August 28, 2024

Mr. Neil Esho
Secretary General
Basel Committee on Banking Supervision
Centralbahnplatz 2
4051 Basel, Switzerland

Submitted via online portal and via electronic mail

Re: **ISDA/IIF Public Comment on the Basel Committee's Consultation on Guidelines for Counterparty Credit Risk Management**

Dear Mr. Esho:

The International Swaps and Derivatives Association ("ISDA") and the Institute of International Finance ("IIF", and, together with ISDA, the "Associations[1]") appreciate the opportunity to provide comments to the Basel Committee on Banking Supervision ("BCBS") on its consultative document on "Guidelines for counterparty credit risk management" issued in April 2024 ("the guidelines").

The Associations appreciate the BCBS's goal to update the 1999 BCBS publication[2] to address recent lessons learned and incorporate industry best practice into counterparty credit risk (CCR) management. However, while that prior publication was quite brief and narrowly focused (on just "highly leveraged counterparties"), the consultative draft guidelines are wide-ranging in respect of counterparty type and banks' counterparty risk practices, protocols and frameworks. The Associations strongly support the BCBS objective that banks and supervisors should take a "risk-based and proportional approach in the application of the guidelines".

This letter highlights certain issues the Associations have identified in the consultative document along with recommendations to enhance the effectiveness and practical implementation of the guidelines.

In line with the stated objectives of the BCBS, it is imperative that the principle of proportionality be embedded throughout the guidelines – especially as they are likely to be implemented in individual jurisdictions on a paragraph-by-paragraph basis – in order to appropriately reflect the broad diversity of banks and their counterparties.

The Associations strongly encourage the BCBS, along with jurisdictional central banks and supervisors, to engage actively in developing a common understanding of and a more coordinated approach to CCR guidelines. Additionally, we advocate for supervisory engagement with banks to gain insight into industry practices. Providing consistent guidelines for supervisors globally could enhance the effectiveness, efficiency, and comparability of sound CCR practices.

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[1] This response has been drafted on the basis of feedback received from participants in the Associations' working groups that include sell-side and buy-side market participants.
[2] BCBS; Sound practices for banks' interactions with highly leveraged institutions (January 1999); *available at* https://www.bis.org/publ/bcbsc123.pdf

KEY OBSERVATIONS:

- The guidelines should reflect a risk-based, tailored, and proportionate approach to banks' CCR management. This approach should be integrated throughout the guidelines. While the Associations agree that the quality of client disclosures should be a key input into the risk management framework, there is a strong belief that the scope and sophistication of the disclosure framework needs to be risk-sensitive and that banks should have flexibility in defining the requirements for different client segments (e.g., corporates, insurers, investment managers, hedge funds, etc.) and their legal and/or regulatory status. The guidelines should reflect the reality that banks may face challenges in obtaining some information from certain counterparties for a variety of reasons, including legal and/or regulatory constraints counterparties face in providing such data.
- The guidelines should promote and enhance robust, yet flexible, risk monitoring and management by banks rather than focus on the elimination of risk.
- The guidelines should be revised to remove impractical measures and those for which the implementation and maintenance costs are disproportionately high relative to the expected benefit.

Addressing these aspects will allow banks to implement the guidelines appropriately given the CCR they face from a diverse set of counterparties and avoid an overly burdensome risk management framework on banks which could undermine the overarching goal of the guidelines.

The next section contains an Executive Summary that explores the overarching themes and considerations for each section in the guidelines. Following that is part II, which addresses the Associations' comments and proposed edits to the guidelines.

ISDA Safe, Efficient Markets

INSTITUTE OF INTERNATIONAL FINANCE

I. Executive Summary

BCBS CCR Guidelines Section 2: Due diligence and monitoring

The guidelines recommend that firms obtain additional information from counterparties; however, the Associations suggest that such requirements be proportionate and take into account the limitations banks may face in obtaining some information from certain counterparties, including publicly listed counterparties that have legal and/or regulatory constraints relating to the provision of such data. In addition, it may not be appropriate for counterparties to disclose to banks their exposures to other market participants, depending on the nature of their trading relationships.

While the guidelines propose a single disclosure framework for all counterparties, the disclosure requirements should acknowledge the diverse risk profiles of different counterparty types, consider a counterparty's regulatory environment, and adopt a disclosure framework proportionate to those risks.

Before including any provisions in the guidelines that could have the effect of imposing additional data collection or disclosure requirements on market participants for ultimate use by bank regulators for market-monitoring or other supervisory activities, the Associations would urge authorities to perform analysis to assess the significant amount of relevant data that is already available to authorities (including through direct collection from counterparties) and to better understand the legal and/or regulatory constraints that some counterparties face in providing such data to banks. In all cases, the principle of proportionality should be paramount.

BCBS CCR Guidelines Section 3: Credit risk mitigation

In the section on credit risk mitigation, the need "to take a risk-based and proportional approach in the application of the guidelines" is vital. In particular, the Associations note that sector and counterparty risk profile drives the credit risk mitigation requirements (e.g., a large, well-rated corporate client may have a master netting agreement for credit risk mitigation without necessarily having a margining agreement in place).

The Associations agree with the importance of initial margin (IM), which is foundational to CCR management, and support the idea of IM arrangements tailored to the counterparty's risk profile and underlying risks. However, in the event that risk-sensitive margining arrangements are not achievable, firms should ensure adequate IM through an appropriate margin framework, which may include additional margin requirements such as Independent Amount (IA) and/or further haircuts on eligible collateral. Thus, the guidelines should focus on establishing robust margin frameworks to ensure IM adequacy instead of emphasizing risk-sensitive margining requirements.

BCBS CCR Guidelines Section 4: Exposure measurement

The Associations support the use of a suite of metrics to provide a more comprehensive understanding of a bank's CCR and recognize the importance of controlling the bank's overall CCR profile. However, we ask that the guidelines allow banks the flexibility to select the types of metrics they use to monitor CCR without prescriptive requirements regarding the metrics themselves or their level of granularity.

The margin period of risk (MPOR) is already defined in the capital rules with prescribed time horizons in certain cases under both IMM and the standardized approach for counterparty credit risk (SA-CCR), calibrated based on conservative assumptions. Firms should have flexibility to adjust exposures for increased risks, such as concentrated or illiquid portfolios, or types of collateral using mechanisms other than standardized, approximate adjustments to the MPOR that lead to potentially unrealistic MPOR values.

The guidelines prescribe improvements to the calculation of a counterparty's potential future exposure (PFE) to address shortcomings affecting the accurate monitoring of tail and concentration risks. Instead of requiring firms to implement more sophisticated PFE models, firms should have flexibility to implement complementary measures which capture such risks, whilst avoiding an overabundance of metrics that could make it difficult to understand exposures.

Making PFE and stress testing counterparty-specific is not practical and can produce results that are difficult to understand; size, concentration, wrong-way risk (WWR) and liquidity would be better reflected as an additional cost to close out a particular exposure. We would also note that WWR is being used as a catch-all phrase in the guidelines for a wide range of adverse impacts that banks may face.

Finally, modelling should remain transparent. This means that for idiosyncratic exposures and data in illiquid markets, there should be flexibility in how to model CCR.

BCBS CCR Guidelines Section 5: Governance

The banks have varying levels of formal collaboration between market and credit risk management functions in practice, which makes it difficult to implement a one-size-fits-all approach. The Associations propose that banks be given the flexibility to adopt their own approaches.

The Associations agree that risk limits should be set based on the risk tolerance level but note that in some cases it is appropriate to delegate this authority to senior management or senior risk officers without the need to convene a full risk committee.

Given the cost associated with implementing and monitoring intraday exposures, the Associations fully support use of the term "encouraged" in the guidelines as being appropriate to allow for a proportional risk-based approach, rather than the imposition of any kind of mandatory requirement.

The guidelines need to ensure bank subsidiaries can benefit from group-wide systems, processes, and expertise.

BCBS CCR Guidelines Section 6: Infrastructure, data, and risk systems

The guidelines should acknowledge that there is a tradeoff between (1) including granular details into modelling/margining and (2) having transparent and sound measurement systems. Including all idiosyncratic elements and data from illiquid markets does not lead to transparent and sound measurement systems, as required in the guidelines, and may not be practical.

BCBS CCR Guidelines Section 7: Close-out practices

Close-out situations are fact- and-circumstance-specific, and each case may therefore require the allocation of different internal and external resources and the execution of different steps; the guidelines should reflect this.

Involvement from the legal department and counterparty risk management functions is critical throughout the entirety of a counterparty closeout. The process should also have input from other functions such as trading desks, operations, collateral management, and other back-office functions (in each case, as appropriate).

The resource-intensive nature of running mock close-out exercises means these are not practical without prior notification. The bank should not give advance notice to internal participants regarding exact details (such as the name of the target) of such an exercise; however, the approximate timing of the exercise may be communicated in advance. Furthermore, the guidelines should set a minimum requirement for banks to run a mock close-out exercise every two years.

The counterparty should vary for each close-out exercise and should be a complex counterparty. It is critical that such mock close-out exercises are kept strictly confidential in order to avoid incorrect information on the candidate's financial condition or status reaching any person not involved in the mock close out exercise.

II. Recommendations for Specific Paragraphs

2. Due Diligence and Monitoring

Paragraph 1

The guidelines require a thorough initial assessment and understanding of a counterparty's risk profile in both current and stressed market conditions. This includes understanding the rationale and economics of underlying exposures, as well as the key factors driving the counterparty's performance and growth. However, it may not be appropriate for counterparties to disclose information about exposures to other market participants depending on the nature of their trading relationship with that market participant.

The guidelines suggest that the credit approval process should begin with a review of both financial and non-financial information. However, the Associations recommend that this should be an element of the due diligence process, ensuring that credit risk teams are not solely responsible for the comprehensive collection of all relevant information. This collection should involve various functions across the firm, including those outside of credit risk, such as legal and compliance.

Additionally, the guidelines stipulate the need for ongoing monitoring of counterparties, particularly regarding changes in trading activities, leverage, profit and loss, and other significant developments. Banks often rely on due diligence to gain visibility into the counterparty's activities. However, banks are dependent on their counterparty's voluntary disclosure of information, as long as those activities fall within the scope of their objectives or strategies and the counterparty is not obligated to disclose otherwise. It should also be noted that publicly listed companies may be legally constrained by their statutory obligations from providing information to their counterparties that is not in the public domain.

Banks may want to tailor the level of ongoing monitoring to be commensurate with the risks they are taking. For example, in the case of delivery-versus-payment (DVP)-only clients, banks may find it unnecessary to allocate extensive resources to monitor them to the degree stipulated in the guidelines. Similarly, some DVP-only clients may feel that banks are overreaching when credit officers request a large volume of information to support a DVP-only relationship.

The Associations recommend the following changes to the guidelines:

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~~ current and stressed market conditions. The ~~credit approval~~ due diligence 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,~~ This should be based on the nature of the relationship of the bank with a counterparty and take into account the principle of proportionality (including whether additional information is required where there is publicly available data on material exposures or where there may be constraints on listed counterparties in terms of the information they can provide that is not publicly available). In addition, it may not be appropriate or permitted for counterparties to disclose information about exposures to other market participants depending on the nature of their trading relationship with that market participant and the application of confidentiality provisions in any trading documentation or other restrictions under applicable law, including competition law. Where appropriate, banks should understand the rationale 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~~ that should be commensurate with the bank's risk appetite for the relevant activity. Where practical, such ongoing monitoring should cover material developments related to key financial and non-financial risks on a proportionate, risk-based approach with respect to the counterparty, ~~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.~~

Onboarding

Paragraph 4

The guidelines focus on the assessment of a counterparty's past and current reputation and creditworthiness before onboarding. It can be challenging to evaluate proprietary information, such as trading strategies, especially for funds. In terms of industry best practice, while it is typical for the second line of defense to consider aspects such as past reputation, regulatory sanctions, or legal status if they arise during due diligence, the primary responsibility for gathering and reviewing this information should lie with the first line of defense's know your client (KYC) checks. This ensures a comprehensive assessment of the counterparty's background and suitability for onboarding. Any qualitative factors considered should take into account the counterparty's risk profile.

The guidelines note that banks should consider negative supervisory actions such as sanctions. However, they can also rely on positive supervisory assessments of the counterparty, which may be used by banks to grant licenses, certifications, or other approvals.

The Associations recommend the following changes to the guidelines:

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 the level of regulatory oversight, considering available regulatory reviews and becoming knowledgeable about the individuals responsible for managing the institution, including considering any previous supervisory sanctions against the counterparty or the managers. Banks should also assess qualitative factors such as strategy, quality of risk management practices, and senior staff composition ~~and turnover~~ where available. 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.

Paragraph 5

The guidelines highlight the use of margin in the credit risk decision-making process. The BCBS suggests that margin serves to control the amount of leverage in a trading relationship. However, it is important for the BCBS to clarify that the primary purpose of margin is to mitigate potential losses in the event of a counterparty default. This clarification would help ensure a clear understanding of the role of margin.

The guidelines emphasize the importance of establishing clear linkages between the information analyzed during onboarding and continuous monitoring of due diligence and the CCR decisions made by banks. However, assessing a client's proprietary information, such as trading strategies, can pose challenges. Such proprietary information would not be appropriate to be shared with banks in a trading relationship with non-fund counterparties, who may be active both on the buy and sell side in certain markets. The guidelines should consider the complexities involved in evaluating such proprietary information and provide appropriate guidance for banks in these cases, including proportionality, and consider the challenges for publicly listed counterparties. Adopting a one-size-fits-all approach is not appropriate.

The Associations recommend the following changes to the guidelines:

5. Banks with sound onboarding practices recognise that although their initial onboarding decision may be binary, their full credit risk decision-making process can be a spectrum of how much credit and exposure the bank is willing to extend to the counterparty~~, including the terms of margining used to control the amount of leverage in the trading relationship and transactions with the counterparty~~. As a result, banks with sound practices demonstrate thoughtful and clear linkages between information analysed during onboarding due diligence and their CCR decisions, including but not limited to risk ratings, limits, contractual terms and risk mitigants (eg collateral and guarantees).

Paragraph 6

The guidelines suggest that banks should appropriately address the intersection between CCR and geopolitical or country risk. The Associations recommend striking this sentence from paragraph 6 as it is dealt with in other guidelines (e.g., paragraph 75).

The Associations recommend the following changes to the guidelines:

6. Consistent with their risk appetite for the covered activity, banks should ensure, at the point of onboarding, that their processes consider and assess non-financial risks as part of the credit risk decision-making process. Banks should also establish an escalation process and clear communication channels for the review of non-financial risks. ~~For instance, banks should appropriately characterise the intersection between CCR and geopolitical or country risk. This is a process that may benefit from consultation with the legal department at the point of onboarding.~~ In some cases, risks such as reputational risk may not directly impact the counterparty's capacity to repay – i.e. probability of default – or immediate financial performance but may introduce other non-quantifiable risks that could materially impact the overall riskiness of the counterparty. These non-quantifiable risks can transform into CCR over the longer term even in cases where no direct impact on the probability of default can be seen.

Paragraph 8

To enhance the understanding of a client's overall risk profile, the guidelines recommend that banks gather adequate information during the onboarding process. This includes providing additional disclosures and metrics, such as value-at-risk (VaR) or stress test results, particularly for risky and complex counterparties. There are a few concerns regarding these recommendations. Firstly, the specific requirements banks need to meet in terms of additional disclosures and risk metrics remain unclear, and such a level of disclosure may not be appropriate for all counterparties or types of client relationships. Secondly, the guidelines do not provide a clear definition of what qualifies as "risky and complex" counterparties. Thirdly, it is important to note that "additional disclosures and risk metrics – such as value-at-risk or stress test results" should not be taken at face value but could serve as indicators of the quality of the counterparty's risk management framework when available. However, while we agree that financial institutions such as clearing members and intermediaries in bilateral transactions should perform robust due diligence on all their counterparties and take these into account in their own credit risk assessments, we would emphasize that intermediaries should not be responsible for the risk management practices of their counterparties.

Furthermore, banks should have the flexibility to adapt their approach based on specific circumstances and the requirements of each client, while still maintaining the appropriate due diligence and risk management practices. It is possible that some clients may not be able to produce the disclosures mentioned in the guidelines, while others may perceive the bank's request as excessive considering the type or stature of the client, or the nature of the intended relationship.

Consideration of our feedback would help to ensure a more comprehensive and transparent understanding of a counterparty's risk profile. The Associations recommend the following changes to the guidelines:

8. Where it is proportionate to do so, banks should endeavour to collect information on clients' risk management practices, operational controls and governance, which in turn should be factored into the internal risk rating/limit adjudication process. Banks should ~~collect~~ request sufficient information during onboarding to understand the client's overall risk profile, to the extent required to perform its own credit assessment in line with the bank's risk appetite for the covered activity. In some cases, the collection of financial statements alone is insufficient to assess the riskiness of a counterparty. For example, ~~risky and complex~~ depending on the specific sector or the counterparty's risk profile, counterparties should provide additional disclosures and risk metrics – such as value-at-risk or stress test results ~~– so that banks have visibility into the counterparty's own assessment of their underlying leverage and risk profile~~. When counterparties share internal risk reports produced on a regular basis, the bank should use these reports to gauge the quality of the counterparty's risk management capabilities and practices.

Paragraph 9

The guidelines suggest that banks should thoroughly understand the key assumptions about a counterparty's risk profile when establishing a relationship. This includes factors such as their liquidity levels and sources, and the potential for orderly liquidation of underlying positions.

Such understanding helps assess the inherent riskiness of trades with the counterparty, including market directional risk, excessive concentration risk, idiosyncratic risks, and WWR, which arises from the dependency between client default and its underlying exposure. While the Associations agree that these are relevant considerations when onboarding clients for known bespoke transactions, we recommend that the language be amended to be less prescriptive when the exact nature of trades is unknown at the initial onboarding stage (e.g., onboarding a corporate for future FX hedging requirements).

The purpose-payback model[3] may not be suitable for simple flow transactions. In such instances, it may be more relevant to examine the stress test outcomes for related entities in a group, which helps in evaluating whether a parent entity has sufficient liquidity to support its subsidiaries. The guidelines should explicitly allow flexibility to ensure banks can use their judgment about the level of evaluation requirements, depending on the overall counterparty profile. To the extent that elements of credit and

[3] The purpose-payback model is a structured approach to credit analysis that considers why companies borrow/issue debt (i.e., purpose) and how it is repaid (i.e., payback).

market risk management can be enhanced via additional due diligence requirements (under CCR), regulators need to be mindful and allow for appropriate risk adjustments on a case-by-case basis. We note that counterparties' proposed trading positions and sample portfolios are an example of disclosures which will prove impossible to collate and meaningfully assess. Regarding the liquidity impact on an orderly unwind, we note that banks already consider the amount that could be owed.

The guidelines recommend that banks should develop a framework to incorporate the quality of counterparties' disclosures into the conditions of doing business and suggest that banks' policies should clearly specify the required disclosure information. However, these broad statements cannot be uniformly applied across all counterparty types or even within the same sub-sector (e.g., a fund, where investment strategy and net asset value (NAV) are relevant).

The guidelines recommend that banks ensure adequate proof, assurances, or verification are part of the due diligence process which would ensure that credit risk decisions are not made based on unverified or verbal information. The Associations suggest flexibility in allowing for the acceptance of verbal information from clients.

The guidelines propose that banks could benefit from engaging third-party verification services. However, demonstrating a framework that links the quality of the firm disclosures to business conditions may be challenging, except for general transparency scores. Furthermore, this may be unnecessary in the case of certain counterparty types (e.g., those that are publicly listed). The expectation for banks to verify document assurances is overly onerous. Additionally, the use of external third-party providers to support disclosure verification would not only be disproportionately costly for both sides, but also it will inevitably cause information to reach banks with a substantial delay given that it would require vetting, cleansing and validation. For a pre-settlement exposure, this may prove unnecessarily onerous. In the meantime, a conversation with the counterparty's relevant executives may yield much more relevant, immediate information where appropriate.

Overall, while the Associations agree that the quality of client disclosures should be a key input into the risk management framework, there is a strong belief that the sophistication of the disclosure framework needs to be risk-sensitive and banks should have some flexibility in defining what is required depending on the specific sector or the counterparty's risk profile, including what information is required and the need for third-party verification.

The Associations recommend the following changes to the guidelines:

9. Where appropriate, the credit process should identify the purpose and structure of the transactions for which approval is requested and provide a forward-looking analysis of the repayment capacity based on ~~various scenarios, including stress testing and analysis of idiosyncratic circumstances that could present~~ the creditworthiness of the counterparty and facility-level protections, thereby mitigating material risks to the client. Banks should have a good understanding of key assumptions made about a counterparty's risk profile when establishing a relationship with them – such as their level and sources of liquidity and how the orderly liquidation of underlying positions might occur – to facilitate a deeper understanding of the inherent riskiness of the underlying trades with the counterparty, including ~~market directional risk, excessive concentration risk, idiosyncratic risks and~~ WWR (where applicable) arising from the dependency between client default and its underlying exposure. More generally, banks with sound practices have a framework to directly incorporate the quality of counterparties' disclosures into the conditions of doing business, including but not

limited to the level of margin requested, limit setting and/or the internal risk rating process. Policies should clearly articulate the information required in disclosures~~. After the information from the client has been received, banks should also ensure that adequate proof, assurances or verification are applied as part of their due diligence processes. This type of practice helps ensure that credit risk decisions are not made based on unverified or verbal information. In some cases, banks may benefit from engaging third-party information verification services.~~ This framework should include minimum standards on counterparty disclosure, including an exception process taking into account the constraints mentioned in paragraph 4. The framework should also include requirements for limit setting, margining or other mitigants. A client's failure to provide information should lead to a more conservative approach to risk rating, limit setting, margining and other forms of credit risk mitigation, or even the rejection or offboarding of the client. As noted previously in this section, the credit risk decision-making process can include a spectrum of the exposure, limits and mitigants a bank is willing to extend to the counterparty.

Paragraph 10

The guidelines mandate that banks review proposed trading positions or sample portfolios to assess the underlying risks in the activities the banks will be financing at the onboarding stage. However, it is not always feasible to review trading positions or sample portfolios in all cases – this is typically only feasible during clearing or prime brokerage onboarding. It would be impractical to conduct such reviews when onboarding clients for bilateral OTC activity, as the frequency and composition of future trading activities can be influenced by a range of factors. The Associations suggest that this requirement should not be absolute and recommend that the guidelines use language such as "when relevant". This suggestion takes into consideration the mitigation and controls covered in some of the other guidelines, such as paragraph 98, and that certain counterparties might not be able to provide this information for a multitude of acceptable reasons.

The Associations recommend the following changes to the guidelines:

10. When relevant, banks are expected to review proposed trading positions or sample portfolios to assess the underlying risks inherent in the activity that the bank will be financing. Banks with sound practices apply this review whenever onboarding new clients, new funds or approving new types of trading activities for existing clients. This analysis should span at least the main internal metrics used for risk monitoring – including ~~BAU~~ exposures calculated using current/recent and stressed ~~exposures~~ market conditions. In the case of new trading positions of existing clients, the incremental impact of the new positions should be assessed against the existing risk limits for the counterparty. Better due diligence practices incorporate specialised evaluation and technical knowledge within banks on industries such as commodities, where terms vary significantly depending on the type of product being traded and collateral obtained.

Ongoing Credit Assessment

Paragraph 11

The guidelines emphasize that due diligence obligations extend beyond the initial onboarding of a counterparty. It is necessary to regularly gather and assess information that impacts a counterparty's risk profile, including changes in trading activities and performance (e.g., NAV, profit and loss developments, significant changes in leverage, modifications to risk management procedures or processes, and changes in key personnel). Currently, the ongoing minimum market standard for hedge fund disclosure is typically limited to NAV and monthly performance. Some counterparties may provide a portfolio overview, including leverage, liquidity, and directionality, if they share monthly factsheets. However, not all counterparties produce or are willing to share such factsheets. In addition, trading strategies and portfolio analysis would be inappropriate to share externally for certain counterparties.

The guidelines should explicitly allow banks to align their ongoing monitoring to market standard, depending on the type of counterparty and the activity undertaken with them. Changes in personnel are unlikely to be communicated outside of the annual review unless there is a change at the C-suite level.

The Associations recommend the following changes to the guidelines:

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 according to the counterparty's risk profile to regularly receive and assess public information that sheds light on a counterparty's risk profile. For example, where appropriate, 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 developments on a regular basis, and other information, such as significant changes to leverage, alterations to their risk management procedures or their risk measurement processes, and changes in key personnel at a (pre-defined) regular frequency. ~~Banks~~ Where appropriate, based on the type of counterparty and the nature of the banking relationship with that counterparty, banks with sound practices rigorously explore according to the counterparty's risk profile 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.

Paragraph 12

The guidelines suggest that banks should have a process for continuously monitoring various metrics such as performance, volatility, liquidity, management quality, and concentration. However, it should be noted that setting an objective trigger around "management quality" may not be feasible and does not fit within a continuous monitoring plan. Additionally, the Associations recommend changing the wording from "tracked" to "monitored" since the rest of the guidelines use the latter with respect to metrics.

The Associations recommend the following changes to the guidelines:

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~~ monitored and lead to adjustments in the ongoing monitoring process as appropriate. Banks should also establish a frequency for ongoing monitoring and predefined intervals for due diligence, rating review, and limit reviews ~~triggers for metrics such as performance, volatility, liquidity, management quality and concentration~~, which should be commensurate with the risk presented by the client ~~under normal and stressed market conditions~~. The frequency of ongoing monitoring should also take into account the assessment of a counterparty's non-financial risks.

Paragraph 13

The guidelines state that banks should consider an exit policy from the contract if the client fails to deliver key due diligence information. We suggest that this requirement be explicitly risk-based and include "where appropriate", depending on, for example, the type of exposure, activity, collateralization, and tenor. This requirement should also reflect the fact that banks have policies and procedures in place defining the steps they may take, with exit as a final resort. Such risk can be mitigated in other ways, including escalation and increased collateral.

"Sufficiently timely" can include "on demand", for example, in a crisis situation, so this does not need to be repeated in the guidelines.

The Associations recommend the following changes to the guidelines:

13. Banks with sound practices monitor the timeliness and quality of financial statements and risk information provided by the client on an ongoing basis, and track exceptions to established policies at the counterparty level as well as at aggregated portfolio levels. Further, banks should ensure that all information relevant to a counterparty credit relationship, including risk analysis performed by the counterparty, is made available to the bank on a sufficiently timely and ongoing basis~~, including on an on-demand basis when warranted~~. When relevant and proportionate for the specific sector or the counterparty's risk profile, banks ~~should~~ may also consider including additional termination rights in ~~an exit policy from~~ the contract if the client fails to deliver key specified due diligence information within a specified time period.

Paragraph 14

The guidelines provide recommendations for operating an internal risk rating system, including the frequency of internal risk rating reviews for counterparties. The guidelines suggest that a revised assessment should be triggered by a material change in the counterparty's leverage or risk profile. The Associations propose edits to reflect the range of considerations that go into the frequency of reviews.

The Associations recommend the following changes to the guidelines:

14. An internal risk rating system used to assess and monitor the quality of individual counterparties and across the portfolio should be suitable for and commensurate with the nature, size and complexity of a bank's activities. For counterparties with CCR exposures, due consideration should be given to the dynamic nature of these relationships, as mark-to-market (MTM) exposures can change materially over short time frames that may require updated credit risk assessment and decisions. ~~The frequency of internal risk rating reviews for these counterparties should account for~~ The risk profile, the dynamic nature of ~~their~~ ~~a client's~~ positions and the risk rating ~~process~~ should determine the frequency of reviews. ~~Ensure that any material change in the counterparty's leverage or risk profile should trigger a revised assessment~~. These revisions should include, but are not limited to, the risk rating score, ~~products allowed for the relationship,~~ scope of products offered, margining terms, and, where appropriate, exposures and concentration limits.

Paragraph 16

The guidelines recommend that banks adopt a margining framework that "is consistent across all trading products and onboarding platforms". We propose that the wording be amended to clarify that this guideline does not mean that the same margin methodology should be used for all products and counterparties.

The Associations recommend the following changes to the guidelines:

16. Banks with sound practices develop and implement a transparent and robust margining framework that ~~is consistent~~ ensures the same minimum standards are applied across all trading products and

onboarding platforms, even if different margin methodologies may be deemed appropriate for particular products, sectors, or counterparties. Such practices are reflective of underlying risks and the bank's risk appetite. As a minimum, the margin framework should adequately capture both the market and liquidity risks associated with the portfolio (including valuation risks), the quality of collateral received, as well as the credit risk associated with the counterparties.

3. Credit Risk Mitigation

Margining

Paragraph 17

The guidelines recommend that margin levels should consider the market risk of the portfolio and be sensitive to changes to the counterparty risk profile and underlying risks. The current margining framework is primarily based on the counterparty's risk profile with the bank and the counterparty's internal rating. This framework faces challenges in reacting to changes in the counterparty's overall market risk profile, especially when a client's new trading strategy affects the broader market and not just the bank. We also note that this part of the guidelines suggests that banks can unilaterally change margining terms, which is not the case, or that banks must document all such margining terms at the start of the relationship with the counterparty, which is not practical.

The guidelines also emphasize the importance of sensitivity-based margin practices that take into account both the market risk profile of the portfolio and the counterparty risk profile. However, in practice, not all margin rates are sensitivity-based, and it may be challenging to implement risk-sensitive margin approaches across the counterparties. In the event that risk-sensitive margining arrangements are not achievable, firms should ensure adequacy of IM and IA through an appropriate margin framework. Thus, we ask that the guidelines require robust margin frameworks to ensure margin adequacy instead of emphasis on risk-sensitive margining requirements.

The guidelines lack clarity regarding the expectations surrounding "implementation of new trading strategies". While a dynamic margin methodology can capture changes in liquidity profile or concentration of the portfolio in prime brokerage frameworks, it may not be feasible, or appropriate, in other areas such as bilateral derivatives trading. In such cases, there may be no systematic ability to identify the "implementation of new trading strategies" or changes in leverage levels, which would be needed to apply bespoke margin levels (i.e., as opposed to the standard trade-by-trade margin calculation methodology). The guidelines should be changed to explicitly allow banks to adjust their approaches depending on the type of counterparty and market.

Flexibility in margin terms, such as accommodating a counterparty's new hedging strategy, is possible when entering new or renewing maturing trades and portfolios (e.g., repos within the broader envelope of securities financing transactions (SFTs)). However, for longer-dated transactions like portfolios of longer-dated interest rate swaps or inflation trades, IM (and if warranted, IA) terms are negotiated upfront and cannot be unilaterally amended. As a result, the ability to adjust terms or haircuts due to changes in the counterparty's circumstances or market stress may be limited unless explicitly defined and documented upfront via specific triggers that must also be mutually agreed upon, along with necessary reporting. The guidelines should be changed to recognize these different practices. It should be noted that stability and predictability of margin calls on bilateral OTC transactions can serve as a strength in times of market stress.

It is important to note that margin locks, which represent a written notification period before margin requirements can be altered, can restrict flexibility in changing terms for certain clients. The language used should be balanced and focused on changes in market risk rather than directional or strategy-based changes.

The Associations recommend the following changes to the guidelines:

17. Margin levels should account for the market risk of the portfolio and be ~~sensitive~~ calibrated to ensure adequacy of margin through various mechanisms including charging upfront margin, such as IA based on a per trade notional amount, that is appropriate and is sensitive to changes to the counterparty risk profile, ~~and~~ underlying trade risk~~s~~ characteristics and credit quality of the counterparty. For example, the preference is that margin for ~~hedge fund~~ a counterparty's exposure should be sensitive to the implementation of new trading strategies, as well as changes in portfolio directionality, concentration or leverage. As a substitute, where simpler or less dynamic margin mechanisms are applied this should be at an appropriate confidence level, and risk mitigants should include an assessment of adequacy of initial margin through market cycles. 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 exposures, and capture material risks at the portfolio level ~~single name and risk factor level~~. Banks should also require margin levels that reflect material risks arising from other contractual terms such as early termination, ~~margin lock-up and frequency of margin resets,~~ among others.

Paragraph 18

The guidelines recommend that the margining framework should consider the overall risk profile of the counterparty, not just the narrow risk profile of the bank's trading relationship with the counterparty. However, it will be challenging to obtain information about a counterparty's aggregate risk profile, including stress testing, across the entire market. Counterparties are often reluctant to share detailed information about their wider portfolios held with other banks, making it difficult for banks to have an ongoing view of these portfolios. In many cases, it will not be appropriate for counterparties to share this kind of commercially sensitive information externally. Counterparties may also face restrictions on sharing this information externally (e.g., for publicly listed counterparties).

Regarding the assessment of "risk taken outside its portfolio", the guidelines suggest that banks review a counterparty's financials and perform an internal risk assessment, including with respect to jurisdiction risk and stress testing, to infer the risk taken outside its portfolio. However, assessing this risk can be difficult, especially when it involves processes like reverse stress testing, which are typically very challenging to implement and to communicate the model assumptions and output with external stakeholders.

The guidelines also propose that banks and their counterparts rely on professional third parties to calculate and share risk measures and stress results at an agreed-upon aggregation level. However, this is not considered to be a common practice. Further, it is unlikely that such a mechanism would materially improve the ability of banks to mitigate CCR. Any information provided through third parties would inevitably be standardized, perhaps to the point of not being helpful for risk assessment, and banks would inevitably receive the information only after substantial delay (to allow enough time for the information to be vetted, cleansed, and validated by both the counterparty and the aggregator). Such information would likely not be materially useful to banks, who would instead likely still have conversations with the counterparty's relevant executives, as appropriate, based on the nature of the banking or trading relationship with that counterparty, which would yield much more relevant and timely information.

The Associations recommend flexibility for this guideline by removing the example and the reliance on third parties for gathering information on CCR:

18. The margining framework should be informed and reflective of the firm's assessment of the overall risk profile of the counterparty, based on available information including financial statements, and where appropriate, NAV trends and volatility. ~~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 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.~~

Paragraph 19

The guidelines advise against engaging in margin customization or deviating from approved margin policies to accommodate commercial or competitive pressures without proper governance and support from margin sufficiency benchmarking. Based on our interpretation of this guideline, it appears to prohibit or restrict the extension of credit in such cases. Besides, with respect to cleared margin, we would like to highlight that the use of margin multipliers or buffers is part of a dynamic and prudent risk management framework undertaken by clearing member banks who underwrite the risk of end-users, and which is in line with the practice set out under paragraph 29 of the guidelines. As set out in the ISDA/IIF response to the BCBS-CPMI-IOSCO consultation on margin transparency[4], clearing members already provide transparency when they require clients to post margin incremental to CCP minimums in the minority of cases, and clients are able to negotiate ex ante the circumstances, including notice period, under which they might be called for additional margin by their clearing member.

The Associations recommend the following changes to the guidelines:

19. Banks should avoid opaque margining frameworks that lack effective oversight and fail to ensure that ~~risk-sensitive~~ adequate margins are charged on trades or portfolios at the inception of the relationship and on an ongoing basis. Additionally, banks should not engage in margin customisation or deviate from approved margin policies to accommodate commercial or competitive pressures without appropriate governance and the support provided by margin sufficiency benchmarking.

[4] ISDA/IIF Response to the BCBS-CPMI-IOSCO consultative report "Transparency and responsiveness of initial margin in centrally cleared markets – review and policy proposals" (April 2024), *available at* ISDA-Response-to-Margin-Transparency.pdf

Paragraph 20

The guidelines propose that banks with sound practices should have systems, policies, and procedures in place to monitor the effectiveness of their margining frameworks and methodologies. These monitoring activities should be reported periodically to senior management. However, the requirement to report margining frameworks and methodologies to senior management could be highly specific and technical, and it is unclear how effective such reports would be. In relation to what constitutes an effective margin framework, we interpret that as not expecting margin to cover underlying movements under stress, as that may not be practical in all scenarios. Control mechanisms such as credit limits and stress limits are commonly used, where lower margin charges result in higher credit and stress usage.

Backtesting evaluates a model's performance by comparing its forecasts with historical realizations. The guidelines recommend backtesting margin frameworks using realized historical exposures of the bank to the relevant counterparty, which is considered industry best practice. However, backtesting based on stress scenarios does not make sense. If an IM is calibrated to current/recent market conditions, it will, by definition, be lower than an IM calibrated to stressed market conditions. This does not necessarily imply that the IM must be increased, as a bank can manage the relevant risks through different means. Stress testing should be approached in a holistic manner, rather than focusing solely on an IM model, and the rationale behind the requirement to benchmark an IM model against stress scenarios is not clear. Also, we seek additional flexibility around backtesting of margin frameworks by recommending they be "subject to rigorous quantitative testing" rather than against realized historical exposures.

The Associations recommend the following changes to the guidelines:

20. Banks with sound practices have systems, policies and procedures to monitor the effectiveness of their margining frameworks and methodologies, which should be periodically reported to banks' senior management. Margin frameworks should be subject to ongoing monitoring and governance related to margin sufficiency, underlying assumptions, contractual terms and limit setting and risk appetite. The monitoring should be undertaken on both the counterparty level and on an adequate portfolio aggregation level. House margin frameworks should undergo a level of governance and scrutiny that is proportionate to their materiality. As part of this, margin frameworks should be ~~back tested using realised historical exposures as well as stress scenarios~~ subject to rigorous quantitative testing. For details on risk reporting, refer to the section titled "Management reporting" in Chapter 5 of this consultative document.

Paragraph 21

The guidelines propose that banks should regularly evaluate and test the assumptions underlying their margin models. However, these requirements are already addressed as part of the existing model review framework for banks in scope, making it redundant to duplicate these requirements in the guidelines.

The Associations suggest removing this guideline:

~~21. Banks should regularly assess and test the assumptions underlying their margining models. Banks with sound practices test both the appropriateness of the margin over time and reassess the assumptions underlying their margining models. Such models should be subject to proper review and challenge, including initial and ongoing independent reviews.~~

Paragraph 22

The guidelines recommend that banks establish a formal risk appetite for deviations from their margin terms and monitor their exposures against it. However, it is worth noting that implementing a consistent risk appetite for deviations in margin terms across all businesses may pose challenges, which raises concerns that the BCBS may be promoting a new limit framework for margin that deviates from existing margin terms. We agree that monitoring material deviations from margin terms and implementing effective escalation processes within the second line is essential. However, the use of the term “risk appetite” could be misinterpreted as requiring an aggregate limit. For instance, certain banks already evaluate the margin collected from clients in comparison to the levels that would have been charged according to the “standard” policy. Credit teams then provide approval based on various other factors, such as ensuring stress exposure remains within acceptable limits. If the intent of the guideline is for firms to aggregate all the monetary margin benefits received by clients and impose a limit on it, it is anticipated that this would result in significant administrative burden and introduce complications.

The Associations suggest the following changes to the guideline:

22. Where applicable, banks should establish a formal risk ~~appetite~~ framework for deviations from their margin terms ~~and monitor exposures against it~~. ~~A clear governance~~ This framework should ~~also establish escalation procedures in cases in which the appetite for risk is exceeded~~ include clear escalation and approval requirements for material deviations.

Paragraph 23

The guidelines also highlight the significance of IM requirements within the broader margining framework. However, there is apprehension that incremental IM requirements could potentially affect the competitiveness of certain products.

Consideration should be given with respect to how the guidelines interact with the “Margin requirements for non-centrally cleared derivatives” (BCBS IOSCO framework). In the BCBS IOSCO framework, a €50 million IM threshold was introduced to avoid unnecessary operational burden on smaller entities or bilateral relationships that do not pose systemic risks. Many Phase 5/Phase 6 entities calculate their IM using Standard Initial Margin Model (SIMM) but do not actually exchange the regulatory IM under the BCBS IOSCO framework because of the IM threshold. However, some banks voluntarily apply stricter in-house margining requirements beyond the minimum requirements in the BCBS IOSCO framework when they find it appropriate and necessary.

We would note that some banks were requested by their supervisors to apply specific stricter in-house margining requirements beyond the BCBS IOSCO framework for certain segments of clients (in particular, highly leveraged institutions). This may lead to an unlevel playing field issue. We believe the decision whether to apply stricter in-house margining requirements to a client should in principle be left to individual banks, and banks can make such a decision consistent with their risk appetite.

The Associations recommend the following changes to the guidelines:

23. Initial margin (IM) requirements are a particularly important part of a margining framework. They represent the amount of collateral necessary for absorbing potential losses in relation to a particular trade or portfolio of trades that may arise in the time between the last exchange of variation margin, and the liquidation or hedging of the positions. Such margin is either static, or re-evaluated and adjusted over time (i.e. dynamic) to reflect changes in a portfolio’s risk. When adopted, static margin

should be set ~~conservatively~~ appropriately to cover unexpected changes in underlying exposure to market value and riskiness.

Paragraph 24

The guidelines' requirement that banks "apply daily variation margin to all material counterparties with zero thresholds and small minimum transfer amounts" will only increase operational risk without improving counterparty risk mitigation/management. In other words, if a firm has to post margin/collateral for every additional euro, it only creates an operational burden with little concomitant benefit. Currently, there are market standards for the threshold and minimum transfer amount, and there is little risk in maintaining those standards. Rather, the guidelines should allow the relevant thresholds and minimum transfer amounts to be risk based.

The Associations recommend the following changes to the guidelines:

24. Variation margin (VM) is another important component of the margining framework, generally defined as the amount of collateral necessary to cover the current portfolio exposure, accounting for changes in the MTM valuation of the positions on a contractually agreed frequency. Banks with sound practices have rigorous and robust margin (IM and VM) dispute resolution procedures in place with their counterparty, and, to the extent possible, apply daily variation margin to all material counterparties ~~with zero~~ where thresholds and ~~small~~ minimum transfer amounts are set in line with the banks' risk tolerance.

Paragraph 25

The guidelines suggest that banks should ensure that contractual terms regarding two-way VM do not result in an increase in counterparty leverage and credit exposure. It should be noted that for counterparties subject to Uncleared Margin Rules (UMR), two-way VM is a regulatory requirement. Additionally, as VM is usually a title transfer, counterparties have the right to reinvest VM posted to them, and banks do not have the authority to restrict this in such cases.

We recommend that the BCBS acknowledge in this guideline that two-way rehypothecable VM is a common market practice, in certain circumstances is a regulatory requirement and is an important component of liquidity management. For rehypothecable VM, streamlined operational processing should be confirmed before counterparties agree to such terms.

The Associations recommend the following changes to the guidelines:

25. Banks should ensure that contractual terms stipulating two-way variation margin do not exacerbate risk by increasing the counterparty's leverage and its credit exposure. In granting two-way margining and rehypothecation rights, banks should give due consideration to the credit quality of the counterparty and the riskiness of the underlying exposure, including collateral. If banks agree to two-way collateral provisions, they should make sure that the resulting additional exposure – of the posted collateral – is monitored and fully integrated in the overall risk management and measurement processes. This guideline does not supersede any regulatory requirements to enter two-way margin agreements with certain counterparties.

Paragraph 26

The guidelines also require banks to consider collateral substitution when assessing the need for margin. However, this becomes particularly challenging in the case of SFTs where tri-party trades are common;

typically, margin and haircuts on different collateral securities are pre-agreed in the tri-party schedule. For VM, IM, and IA non-cleared collateral and IM cleared collateral, substitutions are usually allowed, and before counterparties agree to such terms, streamlined operational processing should be confirmed.

Paragraph 27

The guidelines suggest that banks should not receive a double benefit from collateral when measuring both default and exposure risks. However, the expectations regarding this matter are not clearly defined, and we do not consider there to be such a double benefit. Collateral cannot be used simultaneously to reduce exposure and lower the loss given default (LGD), so these guidelines go well beyond standard market practices and should be reconsidered.

The guidelines also state that default risk should be evaluated solely based on the lower risk of underlying exposure to counterparties, considering factors such as perceived diversification or market neutrality in long/short exposures. For a proprietary trading counterparty, the trading strategy and default risk tend to be closely linked.

The Associations recommend the following changes to the guidelines:

27. In managing the risk of counterparties at low risk of default, banks ~~should not~~ cannot have a double benefit from collateral in the measurement of both default and exposure risks. Further, in dealing with highly rated counterparties, banks should assess margin needs based on the riskiness of the underlying exposure, including collateral being posted. Similarly, default risk should not be assessed based solely on the lower risk of the underlying exposure to counterparties due to perceived diversification or market neutrality in long/short types of exposure.

Paragraph 29

In terms of derivative transactions, the guidelines propose that banks, when acting as agents, should independently assess appropriate margin levels for their counterparties. Banks should have processes in place to determine if and when they need to consider applying margin multipliers. While this approach promotes prudent risk management, it is important for standard setters to ensure consistency. The Associations note that the BCBS-CPMI-IOSCO consultation on margin transparency[5] was initiated with the intention of making CCPs' margin methodologies and add-ons more transparent to clearing members and clients.

Paragraph 30

The guidelines emphasize the importance for banks to carefully consider scenarios where the margin and collateral set to mitigate counterparty credit exposures could be reduced if the probability of the counterparty's default is negatively correlated with the value of the collateral or positively correlated with the market value of the contracts, such as concentration and WWR, as previously noted.

The Associations recommend the following changes to the guidelines:

30. Banks should pay particular attention to ~~situations~~ concentration and WWR in which margin and collateral established to cover counterparty credit exposures may be significantly reduced if the

[5] BCBS-CPM-IOSCO, Transparency and responsiveness of initial margin in centrally cleared markets: review and policy proposals (January 2024), *available at* https://www.bis.org/bcbs/publ/d568.htm

probability of the counterparty's default is negatively correlated with the value of the collateral or positively correlated with the market value of the contracts.

Guarantees and Other Risk Mitigants

Paragraph 31

The guidelines suggest that bank policies and procedures should establish the permissible range of credit risk mitigants. Taking the case of Archegos as an example, it becomes evident that bullet swaps carry significantly higher risk compared to plain vanilla swaps and, therefore, require different treatment within an exposure measurement system.

We request flexibility on documenting credit risk mitigants given the various policies banks need to work through for each one.

The Associations recommend the following changes to the guidelines:

31. Bank policies and procedures should determine the range of allowable credit risk mitigants where possible. ~~These policies should ensure that the usage of mitigants is controlled and monitored appropriately across the bank's portfolio~~. Furthermore, assessment of such mitigants, ~~they~~ should closely relate ~~the allowable mitigants~~ to the credit worthiness of the counterparty and the riskiness of the underlying exposures.

4. Exposure Measurement

Exposure Metrics

Paragraph 38

The guidelines recommend that banks have the ability to produce and aggregate exposure metrics for all trades that give rise to CCR, spanning across different product types, business lines, and legal entities. Aggregating capabilities should be commensurate with the size and complexity of the bank's CCR portfolio.

The Associations recommend the following changes to the guidelines:

38. CCR exposure metrics for a given counterparty should be computed with appropriate consideration for the level of aggregation embedded in the calculation. Exposure metrics should be produced frequently and in a timely manner and include all trades giving rise to CCR, across product types (eg bilateral, centrally cleared and exchange traded derivatives and SFTs), as well as across business lines and legal entities, commensurate with the size and complexity of the bank's CCR portfolio. In addition, the CCR risk monitoring process should be fully informed of any additional credit exposure with the counterparty, such as loans outstanding or unused credit commitments.

Paragraph 39

The Associations agree that utilizing a wide variety of metrics for managing CCR is appropriate to ensure coverage of the risk and to achieve a comprehensive and granular understanding of the portfolio. However, the guidelines currently specify granularity at a single risk factor level. We propose that the guidelines adopt a more flexible approach, allowing banks to choose metrics based on their unique counterparty risk profiles.

The Associations recommend the following changes to the guidelines:

39. CCR exposure metrics should be comprehensive in covering banks' material risks at portfolio, counterparty and at a more granular ~~risk factor~~ level, as appropriate. For every counterparty, exposure metrics should account for the contractual terms – and for their inherent risks, e.g., related to netting and collateral enforceability – and be consolidated across product types, desks and books. Overall, this suite of metrics should provide a holistic view of the characteristics of the entire distribution of CCR exposures, including average, high quantiles and residual tail risks. Residual tail risks can be very significant for counterparties such as highly leveraged institutions in which solvency, liquidity or both closely depend on portfolio performance.

Paragraph 41

The guidelines propose the active involvement of senior management in the challenge process for exposure metrics. While we agree that it is important to ensure senior management's oversight and decision-making authority, the extent of their participation should be determined based on the organization's structure, size, and risk management practices. Flexibility is necessary to tailor senior management involvement in line with the unique circumstances and requirements of each institution.

The Associations recommend the following changes to the guidelines:

41. The metrics in use to quantify risk at any stage of the CCR management should undergo the appropriate level of internal governance and independent review applicable to the models used, irrespective of any perceived analytical simplicity. ~~This should include the initial and ongoing review by an independent validation unit. As part of the challenge process for the metrics, end users as well as senior management could be actively involved by means of reviewing parallel runs, impact studies and concrete examples based on existing and/or historical portfolios.~~ Stakeholders should maintain a sound understanding of (i) the risks captured by each of these risk metrics and (ii) the inherent limitations of these risk metrics.

Paragraph 42

The independent validation unit should not be involved in reviewing the taxonomy of CCR metrics. Subject matter experts should be allowed to determine appropriate CCR metrics and their applicable scope without the need for independent validation review, as long as the metric is not deemed a model. For example, monitoring and establishing a limit on a new product's gross notional should not require excessive governance to implement.

The Associations recommend the following changes to the guidelines:

42. Related to the previous paragraph, end users and key stakeholders should be provided with a clear ~~and actionable taxonomy~~ definition of the supported CCR metrics – including their range of applicability and known limitations – across counterparty groups, product types and contractual arrangements. ~~Such taxonomy, given its central role within the CCR management process, should be reviewed by an independent validation function and agreed by all the relevant risk committees.~~

Paragraph 43

The guidelines highlight the importance of complementary exposure metrics that provide banks with visibility into exposure drivers in both current and stressed market conditions.

The Associations acknowledge the limited actionable signals generated by PFE, IMM, and CVA expected exposure (EE) profiles for heavily collateralized counterparties and support the guidelines' position that modelling every single type of idiosyncratic risks within the PFE, IMM and CVA EE profiles is not necessarily feasible, and those metrics should be complemented by additional metrics. The Associations note that this is the reason many prime brokerage businesses already adopt a different risk management framework.

The guidelines highlight the challenges posed by partial information which can complicate risk modelling. In recognition of this, banks should have the flexibility to approach risk modelling in a manner that suits their needs. Furthermore, models should be user-friendly and transparent.

The Associations recommend the following changes to the guidelines:

43. The exposure metrics, collectively, should provide complementary risk capture and allow banks to have visibility of material drivers of exposure under ~~BAU~~ current and stressed market conditions. Such drivers should account for potential structural risks and vulnerabilities of the positions – considering factors such as leverage, concentration, liquidity and WWR – even when they cannot be fully characterised because of partial information regarding the true risk profile of the counterparty. In a similar fashion, exposure metrics should account for the possibility that perceived risk mitigants or diversification benefits may not work as intended. For example, PFE, as well as IMM and CVA EE profiles, generally produce hardly any actionable signal for over-collateralised counterparties (such as hedge funds or other highly leveraged institutions), since they are often computed ignoring (at least general) WWR and the possibility of margin-driven defaults.[8] Therefore, such metrics should be complemented by additional metrics that better capture the residual risks.

Paragraph 44

Paragraph 44 focuses on the same principles as paragraph 43, but specifically addresses idiosyncratic risk and how such risks may affect portfolio correlations and the accuracy of valuations used to determine margins. The Associations note the term "horizontal hoarding" is not common across all jurisdictions and ask that the BCBS be clearer on this point.

The Associations recommend the following changes to the guidelines:

44. In measuring exposure, banks should properly ~~identify, evaluate and capture~~ consider 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 relative to average daily trading volume. 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 ultimately magnify closeout losses. In this context, the overall risk profile of the counterparty should be ~~modelled~~ measured conservatively, giving due consideration to scenarios such as horizontal hoarding or crowding that can materially skew the exposures distribution.

Paragraph 46

The guidelines offer examples of metrics including gross notional amount or gross market value, gross trades' delta exposure, received and posted collateral composition, and country or regional gross exposure. While these metrics may provide useful insights, it is important to note that they are all measured in gross terms. This could potentially result in an inflation of exposure figures to an extent where the numbers may not be perceived as accurate. The Associations propose adjusting the wording slightly to emphasize that these gross metrics are examples which banks may choose to employ.

46. ~~Examples of sound practices of m~~ Metrics described in the previous paragraph monitored by banks with sound practices – either at the counterparty or bank's portfolio level – include for example: (i) gross notional amount or gross market value (a tool to identify a vulnerability to the breakdown of specific long/short hedges within a counterparty's portfolio); (ii) gross trades' delta exposure (a tool to identify, either at the counterparty or bank's portfolio level, a potential exposure concentration in specific risk factors); (iii) received and posted collateral composition (a tool to identify, at the bank's portfolio level, a potential concentration in specific collateral assets); and (iv) country or regional gross exposure (a tool to identify, at the bank's portfolio level, potential exposure concentration with regard to countries or regions with significant geopolitical risk).

Paragraph 47

The guidelines propose that institutions should establish a dedicated WWR framework that is incorporated into the overall risk assessment framework. This framework should take into account both General WWR (GWWR) and Specific WWR (SWWR). We reiterate previous remarks that expanding the conventional understanding of WWR to encompass everything can be overly broad. It can be argued that anything that increases exposure can be considered WWR, so it is crucial for the BCBS to provide clear guidance on where to set the boundaries.

Paragraph 48

The guidelines suggest that the GWWR process should be supported by well-defined stress testing, which should be based on credible and severe scenarios. These scenarios should be reported at an appropriate frequency to senior management. However, it is important to consider that implementing a large number of stress scenarios might overwhelm banks' systems. Additionally, the guidelines propose that banks should have clear definitions for risk categories such as industry, region, business areas, and products. However, it is not clearly explained how a business area or product influences GWWR. While these dimensions can provide additional granularity to segment GWWR metrics, they are not the primary dimensions of GWWR itself.

Paragraph 49

The guidelines require the identification of correlations between a counterparty's creditworthiness and the CCR exposure to the counterparty. The Associations restate that for regulatory capital requirements, SWWR should be based on a clear definition of legal connection. Whilst acknowledging that in certain cases, identifying and monitoring SWWR where there is no legal relationship can pose challenges, it is a critical item for CCR management, and the Associations support the BCBS drawing attention to it and requiring action. Further, "relationship" is a more appropriate term than "correlation", which implies a quantitative measure that banks do not always have.

The Associations would like to point out the example of banks engaging in repos with underlying exposure to their own sovereign country. Literal reading of the guidelines could argue for this to be categorized as SWWR due to the strong correlation. One unintended consequence of such categorization would be reduced liquidity in repo markets. Therefore, it is essential to carefully consider the potential impacts of defining SWWR in certain scenarios.

The Associations recommend the following changes to the guidelines:

49. Banks' processes and methodologies for SWWR assessment and monitoring should be well defined and documented. They should enable the identification of ~~correlations~~ relationships between a counterparty's creditworthiness and the CCR exposure to the counterparty. In IMM, the SWWR classification ~~should be~~ is based on a clear definition of legal connection that considers legal frameworks on ownership, including control or consolidation requirements. ~~In addition,~~ For CCR management, banks should also consider applying the SWWR classification to cases with no strict legal connection but where the counterparty is significantly economically dependent on its underlying exposure. The results of the regular SWWR identification process should be reported with adequate frequency and escalated to senior management where necessary.

Potential Future Exposure

In the next guidelines, the BCBS suggests improving the calculation of a counterparty's PFE. However, other guidelines highlight numerous shortcomings of PFE, which hinder accurate monitoring of tail and concentration risks. Instead of implementing more sophisticated PFE models, it may be preferable to improve complementary metrics such as stress testing in the guidelines.

Paragraphs 50 and 51

The guidelines endorse using PFE to measure exposure to a counterparty in the event of its default. The guidelines advise banks to consider the parameterization of stochastic risk factor dynamics, including jump processes or similar methods, to model gap moves in underlying assets. The Associations recommend that the BCBS clarify that alternative metrics are also permitted under the guidelines, especially as metrics tend to evolve over time, and especially since the Great Financial Crisis, many have come to realize that PFE may not be truly reflective of risk.

The Associations recommend the following changes to the guidelines:

50. Banks should quantify CCR exposure daily, using PFE to measure the future exposure against a given counterparty conditional upon its default. PFE is a risk metric calibrated on ~~BAU~~ current/recent market conditions that quantifies, over a defined future horizon and at a specified confidence level, how sizeable the CCR exposure of a given counterparty's portfolio may become given the applicable contractual terms and credit risk mitigants. PFE is predominantly computed based on scenarios generated with Monte Carlo simulations, considering multiple forecasting horizons (typically up to the life of the contract) and a high percentile (e.g., 95% or 99%) of the simulated portfolio exposures distribution (alternatively, expected shortfall measures linked to such confidence levels are used). For risk monitoring, when calibrating PFE or alternative metrics, banks should have due regard to ~~model specifications such as the parameterisation of the stochastic~~ risk factor dynamics (including jump processes or similar ways to model gap moves of the underlying assets), as well as the applicable margin period of risk (MPOR) and collateral haircuts to the extent possible.

51. While using PFE to monitor ~~BAU~~ risk limits at counterparty and product levels, banks should ensure that the counterparties' PFEs are: (i) reflective of the contractual terms, including trade attributes, netting and collateral requirements; (ii) computed and monitored across all the applicable risk horizons; (iii) based on risk scenarios that conservatively account for the stochastic behaviour of the portfolio's material risk factors and the collateral dynamics over the MPOR; (iv) computed with a sound modelling of correlations among risk factors and of any risk basis (e.g., long/short positions

with residual dispersion) that may materialise in ordinary or distressed markets. In general, banks should be conservative in their treatment and modelling of excess collateral received from counterparties.

Paragraph 52

The guidelines propose that banks adjust their MPOR to account for excessive risks arising from concentrated and/or illiquid portfolios or collateral. However, MPOR is an academic concept and a crude measure to achieve this goal, and adjusting it for illiquid portfolios (e.g., by assuming a six-month or one-year close-out period as in the example of Archegos) is an indefensible position and will not address these flaws[6]. Also, the Associations note that the proposal related to MPOR could lead to higher capital requirements that are incremental to those already envisaged by the new Basel standards, especially as the calibration of MPOR for SA-CCR and CVA under the Basel standards is already highly conservative, as evidenced by prior industry studies. For instance, an industry survey (conducted in July 2019, based on 16 participating G-SIBs and internationally active banks) showed that a material percentage of banks (81%) use MPOR assumptions of 5 days and less for the calculation of accounting CVA.[7]

Given that MPOR is already established in capital rules with prescribed time horizons, using different time horizons for risk management MPOR would introduce significant confusion and inconsistent measurement issues. Additionally, adjusting a counterparty's PFE can be challenging, as it comprises underlying trade exposures and offsetting collateral exposures with differing liquidity and concentration dynamics. Further challenges arise from the fact that MPOR applies across the entire PFE profile and for an implementation to be precise, one would have to make assumptions around the liquidity of markets at future points in time, which is impossible to do without applying undue conservatism in the assumptions. In turn, this will negatively impact the PFE's value from a risk management perspective as it would be driven more by estimates and assumptions than actual modelling (i.e., a lower signal-to-noise ratio).

The guidelines also suggest considering idiosyncratic risks that can materialize upon the default of the counterparty, such as increased risks during liquidation and a subsequent large drop in asset value. However, there are numerous challenges with embedding this in the PFE. Similarly, the text implies

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[6] We would like to bring attention to the fact that the example provided in footnote 11 of the guidelines from the Credit Suisse report, suggesting that the MPOR should have been 1 year, may appear somewhat sensationalist. The Credit Suisse report does not explicitly mention the specific MPOR used. While the Credit Suisse report does discuss a severe weekly stress, it is possible that the MPOR considered was 5 days instead of 20 days, as speculated by the BCBS. Furthermore, it is worth noting that the Credit Suisse report utilized the 95th percentile PFE instead of a higher value. Additionally, the prime brokerage business at Credit Suisse may have required a $4 billion initial margin based on dynamic margin calculations, but the treatment of bullet swaps may have been different. Lastly, it is important to mention that Credit Suisse unwound the positions over the course of a month. These additional details provide a broader context to consider when evaluating the implications of the example provided in the Credit Suisse report.

[7] ISDA-AFME, Joint AFME-ISDA ("the industry") Response to the European Commission's Consultation on CRR3 Implementation (December 2019), *available at* https://www.isda.org/a/CkbTE/ISDA-AFME-Response-to-the-EC-Consultation-on-CRR3-Implementation.pdf, page 149

Also, see page 158 that says: "Margin Period of Risk (MPoR): The margin period of risk for margined netting sets must be set to $9 + N$ business days where N is the re-margining period. For a daily margined netting set, the MPoR used for regulatory CVA is 10 business days. Accounting CVA practices for MPoR are typically much less than this for daily margined netting sets."

including market crowdedness in the MPOR, which would require understanding of the risk that other institutions may also need to unwind simultaneously. While theoretically sound, this is challenging to convert into a sustainable and repeatable process. Modeling rare and unpredictable events relies on assumptions that likely cannot be back tested.

The guidelines suggest that for potentially illiquid counterparty portfolios, banks should simulate portfolio dynamics with stochastic models calibrated to a level of distress consistent with the market risk of liquidating highly concentrated positions. However, it is unclear if this is practical.

Overall, while the Associations acknowledge the importance of managing risks related to concentrated and/or illiquid portfolios or collateral within their limit frameworks, there is a strong belief that these risks are better quantified using alternative risk measures within the limit framework, rather than relying solely on PFE. On that basis, the Associations suggest that banks retain the flexibility to choose their approach, rather than being compelled to adopt complex and questionable modeling for PFE.

The Associations support the view that banks should have flexibility to develop their risk monitoring frameworks. We urge the BCBS to revise paragraph 52 accordingly.

Paragraph 53

The guidelines suggest that PFE should account for WWR either directly or via suitable adjustments or overlays. However, including WWR in the calculation of PFE represents a significant challenge and may not result in a measure that can be aggregated across counterparties. It may be more practical to monitor PFE and WWR separately rather than integrating them directly or through adjustments or overlays in the PFE measure, which is similar to the ECB guidelines[8] that suggest that the regular GWWR identification process should be supported by well-defined stress testing and scenario analysis of credible severity. Additionally, it is unclear whether PFE should account for SWWR or GWWR. Given that risk management models should use the same PFE as capital models per the use-test requirements, incorporating GWWR into PFE will present modeling challenges and have capital implications.

The guidelines mention that NBFIs are particularly vulnerable to insolvency due to leverage and concentration, which become materially correlated with portfolio performance. Identifying institutions, including NBFIs, with concentrated positions on a single name requires knowledge of the ultimate directional position of the institution on the single name across all banks. Such an approach is beyond the scope of individual banks and implies a market-wide initiative.

The guidelines suggest that banks should calibrate PFE to historical and idiosyncratic scenarios similar to those observed during the defaults of Archegos Capital Management and Long-Term Capital Management. However, using idiosyncratic scenarios in PFE calibration requires knowledge of counterparties that may be strongly time-dependent or even unavailable upon request. It may not be possible to modify PFE in a way that anticipates scenarios like the defaults of Archegos Capital Management and Long-Term Capital Management. In the Archegos default, the underlying equity price movement was driven by liquidation in the total return swap (TRS) hedges. Incorporating these second-order dynamics into PFE is challenging. These elements may be better incorporated into the stress testing

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[8] European Central Bank, Section 5.2 of Sound practices in counterparty credit risk governance and management, *available at* https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.supervisory_guides202310_ccrgovernancemanagement.en.pdf

framework. Moreover, the cases mentioned are not typically considered WWR, highlighting another instance where adverse dynamics are encompassed in the catch-all term "WWR".

The Associations would reiterate that banks should have flexibility in their risk monitoring frameworks to holistically account for these risks in complementary metrics instead of forcing overly complex modelling in PFE. We urge the BCBS to provide edits accordingly to paragraph 53.

Paragraph 54

The guidelines advise banks to be cautious when offsetting the exposures of scenarios trades with the forecasted level of IM, as this may lead to zero or negligible PFEs for collateralized counterparties. Banks should have the ability to argue that their risk monitoring framework holistically accounts for the risk instead of forcing overly complex modelling in PFE.

Paragraph 56

The guidelines promote backtesting using both real and hypothetical portfolios. However, implementing a statistically meaningful backtesting framework for CCR models on hypothetical portfolios can be conceptually and operationally challenging – especially if it needs to apply to counterparty-specific, extreme tail events that have not occurred in real life. Nonetheless, backtesting is important as it acts as an effective control by comparing exposure metrics against realized results.

Some firms perform backtesting of PFE models using real portfolios, while other firms use hypothetical portfolios[9]. The guidelines could usefully reference the Basel standard.

The Associations recommend the following changes to the guidelines:

56. As part of the ongoing model governance, PFE should be back tested using ~~both~~ either real ~~and~~ or hypothetical portfolios, so as to extensively probe the modelling assumptions versus the realised historical markets. In addition, banks should benchmark their PFE models versus the realised dynamics of well publicised defaults such as Long-Term Capital Management and Archegos Capital Management. They should assess: (i) if their PFE model is able to produce commensurate exposures at realistic quantiles; and/or (ii) if the banks' overall CCR management framework has adequate compensating measures able to flag an excess of CCR for similar portfolios.

CCR Stress Testing and Scenario Analysis

Paragraph 57

The guidelines highlight the importance of CCR stress testing as a necessary complement to PFE which involves fully integrating the resulting stressed exposures into the bank's risk management process and ensuring they are monitored against limits. The Associations seek additional flexibility in addressing various regulatory concerns during the daily risk management process. This flexibility can be achieved through approaches such as stressed bid-ask spreads, close-out risks, concentration penalties, and illiquidity penalties. It is important to note that not everything needs to be included in the PFE risk measure, as long as the banks adhere to the holistic framework and meet regulatory expectations.

[9] BCBS, Sound practices for backtesting counterparty credit risk models (December 2010), *available at* https://www.bis.org/publ/bcbs185.pdf, paragraph 35

Furthermore, banks may choose to set one limit that encompasses all risk measures or opt for a few limits that apply to different risk measures, such as the 95th, 97.5, and 99th percentiles.

The Associations recommend the following changes to the guidelines:

57. As a complementary and necessary metric to PFE, banks with sound practices have developed a dedicated CCR stress testing framework commensurate with the complexity of the bank's CCR portfolio, allowing for an assessment of counterparties' exposures in a stressed market environment, where the resulting stressed exposures are fully integrated in the bank's ~~BAU~~ risk management process and monitored against limits. This is especially relevant for exposures to NBFIs for whom stress testing may be the only systemic approach to identify and quantify the main portfolio's vulnerabilities.

Paragraph 59

The guidelines emphasize that CCR stress testing scenarios should be applied consistently across all business lines and portfolios. Extending the full risk management process to include stressed market conditions, including limit monitoring, implies a significant workload, especially for daily assessments. Instead, the guidelines should make clear that banks can take a risk-based approach to the implementation of CCR stress testing.

Paragraph 60

The guidelines underscore that stress scenarios should be informed by vulnerability analyses that are both severe and varied, capturing idiosyncratic risks. Banks should have the flexibility to incorporate elements from vulnerability analyses into complementary frameworks and metrics, ensuring proportionality without excessively complex stress testing. Maintaining consistent and effective modeling assumptions for stress scenarios may be burdensome, especially if the expectation is to identify idiosyncratic risks for each counterparty. The guidelines should explicitly allow banks to implement these expectations using a risk-based approach.

Paragraph 61

The guidelines recommend that banks consider hypothetical future events related to geopolitical or climate scenarios. This expectation regarding extra-financial risks increases the complexity. It is impractical to granularly assess the impact of hypothetical future events, including geopolitical risks. The guidelines should explicitly allow banks to implement these expectations using a risk-based approach.

The Associations recommend the following changes to the guidelines:

61. In designing scenarios for CCR stress testing, due regard should be given to (i) historical events; (ii) the current macroeconomic and financial environment; (iii) hypothetical future events, including new information and idiosyncratic and emerging risks. ~~Regarding the latter, an effective design process should consider specific hypothetical geopolitical or natural disaster scenarios that for some counterparties – eg in the commodities or insurance sectors – are more likely to be the ultimate drivers of the exposure conditional upon default.~~ Overall, a comprehensive CCR stress testing assessment should entail an in-depth review of the counterparty business model and of its portfolio structure and if required and deemed necessary, customised stress tests to be used to assess the specific vulnerabilities of a client's portfolio. Direct and reverse stress testing, as well as scenario analysis, should be used as active tools to identify and quantify the main portfolio vulnerabilities.

Paragraph 63

The guidelines state that stress testing scenarios should effectively consider the consequences arising from the costs associated with unwinding portfolios or netting sets that consist of less liquid collateral or transactions that are difficult to replace in the event of counterparty default. The Associations have reservations regarding the merits of this guideline, particularly when considering the other guidelines aimed at enhancing MPOR. It appears that the BCBS is requesting banks to customize stress scenarios based on the specific counterparty involved, which may be perceived as going beyond reasonable expectations. Tailoring stresses to individual counterparties could introduce complexities and challenges that may not be practical or feasible for banks to accommodate.

Limits

Paragraph 66

The Associations seek further clarification on the expectations for a limit structure that considers stress-based exposure metrics. In particular, we seek clarity on the expectations for establishing two differentiated sets of limits (i.e., one based on exposure metrics calibrated on current/recent market conditions, and another based exposure metrics calibrated on stressed market conditions) or alternatively a single set of limits that integrates both type of exposure metrics.

The Associations recommend the following changes to the guidelines:

66. It is essential that banks develop comprehensive and effective limit frameworks that allow for monitoring and control of the bank's exposures to its counterparties at both the individual counterparty level as well as the aggregate portfolio level. Banks with sound practices leverage their suite of exposure metrics when designing a limit structure, in recognition that any one metric and limit has weaknesses. Broadly speaking, a bank's limit structure should cover a range of both ~~BAU-based~~ exposure metrics calibrated on current/recent market conditions and ~~stress-based~~ exposure metrics calibrated on stressed market conditions that can include, for example, current net exposure, PFE, gross notional amount or gross market value, as well as other stress-based measures.

Paragraph 67

The guidelines suggest that risk limits should be detailed enough to monitor key risks, including concentration, liquidation, dispersion, and maturity. BCBS should clarify that "maturity" refers to the transaction's tenor if that is the case as this is not clear.

The Associations recommend the following changes to the guidelines:

67. Risk limits should be granular enough to monitor key risks – e.g., concentration, liquidation, dispersion and maturity – in the underlying exposure to a counterparty ~~at the material risk factor level~~. Risk limits should also capture all the credit exposures to the counterparty across all products and financial relationships within the banking organisation. Banks should ensure that risk aggregation practices, for the purpose of limit setting, are accurate and reliable.

Paragraph 68

The guidelines propose the deep tail calibration of effective limit frameworks that reinforce stressed-based measures into the risk management framework. The Associations reiterate our comments on paragraph 57, which calls for additional flexibility in how banks fulfill regulatory expectations.

The Associations recommend the following changes to the guidelines:

68. Effective limit frameworks should be calibrated with a level of severity consistent with a firm's risk appetite statement with justifications on the severities used. ~~severities – eg 99th percentile – that are consistent with those of the risk metrics being controlled and monitored.~~ Risk limits should not be set so high such that they would lead to excessive buildup of risk and prevent a bank from taking the necessary actions to effectively reduce the level of exposure in a timely manner. Additionally, risk limits should not be set too low such that they do not serve as a credible reflection of the bank's risk tolerance.

Paragraph 69

The guidelines advise that banks ensure their limit calibration processes are rigorous and subject to independent review and challenge. Limit frameworks should be recalibrated in response to changes in market conditions, business strategy, business organization, risk measurement methodologies, riskiness of the counterparty, and the riskiness of underlying exposures. Additionally, the materiality or significance of what constitutes a limit recalibration event is crucial. Not every event should trigger a change in policy or the limit calibration framework in general. Besides that, the definition of "independent unit" that will perform the "independent review" should be clarified in the guidelines since the independent review is broadly used for models and the limit calibration is not deemed to be a model.

5. Governance

People and Risk Culture

Paragraph 72

The guidelines emphasize the dual nature of CCR, which encompasses both market risk and credit risk. This highlights the need for strong collaboration between the market and credit risk functions at the bank. However, in practice, the level of formal collaboration between these two functions on a day-to-day basis varies. In most firms, there is limited information exchange between market and credit risk regarding counterparty deterioration. Market risk may not be aware of specific events that could lead to counterparty distress, especially due to information barriers between public- and private-side employees.

To incorporate market risk considerations, some firms may have product-risk oriented functions within CCR coverage, others have dedicated functions within CCR coverage that monitor and quantify market risks at a counterparty or portfolio level, while more complex firms may have credit-contingent market risk functions[10]. While the guidelines promote a holistic approach to managing CCR as a risk stripe across credit risk and market risk, the Associations believe that the guidelines should explicitly allow banks the flexibility to adopt their own approaches.

The Associations recommend the following changes to the guidelines:

72. The 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. While banks should have the flexibility to adopt their own approaches, banks with

[10] Risk.net, When market and credit risk collide, *available at* https://www.risk.net/risk-management/1652766/when-market-and-credit-risk-collide
"Most believe shoehorning the market risk and credit risk together is necessary, but a three-leg approach is better. A dedicated event-driven, credit-contingent market risk function can identify the risk issues that lie between credit and market risk much more effectively – issues like the impact of collateral assets highly correlated with an issuer that is collapsing, unexpectedly heavy concentrations of exposures, and the potential to be short gap risk."

stronger practices have dedicated functions for CCR. At a minimum, the bank's risk culture should foster ~~strong~~ collaboration, including but not limited to knowledge and information transfer between the market and credit risk departments. Therefore, banks should prevent siloed thinking in their risk departments and ~~strongly~~ encourage the exchange of information gathered, in particular on market or credit risk that may be relevant for assessing the credit risk of a counterparty or potentially market distorting events due to the deteriorating credit quality of a counterparty.

Risk Framework

Paragraph 77

The guidelines mention that significant policy changes should be approved by the relevant oversight committees. However, it is worth noting that these important policy changes are not always approved by oversight committees; they can be approved by cross-functional risk executives with delegated authorities. Additionally, the guidelines stipulate a minimum frequency of yearly policy reviews. However, the frequency of policy reviews should depend on the materiality or complexity of the policy change. Not all policies can be adequately reviewed on an annual basis, and a more flexible approach should be adopted to ensure thorough and appropriate assessment.

The Associations recommend the following changes to the guidelines:

77. Policies and procedures should be clear with regards to ownership, roles and responsibilities – providing clear guidelines for credit approval authority, remediation and escalation processes. Banks with sound practices have a strong balance between ensuring individual ownership of policies, while also ensuring important changes to policy are approved by relevant oversight committees or cross-functional risk executives with delegated authorities. ~~Additionally, regular policy reviews are conducted on a yearly basis, as a minimum, to ensure their continued relevance.~~ In all cases, authorship and ownership of policies and procedures should be clearly separated.

Paragraph 78

The guidelines highlight the importance of effective CCR oversight within banks, including both the second and third lines of defense. It is crucial to have clear mandates, sufficient knowledge and stature, and an environment that incentivizes personnel to identify, challenge, escalate, and resolve risks. However, there is a concern that this emphasis may lead to a push for entity-level capabilities in the second and third lines, potentially limiting the availability of specialist resources that support different entities or geographies across a firm. The guidelines should be changed to note that appropriate employees from within the bank group, even if employed in a different entity (e.g., at parent level), may contribute to fulfilling this expectation.

Paragraphs 80 and 81

According to paragraph 80, banks should establish and empower risk committees as governing bodies with authority over all risk-taking aspects of the trading business. This includes risk limits, permitted products, hedging strategies, collateral eligibility, margins, risk measurement methodologies, and overall risk appetite. The guidelines also state that these governing bodies should be accountable for limit exceptions and approvals, in alignment with the established delegation of authority.

In paragraph 81, the guidelines recommend that banks' governing bodies should have accountability for limit exceptions and approvals in line with the bank's established delegation of authority.

The Associations suggest the following changes to the guidelines to align them with the bank practices regarding risk committee delegation of authority:

80. Banks should establish and empower risk committees as governing bodies with authority over all risk-taking aspects of trading businesses, including risk limits, permitted products, hedging strategies, collateral eligibility, margins, risk measurement methodologies and overall risk appetite. As governing bodies, risk committees should receive appropriate information on a timely basis for the key risk drivers and risk trends of ongoing trading activities, both through risk sensitivities, risk scenarios and stress tests, and should be able to delegate authority for defined risk management activities to senior management as appropriate given the scope and complexity of the bank's CCR activities.

81. Risk committees, as the ~~B~~banks' governing bodies, should have accountability for limit exceptions and approvals in line with the bank's established delegation of authority. Banks with strong practices embed approval authority for policy changes with risk committees that oversee all trading activities for market and CCR and give risk committees review authority for all approved exceptions. Risk committees should be able to delegate authority for defined risk management activities to senior management, as appropriate, given the scope and complexity of the bank's CCR activities.

Paragraph 82

The guidelines suggest that risk committees should include senior managers from trading and risk functions, as well as compliance, finance, legal, and operations. These risk committees should also regularly report to the bank's board risk committee. It is important to note that this approach seems to impose a one-size-fits-all structure on the reporting line to the board risk committee, which may not be already in place at all banks.

The Associations recommend the following changes to the guidelines:

82. Risk committees should include senior managers from trading and risk functions as well as compliance, finance, legal and operations groups. Furthermore, ~~risk committees~~ topics discussed at risk committees should be reported regularly to the bank's board risk committee. Risk committees should be of a size that is adequate to promote the dissemination of decisions taken throughout the organisation, but without reducing the accountability of individual participants. Ideally, the chair of the committee is accountable for the committee's decisions.

Paragraph 83

The guidelines propose that banks should manage their counterparty exposure using booking models that are simple and have clear accountability embedded in the framework. However, it is worth noting that booking models are often driven by technical constraints, business constraints, and operational constraints, rather than solely by the guidelines' recommendations. Since they may go against simplicity, the guidelines should recognize that these other constraints will affect booking models.

Management Reporting

Paragraph 86

The guidelines put forth a proposal that management reporting should include information on non-standard terms and conditions in CCR contracts to keep senior management informed. However, objectively defining "non-standard terms" is challenging, making it difficult to include them into management reporting. While there is a control process in place for granting exceptions to terms and conditions, not all exceptions are considered material. It is crucial to strike a balance between the effort expended and the value gained in this regard. The guidelines should be changed to make it clear that not all non-standard terms need to be reported and reviewed by management, but rather that firms should be able to adopt a risk-based approach depending on the materiality of the non-standard terms.

Paragraph 88

According to the guidelines, it is the responsibility of banks' management to develop a management information system (MIS) that facilitates management reporting without overwhelming users with excessive data. This system should enable on-request analysis for material counterparties or those on watch lists/close monitoring lists, without the need for external assistance.

The BCBS should also clarify what they mean by "without external help". "Without external help" could imply that managers should not receive the assistance of more junior team members. Depending on jurisdictional interpretations, there is also a risk that this language could be understood as excluding assistance from entities outside the local entity. This interpretation could hinder the ability to perform tasks on a group-wide basis and hinder the ability of subsidiary banks from gaining the benefit of group-wide systems and processes. It would be preferable if the BCBS framed this requirement as "without any help from outside the bank group" to avoid any misunderstandings and unfavorable interpretations.

Additionally, the phrase that MIS "does not overwhelm users with data" is subjective and unclear. Therefore, it is recommended to remove this phrase.

Limit Governance and Exception Management

Paragraph 95

According to the guidelines, both passive and active breaches of counterparty credit limits should undergo the same review and challenge process. Independent risk functions should have the authority to approve limit exceptions and allocate risk appetite, such as PFE, RWAs, or stress exposure, among businesses and products with respect to the same counterparty. However, independent risk management should not have sole authority to allocate RWAs; this is often done by a first-line function under the oversight of independent 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.

Paragraphs 91 and 96

The guidelines state that banks should implement a limit governance framework that encompasses a remediation process for breaches, a review and challenge process, and a formal calibration process through a committee. The guidelines should be changed to explicitly allow banks to adopt a risk-based approach in implementing these guidelines. It should be noted that not all limits go through a committee process, such as single name limits.

The guidelines suggest that risk limits should be established based on the risk tolerance level determined by the designated committee within the bank. However, it is important to note that not all risk limits are decided by a committee. Risk limits may be approved at different levels in the organization based on their materiality, and individuals with delegated authorities can approve them. Flexibility should be allowed in this process, and not every limit should require committee approval.

The Associations would also like to point out the role of committees in a firm's governance structure. They serve as official forums with a defined charter, official chair, membership, and quorum. However, requiring a committee meeting every time a client's risk tolerance level needs to be established, changed, or reconfirmed may be burdensome. For example, an official committee can be responsible for setting CCR limits that define the firm's risk appetite. These limits can then be allocated to specific sectors, client segments, activities, or even individual clients. While we acknowledge the importance of committees in establishing, changing, and reconfirming limits, both overarching and material ones, the Associations also believe in providing flexibility. Senior members within a risk department, who are likely members of an executive committee, should have the authority to fulfill their duties. This includes having some delegation from the Chief Risk Officer (CRO) to make decisions regarding client-specific risk tolerance levels.

The Associations recommend the following changes to the guidelines:

96. Risk limits should be set based on the risk tolerance level as established by ~~the designated~~ risk committees or risk officers with appropriate approval authority within the bank. ~~The risk committee should be represented by senior management, including senior risk officers.~~ Members of the risk committees should have the ability to mandate decisive actions to reduce risk even when there are disagreements with the business units.

Paragraph 98

The guidelines also recommend that banks monitor actual exposures against established risk limits on a daily basis. The use of ad hoc intraday exposure monitoring is encouraged. However, there is a need for clarification of "intraday" and the requirements for intraday exposure monitoring. Implementing ad hoc monitoring at a portfolio level can be a significant undertaking, given the complexity of some of the underlying products. Banks should have the flexibility to choose which products, execution channels and clients require intraday monitoring, rather than having this expectation apply to all client segments. It is important to understand intraday moves in risk exposure, but implementing this for all business lines poses challenges. Lastly, given the cost associated with implementing and monitoring ad hoc intraday exposures, the use of the term "encouraged" is appropriate. The Associations strongly advise against changing it to a mandatory requirement in the final guidelines.

The Associations recommend the following changes to the guidelines:

98. Banks monitor ~~actual~~ exposures against established risk limits at least on a daily basis. In addition, banks are encouraged to develop a framework for intraday exposure monitoring that can provide early warning of material developments in counterparties' portfolios and mitigate the risk of a breach of relevant risk limits. ~~Furthermore, banks should be able to assess, in a time period that is adequate for trading purposes, whether a new transaction leads to a limit breach or not. In addition, banks are encouraged to establish ad hoc intraday exposure monitoring, which should be adequate for assessing impacts of large intraday market moves on risk limits.~~ For transactions with material risk impact, banks should be able to estimate in a timely fashion~~,~~ whether a new transaction could potentially lead to a breach of the applicable limit and consider controls to mitigate the occurrence of a breach or the size of the breach.

6. Infrastructure, Data, and Risk Systems

Paragraph 102

Incorporating all CCR-specific elements into modelling and margining, as mandated in the guidelines, is not always in line with the requirement in paragraph 102: "Systems, models and data management capabilities should be sound and sufficiently sophisticated to support CCR measurement under current and stressed market conditions." This creates a tradeoff between (1) including sufficient details into modelling/margining and (2) having transparent and sound measurement systems.

The Associations recommend the following changes to the guidelines:

102. Banks should ensure that risk systems (e.g. front office, valuation and booking systems, and risk engines) and data management capabilities underpinning CCR management – including risk measurement and limit monitoring – are commensurate with the size and complexity of counterparty exposures. Systems, models and data management capabilities should be sound and sufficiently sophisticated to support CCR measurement under ~~BAU~~ current and stressed market conditions, and they should be enhanced as the bank's risk profile evolves and newer sound practices are established.

Paragraph 104

The guidelines suggest that banks should aim to reduce the number of systems involved in CCR exposure measurement and management in order to reduce operational risk. However, achieving this reduction requires significant transformation initiatives and costs to optimize modern systems and decommission older ones. Due to limited time and resources, regulatory initiatives and those with direct financial impact will be given priority.

Paragraph 107

The guidelines recommend strong governance practices and a set of controls that banks should maintain to support the aggregation and measurement of counterparty credit risk data. While many governance practices were already implemented as part of BCBS 239[11], some gaps still exist due to legacy systems. One of the controls includes a framework for key performance indicators (KPI) or key risk indicators (KRI) to measure technology outcomes and data management controls. However, implementing KPI or KRI measurements against manual adjustments in various systems may be challenging or even impossible.

7. Close-out Practices

Introduction

Generally speaking, the Associations agree with the introductory paragraph, but have a few recommendations below:

"Sound management of CCR includes banks recognising the need to act quickly based on their contractual ability to close out a counterparty when necessary, with full knowledge of all steps needed to initiate, execute and manage residual impacts, including, where applicable, collateral liquidation and ~~trade~~ risk replacement."

[11] BCBS, Principles for effective risk data aggregation and risk reporting (January 2013), *available at* https://www.bis.org/publ/bcbs239.pdf

Watch List Practices and Default Management Protocol

Paragraph 114

The guidelines make substantively the same point on costs in the first and last sentence and so we suggest removing the first instance in order to avoid duplication.

The guidelines propose that the close-out process requires business, legal, and risk staff to carry out the necessary actions properly in accordance with the contractual provisions in agreements, such as the ISDA Master Agreement, the related Credit Support Annex or other similar document, the ICMA Global Master Repurchase Agreement, or the Global Master Securities Lending Agreement. The intention seems designed to emphasize the importance of firms understanding their contractual rights and obligations when closing out a counterparty and acting in accordance with the applicable agreements as well as involving key internal functions in carrying it out. The particular facts and circumstances of each instance will help dictate which internal and external resources need to be involved in the process and the steps which need to be taken in accordance with the agreed-upon contractual terms of the relevant agreements. The list of potentially relevant contracts to be considered is too long to list out in the guidelines and would include, for example, non-Master Agreement documents such as cross-product netting agreements. Contractual provisions in any applicable IM documentation, however, will be highly relevant to the close-out process and, as such, should be particularly mentioned in the guidelines.

The guidelines suggest that the liquidation of trades typically results in the realization of MTM losses and the need for replacement trades. However, it should be noted that early termination may not always lead to a loss, especially when the counterparty in default is in a favorable financial position, and banks may have excess collateral. Furthermore, derivative exposures are often hedged on a portfolio basis rather than on a trade-by-trade basis.

Lastly, the guidelines state that the costs incurred by the bank during the close-out process are significant and should be known. However, it is important to acknowledge that the cost of replacing the risk may exceed the mid-MTM value (which, among other things, is generally used to determine the amount of collateral required to be held), and the exact amount is dependent on a range of factors, including liquidity and other market conditions at the time of the close-out, making it difficult to quantify in advance. Further, the level of costs will depend upon the complexity of the situation, contractual relationships, and reasons for the default/close-out. Therefore, the final sentence of paragraph 114 should be amended to read "The costs to the bank of carrying out a close-out can be material; banks should be aware of the types of costs which may arise in the context of a close-out."

The Associations recommend the following changes to the guidelines:

114. ~~Banks closing out counterparties should know that the potential costs of such actions can be high.~~ Close-out situations are fact-and-circumstance specific and each case may therefore require the allocation of different internal and external resources and the execution of different steps.~~ of counterparties involves business, legal, and risk staff carrying out actions properly, as banks serving notice on counterparties should not breach legal provisions in~~ Agreements that govern the bank's trading relationship with the counterparty, such as the International Swaps and Derivatives Association Master Agreement, and ~~the~~ related credit support documents (such as a Credit Support Annex, collateral transfer agreement, and any associated security agreements), the International Capital Market Association Global Master Repurchase Agreement or the Global Master Securities Lending Agreement, or local law master agreements, each include different (and, sometimes,

interconnected) procedures that must be understood and followed. Staff from functions including business, legal, compliance, operations, and risk, will need to coordinate in order to gain a comprehensive understanding of the steps to be undertaken when serving default or termination notices on counterparties, which should comply with such ~~not breach legal provisions~~ agreed contractual terms. Liquidation of trades ~~invariably~~ may lead to the realisation of MTM losses (or gains) and the need ~~for new replacement trades~~ to re-hedge exposures. The costs to the bank of carrying out a close-out can be ~~are~~ material ~~and should be known~~ ; banks should be aware of the types of costs which may arise in the context of a close-out.

Paragraph 115

While the Associations agree that involvement from the legal department is critical to carrying out a counterparty close-out, involvement throughout the process by CCR management functions is equally vital. The words "all aspects of" are too vague and we suggest replacing them with "throughout the entirety of a counterparty close out". It should be noted that firms may manage their counterparty risk functions in a variety of ways and so we suggest replacing "independent credit officers" with "credit or counterparty risk officers independent from the front office market making function". Therefore, the Associations suggest the following revisions to reflect the reality in banks more accurately:

115. Banks should ensure that seasoned professionals familiar with legal processes for carrying out a declaration of counterparty default and with requisite authority to do so are able to initiate or to oversee closeouts as needed. Involvement from the legal department and counterparty risk management functions is critical ~~to carrying out all aspects~~ throughout the entirety of a counterparty closeout. The process should also have input from other functions such as trading desks, operations, collateral management and other back-office functions (in each case, as appropriate). ~~Credit risk and risk management more broadly~~. As part of the bank's ongoing credit monitoring process, ~~independent~~ credit or counterparty risk management officers, in each case, independent from the front office market making function, should be engaged in regular oversight of counterparties and they should maintain a watch list of any names that require restricted or risk reducing activity only.

Paragraph 116

The guidelines recommend that banks maintain up-to-date close-out playbooks and conduct mock close-out exercises to uncover potential issues in advance of an actual close-out. The Associations agree that mock close-out exercises serve an important purpose in enhancing firms' readiness and ability to manage distress/close-out situations. However, the Associations suggest making the following revisions to promote efficiency in the process and enhance the clarity and effectiveness of the guideline:

1. The guidelines imply that mock close-outs should take place annually. This appears to be a departure from the US guidelines[12], which require these exercises every other year. Conducting mock exercises necessitates input from a significant number of key personnel from a bank, potentially from different global locations, who must balance participation in these exercises with

[12] Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Board of Governors of the Federal Reserve System, Office of Thrift Supervision; Interagency Supervisory Guidance on Counterparty Credit Risk Management (June 2011), *available at* https://www.federalreserve.gov/supervisionreg/srletters/bcreg20110705a1.pdf

their ongoing day-to-day responsibilities, which may include managing real-time distress and close-out situations. Running the mock exercises, identifying lessons learned, and implementing them into a bank's procedures therefore requires a significant allocation of resources that would otherwise be dedicated to BAU activities. Hence, the guidelines should align with the existing US guidelines in terms of mock exercise frequency. In addition, firms should integrate lessons learned from actual distress and close-out situations, where appropriate, into their policies and procedures, which should mitigate the need for an annual mock exercise.

a. The guidelines currently state that the "counterparty type" should vary from year to year. The Associations recommend referring to a "complex counterparty" instead. Using a complex counterparty for a mock exercise helps to identify new and more intricate issues across a wider range of closeout related aspects, including documents and systems than would be the case for a more straightforward counterparty. It would also allow alignment with the current US guidelines (which refer to "the banking organization's most complex counterparties") while at the same time providing banks with the flexibility to choose a counterparty whose complexity derives from non-structural factors (such as, for example, from their trading strategy).

When undertaking mock close-out exercises, banks should take into account any timing and procedural requirements that would necessitate involving third parties in a real-life situation (i.e., not a mock example), such as custodians (where, for example, exchanges of IM are part of the relationship with the counterparty). However, third parties should never be part of the mock close-out process to avoid any implications that the mock close-out subject has defaulted or is under financial distress. In fact, the mock exercise should be treated as highly confidential, even within the bank itself, and limited to key personnel whose day-to-day responsibilities include taking or overseeing actions related to counterparty distress or close-out situations.

2. The guidelines suggest that banks should not give advance notice to participants regarding the date of a mock close-out exercise. This would be extremely problematic. While the Associations understand the motivation behind this recommendation, conducting a mock close-out exercise without prior notice will divert a significant number of resources (including as it relates to actual counterparty distress and close-out situations) and disrupt ongoing live transactions. Instead, the exercise should be announced in advance to allow participants to manage their daily activities (including available resources) alongside the mock close-out exercise. Our proposal also avoids a situation where the mock default event begins in one region while resources are required in other regions during nighttime or early morning for the exercise.

3. Regarding the participants in the mock exercise, the guidelines propose including credit, finance, legal, compliance, operations, risk, and trading teams. However, the Associations note that the finance department is generally not involved in mock close-out exercises.

4. The guidelines then outline four minimum objectives for participants in the mock exercise. The Associations are concerned that some of the drafting used to describe the objectives is unclear and we have therefore suggested refinements which we believe will make them more certain. In the third objective, the changes are designed to reflect that a one-size-fits-all approach is unlikely to be appropriate for close-outs, which are fact- and circumstance-specific. While it is important

that banks are aware of their internal policies, there may be circumstances in which their best course of action is to take an action that they do not contemplate.

The Associations recommend the following changes to the guidelines:

116. Banks with sound practices maintain up-to-date close-out playbooks. They carry out mock close-out exercises at least every two years to uncover potential issues in advance of an actual close-out. The mock close-out candidate should ~~be a name that involves more than one legal jurisdiction and~~ have an organisational structure and/or contracts which require consideration of the laws of more than one jurisdiction, potentially across multiple business lines. The counterparty ~~type~~ should vary ~~from year to year~~ for each close-out exercise and should be a complex counterparty. It is critical that such mock close-out exercises are kept strictly confidential in order to avoid incorrect information on the candidate's financial condition or status reaching any person not involved in the mock close out exercise.~~, and t~~ The bank should not give advance notice to internal participants regarding the ~~date~~ exact details (such as the name of the target) of such an exercise, ~~even if~~ but the ~~approximate~~ timing of the exercise ~~may~~ should be communicated in advance.~~ t~~The bank's teams should complete a post-mortem exercise following ~~such incidents~~ any mock close-out to compile lessons learned. Where applicable, ~~A~~any lessons learned should then be used to enhance existing playbooks and any other relevant guidance for such events in the future. The mock close-out and lessons learned exercises should include (as appropriate and with particular regard to the need to maintain confidentiality of the counterparty that is the subject of the mock exercise) participants from credit, ~~finance,~~ legal, operations, collateral management, and risk and trading teams with the following minimum objectives:

a. All ~~involved parties~~ relevant internal participants are identified and the bank has ~~have~~ sufficient resources to execute the close-out, ~~prioritised alongside ongoing~~ whilst still performing BAU tasks to an appropriate standard and timeframe.

b. Demonstrate that relevant ~~reporting~~ information is shared with ~~involved functions~~ appropriate internal participants in ~~due time~~ a timely manner, is materially accurate,, and ~~is complete and correct~~ that no significant information is missing.

c. Close-out governance allows fast and ~~consistent~~ informed decision-making by involved management functions and all decisions ~~are in line with~~ take into account internal policies and procedures and are consistent with the legal framework for the affected financial contracts.

d. Trading capabilities that enable the orderly unwinding of positions (including experienced traders, access to capital markets and counterparty limits) are available (where appropriate, and subject to the need to maintain confidentiality of the counterparty that is the subject of the mock exercise).

Paragraph 117

The guidelines suggest that banks with strong risk management should understand that contractual terms[13] may restrict their ability to terminate or reduce activity with a counterparty in various ways. The Associations propose the following points in the guidelines:

1. The reference to "embedded in legal agreements" is unnecessary and can be omitted.
2. The reference to calibration of close-out provisions is impractical, as banks cannot unilaterally change them depending on conditions at the time of default/early termination and close-out.
3. The current wording (i.e., "terms that can limit a bank's ability to reduce or discontinue activity" and "need to maintain flexibility in order to avoid the need to declare a default") is vague and needs clarification.
4. The final sentence of the guideline is unclear and seems to combine two different concepts. The first concept focuses on banks being aware that contractual terms may prevent them from reducing or discontinuing activity with a counterparty, even when there are concerns about the counterparty. The second concept emphasizes the importance of banks not losing their termination rights by failing to exercise them in relation to a single event or in a timely manner and ensuring that any such rights are preserved.

The Associations recommend the following changes to the guidelines:

117. Banks with strong risk management will understand that the contractual terms ~~embedded in legal agreements can limit a bank's ability to reduce or discontinue activity~~ applicable to their trading relationship with a counterparty define the events that may trigger termination of the trading relationship, the steps required to undertake such termination, and the timing required for such actions to effectively minimise any potential losses and/or risks. ~~Close-out provisions should be carefully calibrated based on the bank's assessment of its counterparty's credit quality, including control and ownership~~. Should a bank choose not to exercise its contractual close-out rights for any reason at any time, such decision ~~Any concession to a counterparty regarding such provisions~~ should also consider reservation of any such rights ~~be made with an awareness of the bank's need to maintain flexibility in order to avoid the need to declare a counterparty in default~~.

Paragraph 118

The guidelines suggest that banks should have backups for their systems and secondary providers for crucial vendors and third-party relationships. While the Associations agree with this statement in general, we do not agree that the close-out practices section is the appropriate place to discuss system and vendor backup plans, as these plans can be complex and wide-ranging and should be addressed in firms' business continuity plans (BCPs). Furthermore, activating backup plans with third-party providers in connection with mock exercises may pose the risk described above if it were to become known that a mock exercise is being performed on a particular counterparty. It is also important to note that this specific requirement is not in the US guidelines. The Associations believe that the mock exercise should be undertaken based on a fact pattern assuming a counterparty default, such as bankruptcy or failure to pay or deliver margin

[13] It is important to note that the ability to terminate is not solely limited by the contractual terms. The prevailing circumstances, such as sanctions and lockdowns, can also present their own challenges, such as the delivery of notices, and obstacles to termination. For example, in a sanctions context, there may be a potential requirement to obtain government-imposed licenses before unwinding trades. Additionally, in the case of a financial institution, a resolution stay may further hinder the termination process.

in order to avoid the need for overly complex legal analysis and the involvement of external legal providers. We therefore suggest deleting this part of the guidelines. Additionally, the guidelines discuss the need for banks to conduct mock close-out exercises at the jurisdictional level to account for potential international sanctions. However, banks' experiences with sanctions suggest that they may not always result in widespread close-out activities triggered by contractual provisions. In addition, sanctions are highly complex, with every sanction situation being different and, as such, the Associations take the view that sanctions should not be included when undertaking mock close-out exercises. The recommendation "to contemplate mock close-out exercises at the level of a full jurisdiction" should also, therefore, be removed.

~~118.~~ ~~In an era of rogue actors and geopolitical instability, banks should take special care to ensure that systems have backups and that crucial vendors and third-party relationships have secondary providers in place. They should also take special care to ensure that procedures have been tested in the event that transactions are rerouted and processes remapped. Mission critical payments and securities transfer protocols should be designed with kill switches for manual operation only. The potential for international sanctions to be imposed on an entire legal jurisdiction requires banks to contemplate mock closeout exercises at the level of a full jurisdiction~~.

III. Conclusion

The Associations largely support the guidelines, except where noted, and emphasize the need to adopt a risk-based and proportional approach in their application. It is particularly important that, when the guidelines are transposed into local requirements, the requirements do not reflect a one-size-fits-all approach, an outcome which we understand would also be inconsistent with the intention of the BCBS guidelines.

Regarding due diligence and monitoring, the guidelines should not prescribe the quality or source of information to be obtained from counterparties. Instead, they should note that this information is one of the factors in the credit assessment process. In terms of credit risk mitigation, the sector and counterparty risk profile should drive the requirements, in conjunction with the exposure measurement and limit framework to manage trading levels. Banks should have the flexibility to determine the level of credit risk mitigation necessary to align with their desired risk appetite. For exposure measurement, the Associations fully support having a suite of complementary metrics to provide more comprehensive understanding and control. However, the guidelines should allow banks the flexibility to choose the metrics used to monitor CCR without imposing prescriptive requirements in the metrics themselves or their level of granularity. The governance section generally aligns with market practices, although it should acknowledge that risk committee action is not always required, as senior officers should be empowered to act with delegated authority. The Associations support the requirement to conduct mock close-out exercises but offer several detailed suggestions in the body of this letter.

Thank you for considering these comments. On behalf of ISDA and IIF members, we hope that these global industry perspectives will contribute constructively to your efforts. We would be pleased to discuss our comments further and invite you to reach out to Panayiotis Dionysopoulos (pdionysopoulos@isda.org) at ISDA and Richard Gray (rgray@iif.com) at the IIF.

Yours sincerely,

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IV. About the Associations

About the International Swaps and Derivatives Association:

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 1,000 member institutions from 77 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on X, LinkedIn, Facebook and YouTube.

About the Institute of International Finance:

The Institute of International Finance (IIF) is the global association of the financial industry, with about 400 members from more than 60 countries. The IIF provides its members with innovative research, unparalleled global advocacy, and access to leading industry events that leverage its influential network. Its mission is to support the financial industry in the prudent management of risks; to develop sound industry practices; and to advocate for regulatory, financial and economic policies that are in the broad interests of its members and foster global financial stability and sustainable economic growth. IIF members include commercial and investment banks, asset managers, insurance companies, professional services firms, exchanges, sovereign wealth funds, hedge funds, central banks and development banks.