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

Dear Sirs

Consultative Document: Guidelines for Counterparty Credit Risk Management

United Overseas Bank Limited (UOB) appreciates the opportunity to provide comments on the consultative document on guidelines for counterparty credit risk (CCR) management.

Listed below are our broad comments and clarifications.

1. Section 1 ("Introduction") - Risk-based and proportionate application of guidelines

We understand that the new CCR guidelines were a response to recent CCR management failings which included the failure of Archegos (2021), LME nickel market episode (2022), and gilt market dislocation (late 2022 and early 2023). In addition, the proposed guidelines were targeted towards high-risk exposures to non-bank financial intermediary counterparties.

We agree that there are lessons to be learnt from the recent incidents to enhance the management of CCR. However, we would like to caution that the policy response should be coherent, risk sensitive, and proportionate.

Therefore, we recommend that the new CCR guidelines should only be applied to specific counterparty groups (e.g. hedge-fund, commodity and family offices) with exposures exceeding a threshold. The guidelines should not be applied to normal CCR exposures arising from the counterparties' day-to-day hedging requirements which would result in unnecessary compliance burden.

2. Section 2 ("Due diligence and monitoring") - Commercial feasibility of obtaining and verifying client disclosures

The new CCR guidelines call on banks to ask clients for stress test results, risk reports and even data on underlying positions.

The guidelines (see paragraph 18) also require banks to know the overall risk profile of the counterparty and not just the narrow risk profile of the bank's trading relationship with the counterparty.

In theory, we agree that having such information would be very useful for risk management purposes. However, in practice, it would be very challenging and may not be commercially feasible for banks to obtain such proprietary and sensitive information from their clients. Hedge funds or family offices may not be willing to provide banks with insight into their proprietary trading strategies. This could be due to potential conflict of interest as banks also have proprietary trading operations.

For regulated counterparties, it would be better and more feasible to subject such counterparties to regulatory disclosure requirements. For example, there should be regulatory guidance for large funds to set out what trading information they need to disclose.

After information is received from client, the proposed guidelines also require banks to ensure that adequate proof, assurances, or verification are applied as part of due diligence. In practice, it would be challenging for banks to completely validate if the information provided by the clients is reliable (e.g. positions with other banks).

3. Section 4 ("Exposure measurement") - Simple prolongation of MPOR does not address the key issue

We understand that before Archegos' default, PFE calculation at Credit Suisse was about $500 million. However, the final close-out losses were $5.5 billion. It was noted that assuming the original PFE was computed with margin period of risk (MPOR) of 20 days, the MPOR required to match the realized losses would have exceeded one year.

However, we are of the view that the crux of the issue was with the discipline to enforce the margin call and liquidation process. It was reported in the press that when the stop loss limit was exceeded, Credit Suisse was apparently trying to reach a standstill agreement with other brokers instead of liquidating its Archegos positions.

In addition, losses were also exacerbated by concentration risks and wrong-way risks. For Archegos, the share prices of its largest positions fell sharply (about 50%) within a short span of slightly more than a week. A simple prolongation of the MPOR is an overly simplistic workaround which neither resolves the true issue nor captures the nature of the risk.

Instead of increasing MPOR, the proposed guidelines to supplement sophisticated quantitative measures with simple, model-free risk metrics like notional or gross delta would serve the purpose better. This would allow the Bank to question some of the modelling assumptions and the possible consequences if those assumptions are wrong. In addition, stress testing would be an ideal measure to identify wrong way risk in client strategies.

4. Section 4 ("Exposure measurement") - Potential future exposure should not be conditional on default

The new guidelines require the Potential Future Exposure (PFE) to measure the bank's future exposure against a given counterparty conditional upon its default.

The standard approach for PFE is to simulate different scenarios for future market rates, reprice all clients' FX/derivative positions, and use a high percentile of exposure distribution. Even without conditioning on default, the standard PFE approach is already highly complex and computationally intensive.

We are of the view that PFE should not be conditional on default as this would introduce significantly more model assumptions that are difficult to assess and back-test.

Instead, we should complement PFE with other model-free measures and tools such as wrong-way risk management and CCR stress test.

5. Other clarifications on the proposed guidelines

Below are some additional clarifications that we would like to seek:

- Section 5 ("Governance"), People and risk culture, Paragraph 74 – While we agree that CCR managers should have the relevant experience, expertise and stature, we would like to clarify that the requirement is not for the CCR manager to sit in senior risk management committees and/or Board-level risk committees. Typically, the CCR manager would independently report to the Chief Risk Officer who reports directly to the chief executive officer and the board of directors and sits in these risk committees.

- Section 5 ("Governance"), Risk framework, Paragraph 82 – We would like to clarify that the requirement is not asking banks to set up a risk committee specifically for CCR. Banks typically have various risk committees governing specific risk types (e.g. credit risk, operational risk, legal risk). Such committees are already staffed with sufficiently senior managers from relevant functions (e.g. risk, trading, compliance, finance, legal and operations) to deliberate on the relevant risk matters.

Conclusion

We would like to thank the committee for the opportunity to provide comments on the consultative document. Please do not hesitate to contact the undersigned should you require any further information.

Yours faithfully
UNITED OVERSEAS BANK LIMITED

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