EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Template for comments

ECB report on "Sound practices in counterparty credit risk governance and management"

Institution/Company

International Swaps and Derivatives Association (ISDA) and Association for Financial Markets in Europe (AFME)

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General comments

Template for comments

ECB report on "Sound practices in counterparty credit risk governance and management"

Please enter all your feedback in this list.
When entering feedback, please make sure that:
- **each comment deals with a single issue only;**
- **you indicate the relevant article/chapter/paragraph, where appropriate;**
- **you indicate whether your comment is a proposed amendment, clarification or deletion.**

Deadline:	14 July 2023

ID	Chapter	Paragraph	Page	Type of comment	Detailed comment	Concise statement as to why your comment should be taken on board	Name of commenter	Personal data
1	Risk control, management and measurement	4.2.20	25	Amendment	The industry would like to highlight that illiquidity and concentration must be assessed against the global exposure of the netting set and its impact in the context of the wind down of a portfolio. Notably a portion of illiquid collateral shall not imply that the collateral pool as a whole is illiquid. Consider for example a netting set with vanilla IR derivatives generating an exposure of 100 collateralised by 90 of cash. Assuming no illiquidity or concentration, the exposure of the netting set is 100 - 90 = 10. if the institution receives additional illiquid collateral of 5, in a worst case scenario, this additional collateral is worth 0 and the bank is not worse off. In any other scenarios, the illiquid collateral retains some value (arguably lower than 5) and the bank has reduced its risk. **We recommend the following formulation:** « Institutions monitor illiquidity and concentration at least at portfolio level, for both transactions and collateral, and reflect, when deemed material, the impact of such positions in economic risk measures. »	Illiquidity and concentration must be assessed against the global exposure of the netting set and its impact in the context of the wind down of a portfolio. Notably a portion of illiquid collateral shall not imply that the collateral pool as a whole is illiquid.	Jones,Gregg	Publish
2	Risk control, management and measurement	4.2.21	25	Amendment	The industry believes that in most cases, the PFE model is already a rigorous and sufficient to provide institutions with CCR measures that are conservative enough, especially when applying the regulatory MPOR framework. Indeed, due to the modelling principles applied, PFE models provide in most cases conservative measures even if some assumptions or proxies are being applied or if not all the drivers of the wind-down costs are captured in the model. As a consequence, according to the proportionality principle, the proposed setup should be constrained to high-risk counterparties, where institutions consider the PFE metrics are not sufficient to provide an adequate measurement of counterparty credit risk. In particular, a low-risk counterparty with less liquid collateral shall not automatically trigger the deployment of an additional economic measure. The industry considers additional measures of the counterparty credit risk are necessary to monitor the risk linked to less liquid risk factors, those are not necessary in addition to the PFE metric / pillar 1 capital requirements, but rather as an alternative measure of the same risk, to which the PFE or the EAD should be applied. **We recommend the following formulation :** 21. **Appropriate economic measure for costs of CCR portfolio wind-down** For risk management purposes, when the PFE model is deemed not to be providing an adequate measurement of risk, institutions go beyond the sole application of the regulatory MPOR and deploy complementary economic measures for the costs of winding down portfolios with high-risk counterparties ~~or netting sets~~ comprising less liquid collateral or hard-to-replace transactions. When deploying such economic measures, due consideration is paid to the effects of a netting set wind-down on hedging positions with other counterparties, and to potential additional market risk losses from the unmatched hedging positions which would exceed the estimates provided by the PFE or EAD exposure metrics.	The implied requirement shall be constrained to relevant situations (only high risk counterparties for which EAD and PFE are not adequately reflecting the risk). The actual formulation may imply an additional treatment to a large number of counterparties (ie. including low risk counterparties), and seems to oversee the fact that exposure measurement may be already conservative due to modelling/metric assumptions. To be effective and consistent with the initial intent this requirement should focus on situations where the main CCR metrics present shortcomings. We provide the following examples as an illustration: - a relative value trade where the counterparty is long a 1y call option on an equity index, and short an option on a basket of stocks, one of them being illiquid. Because of the scenarios evolving over time the PFE metric ranges from between 300 to 600, or even 850 to 1,000 if the MPoR extension is applied. This is due to the fact that this relative value trade is not rebalanced over time, thus leading to some directional exposure. As a comparison, a stress test applied on this position, that captures in full valuation the volatility risk (including shifts in the vol surface) only reaches 400. So the PFE is sufficiently conservative even though the illiquid features are not captured in it. - a pure volatility position on a basket of illiquid stocks (delta hedged): here the PFE metric, using the MPOR extension, could reach 150 to 300, while a stress test applied on the volatility surface and using a 60 days liquidity horizon may only reach 200. This is because some delta exposure arises over time in the PFE approach, even though this is not the realistic behavior of a counterparty. The above 2 examples illustrate that the PFE metric must be assessed overall, and not each of its individual assumptions.	Jones,Gregg	Publish

3	Stress testing and WWR	5.2.25 5.2.26	30	Clarification	While the report is understood to provide a collection of good practices in CCR governance and management that were observed during the targeted review, the consultation paper does not seem to have observed any good practices related to paragraph 25. The industry is not clear on the expectations from the ECB related to paragraphs 25 and 26 and feel that they already perform activities which address the concerns of the ECB. The industry is unclear where they are not meeting the ECB's expectations, thus we request the ECB to provide more detail on their expectations. We request a detailed formulated requirement which would satisfactorily meet the expectations.	The industry is unclear on the requirements in these paragraphs as there are already measures taken by the banks to address the issue. We request the ECB to provide detailed guidance on what would meet the ECB's expectations regarding these requirements.	Jones,Gregg	Publish