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Basel Committee
on Banking Supervision

Frequently asked questions on the supervisory framework for measuring and controlling large exposures

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1. Interbank exposures and exposures to central counterparties

Paragraph 67

Question 1: The large exposures standard published in April 2014[1] includes in paragraph 67 the following: "*The Committee will undertake further observation and consider whether, for the purposes of ensuring there are no unavoidable adverse consequences for the implementation of monetary policy, a specific treatment for a limited range of interbank exposures may be necessary. This observation period, and any subsequent adjustments to this framework, will be concluded by 2016.*" What is the decision of the Basel Committee regarding the need for a specific treatment for a limited range of interbank exposures?

Answer: After observation of interbank exposures,[2] the Committee decided that there was no need to establish a specific treatment for interbank exposures in addition to the one set out in paragraph 66.

Paragraph 84

Question 2: The large exposures standard includes, in paragraph 84, a review clause regarding exposures to qualifying central counterparties[3] drafted as follows. "*The Committee will consider the appropriateness of setting out a large exposure limit for banks' exposures to qualifying central counterparties (QCCPs) after an observation period that will be concluded in 2016. In the meantime, the assumption is that banks' exposures to QCCPs related to clearing activities are exempted from the large exposures framework.*" What is the decision of the Basel Committee regarding banks' exposures to QCCPs related to clearing activities?

Answer: After observation of exposures to QCCPs,[4] the Committee decided to confirm the exemption from the large exposure limit of exposures to QCCPs related to clearing activities – as defined in paragraph 87 of the standard. However, these exposures will be subject to the regulatory reporting requirements as defined in paragraph 15 and the Committee will continue monitoring the need for this exemption.

Paragraph 86

Question 3: According to paragraph 86, the requirement to group connected counterparties does not apply in the context of exposures to CCPs that are specifically related to clearing activities. Could you provide an example of how to aggregate exposures to a CCP when the bank has both exposures related to clearing and exposures unrelated to clearing towards this CCP?

Answer: Indeed, according to paragraph 86 clearing exposures to CCPs are not subject to the concept of connected counterparties described in paragraphs 19–28 of the large exposures standard published in April 2014, whereas non-clearing exposures are subject to the concept. Therefore, banks must separately measure and report to their supervisors clearing and non-clearing exposures to CCPs and, for the latter,

[1] See *Supervisory framework for measuring and controlling large exposures*, April 2014, www.bis.org/publ/bcbs283.htm.

[2] See *Basel III monitoring report*, September 2016, www.bis.org/bcbs/publ/d378.htm.

[3] *The definition of QCCP for large exposures purposes is the same as that used for risk-based capital requirement purposes. A qualifying central counterparty (QCCP) is an entity that is licensed to operate as a CCP (including a license granted by way of confirming an exemption), and is permitted by the appropriate regulator/overseer to operate as such with respect to the products offered. This is subject to the provision that the CCP is based and prudentially supervised in a jurisdiction where the relevant regulator/overseer has established, and publicly indicated that it applies to the CCP on an ongoing basis, domestic rules and regulations that are consistent with the CPSS-IOSCO Principles for Financial Market Infrastructures.*

[4] See *Basel III monitoring report*, September 2016, www.bis.org/bcbs/publ/d378.htm.

to check whether the CCP is connected to other counterparties by meeting either the control relationship or the economic interdependence criteria.

As an example, if a bank has exposures to a QCCP for a total of 100 made up of 50 trade exposures, 10 default fund contribution and 40 liquidity line, it should report 60 under exposures related to clearing. For the other 40, it should check whether the QCCP is connected to other of its counterparties, including other CCPs. Assuming that the QCCP is also part of a group of connected counterparties, the bank would have to add this 40 from liquidity line to other exposures to counterparties in the same group. The sum of these exposures will be subject to the 25% large exposure limit.

2. Definition of connected counterparties

Paragraph 26, fourth bullet point

Question 4: Could you clarify the relationships between the counterparties and the bank described in the fourth bullet point in paragraph 26?

Answer: The case refers to a situation where a bank has exposures to two different counterparties that rely on the same source of income to reimburse the loan. The current wording is misleading as it implies that one of the bank's counterparties lends to the other. This bullet point should instead read as follows.

*"When the expected source of funds to repay the loans ~~one counterparty makes to another~~ **of both counterparties** is the same and ~~the counterparty does not have~~ **neither counterparty has another independent** source of income from which the loan may be serviced and fully repaid;"*

3. Values of exposures

Paragraph 31

Question 5: According to the Basel framework, deductions of some exposures may be made up to a certain amount (eg due to a threshold mechanism). When only a portion of an exposure is subject to deduction from capital, how is this exposure treated for large exposure purposes?

Answer: In such cases, only the exposure amount deducted from capital is excluded from exposure values for large exposure purposes. The remaining part of the exposure should be considered as an exposure for large exposure purposes. Paragraph 31 should read as follows.

*An exposure **amount** to a counterparty that is deducted from capital must not be added to other exposures to that counterparty for the purpose of the large exposure limit.*[5]

Paragraph 42

Question 6: According to paragraph 33, banks must use the standardised approach for counterparty credit risk to calculate the exposure value for an instrument with counterparty credit risk. Should the bank

[5] This general approach does not apply where an exposure is 1,250% risk weighted. When this is the case, this exposure must be added to any other exposures to the same counterparty and the sum is subject to the large exposure limit, except if this exposure is specifically exempted for other reasons.

recognise an exposure to the issuer of collateral when this collateral is recognised in the measurement of the counterparty credit risk exposure?

Answer: The large exposures framework requires that when a risk mitigation (CRM) technique reduces the value of an exposure, the bank must recognise an exposure to the provider of the CRM technique (for instance the issuer of a financial collateral). This substitution approach, requested in paragraph 43, also applies to collateral recognised in the measurement of the counterparty credit risk exposure, although it was not explicit in the large exposures standard. Therefore, paragraph 42 should read as follows, and then paragraph 43 would also apply to these exposures.

D. Recognition of CRM techniques in reduction of original exposure

42. A bank must reduce the value of the exposure to the original counterparty by the amount of the eligible CRM technique recognised for risk-based capital requirements purposes. This recognised amount is:

- *the value of the protected portion in the case of unfunded credit protection;*
- *the value of the portion of claim collateralised by the market value of the recognised financial collateral when the bank uses the simple approach for risk-based capital requirements purposes;*
- ***the value of the collateral as recognised in the calculation of the counterparty credit risk exposure value for any instruments with counterparty credit risk, such as OTC derivatives;***
- *the value of the collateral adjusted after applying the required haircuts, in the case of financial collateral when the bank applies the comprehensive approach. The haircuts used to reduce the collateral amount are the supervisory haircuts under the comprehensive approach.*[6] *Internally modelled haircuts must not be used.*

[6] The supervisory haircuts currently in use are described in paragraphs 151–3 of the Basel II framework.