty, including information that may be impossible to collect, collate and meaningfully assess. As we suggest above, comprehensive collection and review of information may not be uniformly feasible or useful for all counterparties, particular where the potential exposure is not material. Although the Guidelines should clearly and specifically articulate its intended objectives, it should provide banking organizations flexibility to achieve those objectives.

First, applying the same rigid information collection requirement for each counterparty may not be feasible in every instance, especially as banking organizations depend on counterparties' voluntary disclosure of information. For example, although information may be readily available for large, publicly-listed companies, detailed information may not be available for private or smaller counterparties, may be more costly to obtain, or even in the case of public companies, may be subject to legal restrictions on disclosure. In these situations, the broad scope of required information gathering contemplated by the Consultation may make it more costly or inefficient for banking organizations to trade or otherwise provide services to certain counterparties without meaningfully reducing the risk. In other cases, the idiosyncratic nature of the information (*e.g.*, counterparties'

4 Consultation at 3.
5 Consultation at 3.

proposed trading positions and sample portfolio) may render it infeasible for banking organizations to collate and review all relevant information in a timely manner. While more information may allow for better decision-making in many instances, information collection should be tailored to the exposure in question and any practical and operational considerations.

Second, detailed information may not be useful to evaluate a given counterparty, particularly when the exposure is not material. For instance, the Proposal would mandate information collection on "potential activities" or "non-financial risks" (including operational, geopolitical, reputational and etc.). Depending on the counterparty or the exposure, this information may not produce relevant benefits (*e.g.*, the presence of some risk mitigant such as collateral or a third-party guarantee may obviate the need for detailed analysis of the immediate counterparty), but could, as the Consultation describes "overwhelm users with data," and make it more difficult for banking organizations to distinguish signal from noise and achieve the objectives of the Proposal. Imposing a uniform data collection requirement in these cases would increase the time and cost of bringing on new counterparties without advancing the Consultation risk management goals.

Therefore, we recommend that the Guidelines should state the policy objectives for information collection and review, but also state that banking organizations should tailor the type of information they collect and use in evaluating CCR to the particular counterparty and transaction, taking into consideration the marginal costs and benefits of additional information. Where relevant, the Guidelines should cross reference other relevant BCBS guidance, including the "principles for operational resilience" and "principles for the sound management of operational risk."[6] The Consultation should also specifically clarify that information need not be collected to the extent that collection of information is inconsistent with relevant confidentiality or other applicable legal obligations, or where information would not materially enhance the banking organization's credit risk assessment (as would be the case with "potential activities" and many non-financial risks).

2. *Initial and ongoing counterparty monitoring should <u>each</u> be commensurate with risk appetite.*

The Consultation requires credit standards to "clearly dictate initial and ongoing due diligence expectations for different types of counterparties and conform to the bank's stated risk appetite." In this regard, the Consultation appears to suggest uniform due diligence expectations for initial and ongoing relationships for each counterparty type.

[6] BCBS, "Principles for Operational Resilience" (Mar. 31, 2021), https://www.bis.org/bcbs/publ/d516.pdf; BCBS, "Principles for the Sound Management of Operational Risk" (Jun. 30, 2011), https://www.bis.org/publ/bcbs195.pdf; and BCBS, "Revisions to the Principles for the Sound Management of Operational Risk" (Mar. 31, 2021), https://www.bis.org/bcbs/publ/d515.pdf.

Although we acknowledge the utility of due diligence and review at all stages of the credit lifecycle, there are many instances in which a fulsome review at the level of granularity contemplated by the Consultation would not be appropriate.

For example, credit officers typically do not undertake comprehensive ongoing due diligence on counterparties for which there is little business activity or exposure, because such extensive diligence would be inconsistent with the banking organization's risk appetite and limit utilization. As another example, the Consultation includes a requirement to "track non-standard contractual terms." Standard contractual terms may vary across banking organizations, and are ultimately qualitative in nature and therefore difficult to capture as data inputs. Thus, tracking and monitoring non-standard contractual terms can be resource intensive, and may be of limited utility. To maximize the utility of any contractual terms database, a banking organization should be encouraged to tailor its data collection to focus on the most material terms (*e.g.*, cross-default clauses, broad indemnifications).

Thus, we recommend that the Guidelines clarify that initial and ongoing due diligence expectations <u>each</u> should be commensurate with a banking organization's risk appetite. That way, a banking organization would be able to prioritize its resources for monitoring higher-risk counterparties and exposures.

3. *Banking organizations should be permitted to reasonably rely on verbal information when making credit-risk decisions*.

The Consultation mandates that "banks should ensure that adequate proof, assurances or verification are applied as part of their due diligence process." [7] The Consultation goes on to explain that, "[t]his type of practice helps ensure that credit risk decisions are not made based on unverified or verbal information"[8] These remarks imply that a banking organization would not be permitted to make a credit decision based on verbal information absent a corresponding written record.

While written information may in many instances be more reliable and appropriate than verbal information, in many fast-paced, relationship driven markets, counterparties may interact on the basis of verbal information. In particular, requiring banking organizations to disregard verbal information would greatly increase risk in crisis situations where such information may be vital. In these and other cases, the BCBS should afford banking organizations flexibility to determine whether information relayed verbally is reliable, and should not require banking organizations to document verbal interactions when doing so would not contribute meaningfully to the credit decisioning process. We therefore recommend that the Consultation clarify that banking organizations may take a risk-based approach and that "adequate proof" may include verbal assurances and other forms of

[7] Consultation at 5.
[8] Consultation at 5.

oral communication, even though, in some cases, it may not be appropriate to rely solely on verbal communication.

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

The Consultation notes that in order that credit risk decisions not be based on unverified or verbal information, "banks may benefit from engaging third-party information verification services."[9] Although we recognize that there are contexts in which third-party providers have utility (*e.g.*, ratings reports and credit exposure monitoring technology), mandated, uniform use of external, third-party providers to support disclosure verification raises both proprietary and practical concerns. Banking organizations often take in sensitive information during due diligence and counterparties rely on the banking organization's ability to safeguard such information. Requiring third-party verification when a banking organization is already satisfied with the credibility of information it receives increases the chances that proprietary information would be misappropriated. Moreover, any analysis would need to be vetted, cleansed and validated, which could further reduce the speed at which banking organizations receive and process information, decreasing its potential utility. In contrast, a conversation with the counterparty's relevant executives may yield much more relevant, immediate information and does not raise confidentiality concerns.

We recommend that the reference to third-party information verification services be clarified to permit the use of third-party verification services and (the use of third-party technology providers more generally, where appropriate), but should explicitly state that reliance on such services would not be expected, *e.g.*, to the extent that the risk and delay in relying on such information outweighs any marginal benefit.

5. *Profitability should remain a central focus of banking organizations' attention and should be viewed in a comprehensive manner.*

The Consultation asserts that banking organizations should not "unduly rely on profitability considerations" and, instead, discusses a number of quantitative and qualitative factors to evaluate the "reputation and creditworthiness" of a counterparty.[10] We expect the intention of the advice not to "unduly rely on profitability considerations" was meant to impart the need for banking organizations to take into account non-financial risks, especially reputational, and the full scope of financial risks, including the volatility of profitability, when deciding whether to enter into a transaction with a counterparty, but we think this point should be more precise in the final guidelines. The Consultation

[9] Consultation at 5.
[10] Consultation at 3-4.

should not frame comprehensive risk analysis as an abandonment or de-prioritization of profitability but, in fact, a more comprehensive approach to profitability.

B. Credit Risk Mitigation

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

The Consultation states that, "[c]omputed margins for a particular counterparty should be reflective of its specific portfolio vulnerabilities and exposures, and capture material risks at the single name and risk factor level."[11] This level of customization would be impractical if mandated for all counterparties. While we recognize that in some cases granular detail is valuable, mandating that level of breadth and granularity for *every* counterparty and *every* portfolio would be unfeasible and impose unnecessary costs without providing meaningful incremental credit protection.

For example, a banking organization may determine that its exposure is concentrated in a specific area, whether by jurisdiction, industry or a specific type of risk (*e.g.*, interest rates). A negative shift in such risks (*e.g.*, sanctions) may therefore affect a number of counterparties to which the banking organization is exposed. The Consultation would appear to require the banking organization to take into account individual impacts of such shifts, even though such risks may be better accounted for at the portfolio or enterprise level (such as with a hedge that protects against the decreased value in the counterparty exposure across counterparties).

For large and complex counterparties or large exposures, we agree that margin requirements should be customized given that even small market movements could lead to large losses. On the other hand, for smaller and less complex counterparties, or less material exposures, the potential for loss may be substantially lower even given the same specific portfolio vulnerabilities and material risks. In such cases, the banking organization should be provided the leeway to weigh the marginal benefit of customization against the increased cost to implement bespoke margining arrangements.

We recommend that, at the very least, the Guidelines should note that the degree of customization in margining should be based in part of the nature of the counterparty and the banking organization's level of exposure.

2. *Unless elaborated, the Guidelines should not proscribe "double benefit" from collateral.*

[11] Consultation at 7.

Paragraph 27 provides that banking organizations should not have a "double benefit from collateral in the measurement of both default and exposure risks." Although our understanding is that the reference to "double benefit" is meant to address collateral being used to both (i) reduce exposure and (ii) lower the loss given default (LGD), the phrase could be read in a number of ways (*e.g.*, as a proscription against recognizing the same item of collateral for different transactions), and, unless elaborated, is likely to introduce confusion.

C. Exposure Measurement

1. *The Guidelines should require the quantity, breadth, granularity and frequency of exposure metrics be risk-based, rather than uniformly comprehensive.*

The Consultation states that "CCR exposure metrics should be comprehensive in covering banks' material risks at portfolio, counterparty and a more granular risk factor level"[12] and that banking organizations should "rely holistically on a variety of non-equivalent risk metrics that assess all the material dimensions of CCR." The Consultation also requires banking organizations to identify idiosyncratic risks of counterparties by looking at exposures to, among other things, single risk factors.[13] We believe that this is another instance where the guidelines prescribe a "zero-risk" strategy that encourages banking organizations to avoid, rather than manage, risks.

A critical part of an effective CCR process is demonstrating understanding of when additional information is needed, and when more information is likely to obfuscate more relevant considerations. Within reason, banking organizations should be allowed (and expected) to have the flexibility to make these determinations. Although we agree that for certain portfolios, a comprehensive set of metrics at different levels of granularity may be necessary to capture all material risks, mandating the same level of breadth and granularity (at the single risk factor level) for all exposures would be unnecessary. Moreover, this level of granularity and breadth would make it too burdensome to transact with certain counterparties without a corresponding benefit to banking organizations' ability to manage risk.

We therefore recommend that the Guidelines explicitly clarify that the applicability and choice of exposure metrics should be risk-based (i.e., depending on the counterparty, portfolio and exposure) in recognition of the fact that a variety of "non-equivalent risk

[12] Consultation at 10.
[13] In discussing risk limits, the Consultation also states, "Risk limits should be granular enough to monitor key risks – eg concentration, liquidation, dispersion and maturity – in the underlying exposure to a counterparty at the material risk factor level." For the same reasons discussed herein, we believe this should be pared back to allow for a more risk-based approach. Consultation at 16.

metrics" at varying levels of granularity are not appropriate for every counterparty and exposure, and may not be appropriate "frequently."

2. *Banking Organizations should not be required to model wrong-way risk ("WWR") on a standalone basis.*

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

Even where relevant, banking organizations may choose to manage WWR comprehensively, or on a portfolio or enterprise level, rather than on an individual-exposure level. In these cases, requiring banking organizations to model WWR on an individual-exposure level would be inconsistent with how WWR is managed.

We recommend that the Guidelines allow for banking organizations to implement frameworks to address WWR based on how banking organizations actually manage WWR, allowing for, but not requiring, modelling WWR at the exposure level.[14]

3. *Banking organizations should have flexibility in their choice of metrics depending on the clients/counterparties and not be required to use Potential Future Exposure ("PFE").*

The Consultation would state that banking organizations "should quantify CCR exposure daily, using PFE to measure the future exposure against a given counterparty conditional upon its default."[15] While we support the use of stress metrics as a guiding principle in evaluating CCR, we believe mandated reliance on PFE does not reflect the full range of best practices banking organizations currently use to manage counterparty credit risk.

In particular, although PFE is appropriate in many instances, both banking organizations and supervisors have come to recognize that PFE may not be universally the most appropriate measure in all circumstances, *e.g.*, for complex products.[16] We recommend that the BCBS permit banking organizations to develop use-appropriate metrics to

[14] For example, vulnerability analysis that large U.S. banking organizations perform in connection with company-run stress testing mandated under Section 165 of the Dodd-Frank Act.
[15] Consultation at 12.
[16] Elizabeth McCaul, "Supervising counterparty credit risk – a European perspective" (Feb. 28, 2024), https://www.bankingsupervision.europa.eu/press/speeches/date/2024/html/ssm.sp240228~a9397948a8.en.html (Keynote speech by Elizabeth McCaul, Member of the Supervisory Board of the European Central Bank, at the industry outreach conference on counterparty credit risk management, organized by the Federal Reserve Bank of New York in collaboration with the BCBS).

measure exposure, which may include PFE, but should not mandate any particular methodology or paradigm.

4. *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.[17] The Consultation's proposed guidance to deviate from the Basel framework to account for "excessive risks from concentration, liquidity, idiosyncratic risks," could lead to divergences between risk management practices and minimum capital requirements, in many cases leading to incrementally higher capital requirements for the same activities.

Both banking organizations and supervisors have other tools with which to monitor and manage "excessive risks from concentration, liquidity, [and] idiosyncratic risks," without revising the Basel framework's highly conservative calibration of MPOR, which represents the culmination of a multi-year, multilateral negotiation and comprehensive industry data analysis. Revisiting the MPOR assumptions would result in increased capital requirements for banking organizations without any evidence that it would provide for better protection against CCR.[18]

We therefore recommend that the BCBS avoid re-opening the Basel agreement and potentially increasing the prescribed MPOR requirements, which would in turn lead to higher capital for a highly conservative measure.

5. *Stress-testing should only be required for large or complex counterparties and material concentrations of risk.*

The Consultation would require banking organizations to perform a comprehensive set of severe stress tests "at the counterparty and portfolio levels."[19] Stress-testing is a highly involved and demanding requirement that is usually reserved for macro analysis or

[17] *See* BCBS, Basel Framework CRE 52.50 ("The floors for the margin period of risk are as follows: (1) Ten business days for non-centrally-cleared transactions subject to daily margin agreements. (2) The sum of nine business days plus the re-margining period for non-centrally cleared transactions that are not subject daily margin agreements"); BCBS, Basel Framework CRE54.8(2) ("In all cases, a minimum MPOR of 10 days must be used for the calculation of trade exposures to CCPs for OTC derivatives").
[18] Rama Cont, "Margin Requirements for Non-cleared Derivatives," ISDA at 7 (Apr. 2018), https://www.isda.org/a/Gz9EE/Margin-Requirements-for-Noncleared-Derivatives.pdf ("In a survey of various buy-side and sell-side market participants conducted when preparing this study, respondents noted that in the vast majority of recent default cases involving OTC derivatives, the typical time required for financial institutions to unwind or replace derivatives positions with the defaulted counterparty are of the order of 2 to 4 days, usually counting one day after the last margin payment for confirmation of the credit event").
[19] Consultation at 14.

analysis of large or complex counterparties. To perform stress tests on specific counterparties, especially ones that are "granular at the level of material risk factors, informed by vulnerability analyses – severe and varied – and able to capture idiosyncratic risks," would be a resource-intensive endeavor that would significantly increase the burden and costs associated with onboarding every counterparty.[20] The marginal utility of such exercise would be limited for small or simple counterparties whose risks are either immaterial or easily ascertained without the use of stress tests.

We therefore recommend that stress-testing only be required for large or complex counterparties and material concentrations of risk. This would be in line with current U.S. guidelines for CCR management which recommend "measurement of the largest counterparty-level impacts across portfolios, material concentrations within segments of a portfolio (such as industries or regions), and relevant portfolio- and counterparty-specific trends."[21] Overall, the Guidelines should explicitly allow banking organizations to implement expectations regarding stress testing using a risk-based approach.

6. *The Guidelines should state that banking organizations are only required to consider reasonable risks in the context of stress test design.*

The Consultation notes that banking organizations should test for situations in which risk mitigation measures do not work as intended, but does not restrict the scope of how far banking organizations should assume. Instead, the Guidelines should specify that banking organizations can determine which measures to test based on their analysis of the risk and their risk preferences. For example, legal enforceability of contracts can be questioned in certain high-risk countries but in jurisdictions with fairly established laws, requiring every contract to be considered at risk would lead to untenable results. Overall, the Guidelines should explicitly allow banking organizations to implement expectations regarding stress testing using a risk-based approach.

D. <u>Governance</u>

1. *The Guidelines should not preference CCR management as a single risk stripe.*

The Consultation states that "[t]he dual nature of CCR contains elements of both market risk and credit risk, necessitating that CCR management involves strong collaboration between the market risk and credit risk functions at the bank…" and that banking

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[20] Consultation at 14.

[21] Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Board of Governors of the Federal Reserve System and Office of Thrift Supervision, "Interagency Supervisory Guidance on Counterparty Credit Risk Management" at 7 (Jun. 29, 2011), https://www.fdic.gov/sites/default/files/2024-03/fil11053a.pdf [hereinafter, "SR 11-10"].

organizations with "stronger practices have dedicated functions for CCR."[22] Moreover, the Consultation would appear to require a standalone CCR committee. Thus, the Consultation appears to encourage management of CCR as a standalone risk stripe (distinct from credit risk and market risk).

In practice, formal collaboration between market and credit risk on a day-to-day basis varies from firm to firm, and specific business models may not necessitate a standalone CCR function. For example, some firms may incorporate market risk considerations by having product-risk oriented functions as a part of the CCR function. We recommend that the Guidelines not express a preference for standalone CCR management, or mandate a level of formal collaboration among a banking organization's risk functions, but rather should explicitly allow banking organizations to flexibly design risk management to suit their business models.

2. *The Guidelines should clarify that CCR may be subject to senior management (not just board) oversight.*

The Consultation states that "[b]anks should establish a clear CCR strategy and an effective CCR management process approved by the board of directors and implemented by senior management." The implication is that CCR management should be subject to direct board oversight, regardless of the quantity and quality of a banking organizations CCR exposures. In practice, many banking organizations may delegate responsibility for CCR risk management to senior management, particularly where CCR is not managed as a separate risk stripe. In these cases, it would be inappropriate to mandate direct board oversight of the CCR function. We therefore recommend that the Guidelines clarify that banking organizations' CCR strategy and management processes be approved by the board of directors *or senior management*, and be implemented by senior management.

3. *The Guidelines should not mandate entity-specific risk management capabilities.*

The Consultation provides that "[b]anks should ensure that CCR oversight – including second and third lines of defense – are effective, with clear mandates, sufficient knowledge and stature, and the ability to operate in an environment in which managers and staff throughout the organisation are incentivised to identify, challenge, escalate and resolve risks." This guideline could be read to require banking organizations to develop second and third-line capabilities at the entity, rather than the enterprise level. Requiring entity-level capabilities would be duplicative and inefficient while at the same time making it difficult for banking organizations to leverage specialist resources that may be available at the enterprise level. We recommend that the Guidelines clarify that second and third line functions may be established at higher levels of organization and should not

[22] Consultation at 17.

mandate potentially duplicative and conflicting risk management functions at the level of each legal entity.

4. *Banking organizations should be permitted to use complex booking models if they are able to manage them appropriately.*

The Consultation states that "[b]anks with sound practices manage their counterparty exposure by using booking models that are simple and have clear accountability embedded in the booking model framework."[23] In contrast, the Consultation states that complex booking models are challenging for banking organizations, implying they should not be used if simple models are available. Even if complex booking models may be more challenging for many banking organizations, if a banking organization is able to implement a complex booking model effectively, then the guidelines should not require the banking organization to forgo its established and preferred model simply because such models are "challenging" in an abstract or general sense.

5. *The Guidelines should clarify that banking organizations should be permitted to use affiliated entities to develop management information systems.*

The Consultation makes management responsible for building a management information system in which managers can "perform on-request analysis without external help for counterparties with material exposure or those on watch lists/close monitoring lists."[24] The phrasing of this guideline is ambiguous, and could be interpreted to prohibit banking organizations from enlisting the assistance of personnel or systems outside of the legal entity in which the manager is located. Such an interpretation would be at odds with current risk management best practices, and would make it difficult to coordinate risk management across legal entities within an enterprise. We recommend clarifying the Guidelines to require that managers are able to perform such analysis without help from outside of the bank group.

6. *The limit risk framework should be risk-based.*

The Consultation requires banking organizations to "implement a transparent and actionable limit governance framework with clear and proper oversight and review."[25] This would include a limit governance framework inclusive of a remediation process for breaches, a review and challenge process and a formal calibration process via committee.

Although we would support committee oversight of an overall limit governance framework, the Guidance should clarify that banking organizations be permitted to adopt

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[23] Consultation at 18
[24] Consultation at 19.
[25] Consultation at 19.

a more risk-based approach in constructing a limit governance framework. For example, it may not be practical for all limit breaches to be subject to a formal committee process, particularly where the limit breaches pertain to a non-material exposure or a single name. Allowing banking organizations' flexibility to tailor their limit risk framework would allow the committee to focus their attention and resources on the most material exposures and counterparties.

7. *Significant limits should be approved independently from the business function, but in some cases, it may be more appropriate for the business function to set limits.*

The Consultation requires that "limits should be set and verified independently from the business function." As currently drafted, this restriction is unnecessarily broad. We agree that a banking organization should have significant limits approved independently from the business function, but banking organizations also should have the flexibility to have the business function set certain limits based on their expertise. Indeed, the business function can provide valuable insight into shifting risks, including through limit re-allocations based on business needs and opportunities. So long as there are also limits set above the business function to ensure compliance, business function limits should only enhance CCR management, not detract from it.

8. *The Guidelines should clarify that ad hoc intraday day trading monitoring is not mandatory.*

The Consultation would require banking organizations to monitor "actual exposures against established risk limits at least on a daily basis."[26] This would include encouraging banking organizations to establish "ad hoc intraday exposure monitoring, which should be adequate for assessing impacts of large intraday market moves on risk limits."

Although in certain instances ad hoc intraday monitoring may be valuable, in many instances, such capabilities would be costly to implement and monitor without any corresponding benefit, particularly if the exposures or portfolios in question are not sensitive to intraday market movements. Indeed, some OTC markets with end-of-day collateral settlement, such as securities lending, do not permit for meaningful intraday monitoring in many circumstances. We recommend that the Guidelines clarify that ad hoc intraday may not be necessary or appropriate in all instances. Banking organizations should explicitly have the ability to apply a risk-based approach and choose which activities or clients should require intraday monitoring.

[26] Consultation at 19.

9. *Independent risk management should not have the sole authority to allocate risk weighted assets ("RWAs").*

The Consultation states that "[i]ndependent risk functions should have sole authority to approve limit exceptions, in addition to the authority to allocate risk appetite – such as PFE, RWAs or stress exposure – between businesses and products with the same counterparty."[27] Although we recognize that a core function of independent risk management is to provide an independent monitoring and management of risk limits, including exceptions, allocating RWAs is often done by a first-line function under the oversight of independent risk management. This directly incentivizes the business to structure trades and portfolios to make the most efficient use of RWAs, thereby also reducing CCR in the process. Independent risk functions should play an important role in allocation of risk, but mandating ultimate allocation of firm resources with the independent risk function would disrupt the system of checks and balances under which banking organizations typically operate, and would incentive risk-avoidance rather than risk management. The Guidelines should be changed to recognize that independent risk management will have an oversight role in the process, rather than having sole authority for allocation decisions.

E. Closeout Practices

1. *Close-out exercises should be more narrowly tailored to apply to large counterparties and reasonable scenarios.*

We understand and support the need for close-out exercises to test banking organization's close-out capabilities. In order for such exercises to be effective, however, they must be tested in realistic settings and preferably with respect to counterparties against which a close-out might be complex or difficult. As currently drafted, the Consultation does not place limitations on the scope of such exercises.

First, as is the case in current U.S. guidelines, the Guidelines should restrict close-out exercises to only the largest counterparties.[28] These large counterparties present the most risk and likely would represent the most complicated close-out; close-out exercises focused on these large and complex counterparties would therefore be the most instructive. In contrast, simulating the close-out of a smaller or less complex counterparty would not meaningfully test the efficacy of a banking organization's close-out processes.

Second, the Guidelines should only require a banking organization to consider reasonable scenarios in a simulation. For example, sanctions on certain jurisdictions may be reasonable to consider but sanctions on allies (*e.g.*, the United Kingdom) should not be

[27] Consultation at 19
[28] *See* SR 11-10.

required. The Consultation does not seem to set any limits, potentially requiring banking organizations to consider even highly improbable scenarios. In the same vein, while it would be logical to test a banking organization's strategy in the event that transactions are rerouted and processes remapped due to geopolitical instability or rogue actors, the potential scenarios where disruption could occur are too vast to fully consider in a close-out exercise. In all cases, we believe that such considerations should be limited to a range of plausible scenarios.

We recommend that the BCBS adopt current U.S. guidelines regarding close-out exercises (SR 11-10).

2. *The Guidelines should not require mock close-out exercises annually.*

While the Consultation does not state so outright, by noting that counterparty type should vary "year to year," the Consultation implies that banking organizations would be required to perform mock close-out exercises annually. Close-out exercises are costly and time-intensive measures. While we agree that a banking organization should be prepared for a close-out scenario, an annual exercise requirement is unnecessary for most banking organizations and would only lead to costly repetition instead of actually producing new insights into gaps within a company's close-out procedures. Specifically, executing such a process would necessitate significant senior stakeholder engagement, which could distract from business-as-usual risk management activities, an opportunity cost that, for many banking organizations, would not be commensurate with the risk. Moreover, such processes also would not be consistent with current practices and requirements.[29] Banking organizations already integrate expected close-out measures in their policies, standards and frameworks and should be permitted to continue to determine whether and how frequently a close-out exercise may be needed. The focus should not be on the frequency of the exercises but ensuring banking organizations have the proper governance framework to support a close-out.

Yours faithfully

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[29] *See e.g.*, SR 11-10 at 16 ("Requirements for hypothetical close-out simulations at least once every two years for one of the banking organization's most complex counterparties").