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Secretariat of the Basel Committee
on Banking Supervision
Bank for International Settlements
CH-4002 Basel
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Dear Sir / Madam

Comments on the Guidelines for Counterparty Credit Risk

We thank you for allowing our members the opportunity to comment on matters relating to the Guidelines for Counterparty Credit Risk.

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 Guidelines for Counterparty Credit Risk Management

NR	REFERENCE IN ACT/BILL/DOCUMENT	COMMENT (Why is it a problem?)	PROPOSED WORDING/COMMENT
1.	Introduction	There is a general mention on NBFIs with no distinction between regulated and unregulated NBFIs.	We are of the view that a distinction should be made between regulated and unregulated NBFIs since the risk profiles between these are significantly different especially around what data is available to make credit decisions. Archegos Capital was an unregulated family office. We recommend that in the rest of the guidelines, NBFIs should be replaced with unregulated NBFIs as that seems to be key driver behind these regulations.
2.	Par 8 - Onboarding	For unregulated NBFIs, metrics like VaR might not be possible to obtain. This should be accounted for in the	

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		onboarding process, as well as how much risk banks would be willing to run on such counterparties.	
3.	Par 27 - Margining	The context of default risk is unclear in this paragraph.	Please clarify if this refers to issuer risk or is it referring to the probability of default risk?
4.	Par 29 - Margining	It is a great concept for banks to have independent view of initial margin for cleared products. However, a challenge arises when modelling differences are observed in terms of what actions bank can take. In reality, it is not straightforward for banks to unilaterally introduce additional margins as it has impact on profitability of the business.	Ideally any modelling deficiencies should be addressed at clearing house level. Clearing houses are however not always excited to increase initial margins.
5.	Par 50 -Exposure metrics	Introducing more complex models like jump processes also introduces model risk due to the complexity of these models from calibration perspective and interpretation of these models by non-quants personnel. This also goes against other part of regulations where simplicity is being recommended.	
6.	Par 56 – Exposure Metrics	While real portfolio back testing would add value from risk management perspective, it would be quite a high watermark for some of the smaller banks. The incremental effort and complexity of interpreting results might overshadow the benefits for some of the smaller banks.	Consideration should be given to soften wording to highlight hypothetical portfolio back testing as a minimum requirement and bigger banks can be expected to perform real portfolio back testing.
7.	Par 57 – Stress testing and scenario analysis	PFE is a stressed risk measure, and stressing further would make the numbers not easy to interpret.	We suggest that the regulations be a bit more specific regarding the definition of stress testing in CCR context especially regarding managing

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			stressed exposure within limits. Which metrics are being stressed (e.g. mark-to-market, PFE, EE etc)?
8.	Par 64 – Stress testing and scenario analysis	Clarity is sought on why senior management is required for stress testing in comparison with other risk measures.	It is our view that senior management be involved across the board (as covered in Management Reporting section) however the focus should be on key areas of concern from client risk perspective rather than specific risk measures.
9.	Par 76 – Risk Framework	Clarity is sought on what the expectation for "clear CCR strategy" is and whether CCR strategy is owned/driven by Front Office or Risk function.	
10.	**BIS Index 1** Sound management of CCR requires both a strong initial assessment as well as an ongoing understanding of the counterparty's risk profile in both business as usual (BAU) as well as stress conditions. The credit approval process should begin with comprehensive collection and review of financial and non-financial information – including legal, regulatory, reputational and operational risks, as well as other relevant risks – providing a clear picture of a counterparty's risk profile and risk management standards. Additionally, banks should understand the rationale	Obtaining information for ongoing monitoring may be challenging for certain type of clients (Banks and large FIs). BIS should provide flexibility to banks to have differential treatment and restrict the stricter requirements only for risky and complex counterparties, as defined by Banks (generally hedge funds and real money funds).	

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	and economics of underlying exposures, and of the key drivers of the counterparties' performance and growth. Banks should be particularly wary of any mechanisms for conducting due diligence and managing material counterparties purely on a portfolio basis without due consideration of the individual counterparties and the risks they pose to the bank. Ongoing monitoring of counterparties requires **updated information** about material developments such as changes in trading activities and leverage taken, profit and loss developments, as well as significant changes to how the counterparty measures and manages their risks.		
11.	**BIS Index 4** Before onboarding a counterparty, banks with sound practices inquire about its past and present reputation and creditworthiness, for example, by accessing credit registers, evaluating legal status, considering regulatory reviews and becoming knowledgeable about the individuals responsible for managing the institution, including considering any previous supervisory	We concur with BIS that it is critical for the Banks to track key personnel or turnover of staff who are involved closely in the execution/ settlement of Market transactions. BIS should clarify this aspect and recommend tracking key personnel at client end who are involved in Market or Treasury activities.	

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	sanctions against the counterparty or the managers. Banks should also assess qualitative factors such as strategy, quality of risk management practices, and **staff composition and turnover**. However, a bank should not grant credit solely because the counterparty, or key members of its management, are familiar to the bank or are perceived to be highly reputable. Similarly, banks should not unduly rely on profitability considerations when deciding on the onboarding of a new client.		
12.	**BIS Index 11** Banks with sound due diligence processes understand that due diligence obligations do not end following the initial onboarding of a counterparty. Instead, they recognise the need to continually receive and assess information that sheds light on a counterparty's risk profile. For example, banks should obtain information about material counterparty developments such as changes in the direction of their trading activities and performance (e.g. net asset value **(NAV))**, profit and loss	We note that this requirement is being stipulated keeping in view of exposure with hedge fund and such high-risk clients.	To avoid this getting interpreted as applicable to all clients, we request to update the 3rd sentence as "For example, for risky and complex counterparties, banks should obtain information about material counterparty developments such as.... "

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	developments, significant changes to leverage, alterations to their risk management procedures or their risk measurement processes, and changes in key personnel. Banks with sound practices rigorously explore whether high returns shown in a counterparty's portfolio are associated with higher risks that have not been properly considered or represent unknowns and cannot be substantiated without overreliance on the clients' representations.		
13.	**BIS Index 12** Following the characterisation of the counterparty's risk profile at onboarding (such as through proposed trading positions or sample portfolios noted earlier in this section), deviations from the risk profile should be tracked and lead to adjustments in the ongoing monitoring process as appropriate. Banks should also establish a frequency for ongoing monitoring and predefined triggers for metrics such as performance, volatility, liquidity, management quality and concentration, which should be	There are overlaps in point 11 and 12 as both are referring to ongoing reviews. We request to combine both points and highlight the criticality of ongoing reviews.	

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	commensurate with the risk presented by the client under normal and stressed market conditions. The frequency of ongoing monitoring should also consider the assessment of a counterparty's non-financial risks.		
14.	**BIS Index 17** Margin levels should account for the market risk of the portfolio and be sensitive to changes to the counterparty risk profile and underlying risks. For example, the margin for hedge fund exposure should be sensitive to the implementation of new trading strategies, as well as changes in portfolio directionality, concentration or leverage. Other factors to consider include market conditions impacting the underlying trading activity, such as increased volatility, crowdedness, liquidation and liquidity. The sophistication of margining frameworks should be commensurate with the complexity of banks' portfolios. Computed margins for a particular counterparty should be reflective of its specific portfolio vulnerabilities and	We request BIS to clarify the expectations with respect to the last statement "Banks should also require margin levels that reflect risks arising from other contractual terms such as early termination, margin lock-up and frequency of margin resets, among others."	

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	exposures, and capture material risks at the single name and risk factor level. Banks should also require margin levels that **reflect risks** arising from other contractual terms such as early termination, margin lock-up and frequency of margin resets, among others.		
15.	**BIS Index 18** The margining framework should be informed and reflective of the overall risk profile of the counterparty and not merely based on the narrow risk profile of the bank's trading relationship with the counterparty. For example, banks should review and rely on a counterparty's financials and internal risk assessment, including its jurisdiction risk and stress testing, to infer risk taken outside its portfolio. NAV volatility and growth should inform the riskiness of a counterparty's underlying assets. For gathering this information, banks and their counterparts can agree to rely on professional third parties to calculate and share risk measures and stress results on an adequate, mutually agreed aggregation level. This approach is	In point 18, there are requirements stipulated requiring banks to set "minimum standards on counterparty disclosure". Also, in point 8 and 9, there are requirements stipulated to obtain disclosure from clients. While these disclosures help Banks in risk management, it is practically difficult to get such additional information. At times clients refuse to share information due to lack of market practice. BIS should stipulate 'standard list of disclosure needs to be sourced from the clients,' which will be applicable across jurisdictions. This will set the market practice and help banks in ensuring compliance to this requirement. Accurate information of a client's positions across the street remains a difficult task where banks will use conservative assumptions based on discussions with clients on their other counterparts and wallet share. Asking clients to share their overall positions with a third party will also be difficult as clients like hedge funds are in	

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	especially encouraged when counterparties do not have a sophisticated risk calculation framework and/or financial disclosure obligations, as an alternative to infrequent information-sharing or lack of disclosure on meaningful financial indicators.	general very wary of running any risk of giving their trading strategy	
16.	**BIS Index 44** In measuring exposure, banks should properly identify, evaluate and capture idiosyncratic risks such as excessive concentration to a single name or single risk factor, material dispersion or basis risk between long and short positions, lack of liquidity due to limited trading volume, the presence of complex or bespoke positions in the portfolio, or simply the sheer position size. Banks with sound practices directly consider how such idiosyncratic risks may affect portfolio correlations and the accuracy of valuations used to determine margins. They should also consider how such risks may exacerbate WWR and magnify closeout losses. In this context, the overall risk profile of the counterparty should be modelled conservatively, giving consideration to scenarios such as	Capturing all idiosyncratic risks during exposure calculation may not be feasible and hence BIS should make this a recommended approach. Where there are challenges, Banks should be given flexibility to deploy alternative approaches to address such risks.	

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	horizontal hoarding, or crowding that can materially skew the exposures distribution.		
17.	**BIS Index 53** PFE as a measure of exposure at default should account for WWR (directly or via suitable adjustments or overlays). This is especially relevant for NBFIs, particularly institutions with high leverage and/or concentrated exposures, whose solvency, because of the leverage and concentration, becomes materially correlated with the portfolio performance. In such cases, banks should calibrate the PFE to historical and idiosyncratic scenarios commensurate, for instance, with those observed during the Archegos Capital Management and Long-Term Capital Management defaults, when WWR drove large gap moves for the underlying portfolio assets and ultimately magnified the closeout losses.	While it is ideal to include WWR in exposure calculation, it may not be practical in all cases. BIS should consider providing flexibility to banks to use alternative approaches when WWR is not considered in exposure calculations.	
18.	**BIS Index 58** Banks should have clear, documented governance of their CCR stress testing framework to ensure the appropriate	Reverse stress testing traditionally is to identify the scenario post which a company is no longer a going concern. For every counterparty, the scenario will be different and practically difficult to implement. BIS to clarify if this	

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	identification of relevant scenarios, their design and revision when necessary. The framework should include a robust number of scenarios, exhaustive of the multi-dimensional nature of the risks to which the bank's portfolio is exposed. In addition, institutions should have the capability to perform in a reasonably short time ad hoc stress tests, reverse stress testing and scenarios analysis. Based on the business model of the counterparty, it should be able to characterise extreme but plausible scenarios that could result in significant adverse outcomes.	requirement be satisfied if the stress scenarios being used internally are extreme but plausible in nature.	