

Feedback statement

Public consultation on the ECB's draft report on "Sound practices in counterparty credit risk governance and management"

Executive summary

On 2 June 2023 the European Central Bank (ECB) launched a public consultation on its draft report on "Sound practices in counterparty credit risk governance and management" (the Report). The purpose was to give interested parties – in particular banks and practitioners involved in counterparty credit risk (CCR) management – the opportunity to comment. This consultation ran for six weeks until 14 July 2023. The ECB also informed the European Parliament of the public consultation.

The ECB gratefully acknowledges the efforts of the respondents to this consultation.

As a result of the public consultation process, the ECB received four written responses, amounting to a total of nine comments which were all given due consideration. None of the respondents expressed any general concern or disagreement regarding the sound practices on CCR governance and management contained in the Report. Most respondents sought further clarification in relation to a few sound practices. Around half of the comments have led to the Report being amended, either by adjusting the wording of a particular sound practice or by providing additional clarifying information in other parts of the Report. None of these amendments resulted in any significant change to any sound practice. As a general remark, it is worth stressing that the proportionality principle is an overarching concept applicable to all sound practices, while considering the various organisations, activities and risks of SSM institutions.

Additional editorial changes to improve consistency and readability have been introduced also in the wording of sound practices #42 and #43.

This feedback statement presents the ECB's assessment of the comments received. It is published together with the final version of the Report.

Comments on and amendments to the ECB's draft report on "Sound practices in counterparty credit risk governance and management"

	Section	Respondent	Comment	ECB response and analysis	Amendment
1	General	Deutsche Börse Group	<p>The respondent suggested stressing the importance of the following elements:</p> <p>Due diligence on liquidity risk</p> <p>While some NBFIs remain unregulated, there is an indirect oversight role to play for the banking institutions that trade with them through the customer due diligence activities that should be imposed by banks as a condition of the trading relationship with clients. To the extent that clients cannot meet those standards, this should have tangible consequences through adverse counterparty ratings, more conservative risk limits, faster acceleration to watchlist and more punitive stress-testing (stress loss) outcomes. However, due diligence may mean different things to different institutions.</p> <p>Valuation haircuts on collateral</p> <p>The respondent agreed with the Report that "collateral is neither a substitute for the comprehensive assessment of the counterparty's creditworthiness, nor can it compensate for insufficient information". They went on to criticise the lack of conservatism in valuation haircuts applied for certain SFTs, arguing that banking institutions should be required to apply a risk-sensitive framework when determining valuation haircuts for their client SFTs, which in turn would require institutions to justify their existing (0% for overnight government bond repo transactions) valuation haircuts applied in the market.</p>	<p>Sound practice #9 amended to better explain the characteristics of the due diligence process related to CCR and vulnerable clients.</p> <p>Regarding the comment on haircuts other than zero for government bonds, prescribing minimum collateral valuation haircuts goes beyond the scope of this Report.</p>	Yes
2	CCR governance (3.2.9)	Groupe Crédit Agricole	<p>The respondent requested clarification that the sound practices should not imply a "one-size-fits-all" process for customer due diligence but take into account the various organisations and business models of EU banks. It stressed that, particularly in some banks, there is only one customer due diligence process to fit both the credit-granting process and the KYC requirements, while in other banks the two processes are separated.</p>	<p>The Report provides sound practices for matters to be considered in customer due diligence related to specific features of CCR and/or particularly risky clients. It does not prescribe a "one-size-fits-all" approach but does allow different banks to find solutions reflecting their organisation and business model, based on the principle of proportionality.</p>	No
3	CCR governance (3.2.12)	Groupe Crédit Agricole	<p>The respondent argued that, in some cases, the size and complexity of the CCR business may justify to including the assessment of CCR processes by internal audit in a wider audit scope of other risk categories or processes.</p>	<p>Generally, the principle of proportionality applies to all sound practices, including this one. However, it is acknowledged that a holistic view of CCR-related processes by the internal audit function can be achieved by different means. In any event, the internal audit function must have the full overview of all relevant processes, which have to be covered by regular audit reviews, with no gaps. This has been clarified by amending sound practice #12.</p>	Yes

	Section	Respondent	Comment	ECB response and analysis	Amendment
4	Risk control, management and measurement (4.2.20)	Groupe Crédit Agricole	The respondent asked for clarification regarding the expectation about the level (counterparty level or bank overall portfolio level) at which the illiquidity and concentration assessment of portfolios should be performed.	Illiquidity and concentration should not be assessed solely from a single counterparty/netting set perspective. It is important for risk management to understand and monitor things like concentration with certain issuers that an institution might be willing to accept only up to a certain limit, within the overall portfolio. Additionally, an institution might accept some collateral or trades that are not very liquid, but only up to a certain amount. Awareness of such issues requires a portfolio-level view.	No
5	Risk control, management and measurement (4.2.20)	ISDA	The respondent stressed that illiquidity and concentration must be assessed against the global exposure of the netting set and its impact in the context of winding down a portfolio, arguing in particular that a portion of illiquid collateral shall not imply that the collateral pool as a whole is illiquid.	Generally, the principle of proportionality applies to all sound practices, including this one. From an economic perspective, however, it is acknowledged that a small portion of illiquid collateral does not necessarily imply that the whole collateral pool is illiquid. This aspect can be taken into account by the economic risk measure chosen by the institution.	Yes
6	Risk control, management and measurement (4.2.21)	ISDA	<p>The respondent argued that, in most cases, the PFE model is already rigorous and sufficient to provide institutions with CCR measures that are conservative enough, especially when applying the regulatory MPOR framework. Hence, they ask for sound practice #21 to only apply to high-risk counterparties, where institutions consider the PFE metrics insufficient to provide an adequate measurement of counterparty credit risk. In particular, a low-risk counterparty with less liquid collateral should not automatically trigger the deployment of an additional economic measure.</p> <p>The respondent acknowledged that additional measures of CCR are necessary to monitor the risk linked to less liquid risk factors, albeit not in addition to the PFE metric/Pillar 1 capital requirements, but as an alternative measure of the same risk, to which the PFE or the EAD should be applied.</p>	<p>Sound practice #21 addresses not only high-risk counterparties, but also situations where the liquidation of a low-risk counterparty might lead to additional costs when winding down the portfolio because of the particular composition of the claim against that counterparty, in the event of a default. Economic measures could take into account the different probabilities of a counterparty default but should also incorporate the change of riskiness of counterparties in cases where these might be vulnerable to certain market risk events.</p> <p>To accommodate a variety of solutions by institutions, the Report does not prescribe the use of models or of a particular model. Nevertheless, PFE models might be used for this purpose. It is worth mentioning that the hedging position is usually with a different counterparty than the one defaulting. This means that, if it remains open during the counterparty's close-out and is then subject to potential changes due to market movements, it might not be sufficiently reflected in the PFE or EAD. If, for risk management purposes, the hedging position is partially or totally disregarded, there could be a blind spot when a counterparty defaults.</p> <p>It is acknowledged that the economic measure is meant to complement the information that can be retrieved from the application of MPOR. For risk management purposes, however, the application of MPOR (and its extensions) alone might not be sufficient.</p>	Yes
7	Risk control, management and measurement (4.2.21)	Groupe Crédit Agricole	The respondent argued that the additional measures for a portfolio wind-down are specifically relevant for prime brokerage activities and that the guidance should target the institutions conducting prime brokerage activities. The respondent stated that, as long as an institution does not conduct any prime brokerage activities, the significant costs of developing such a tool are not justified, the MPOR setup being sufficient.	Based on the general principle of proportionality, the sound practices address institutions for which the issues are relevant. However, additional costs of exposure wind-down do not exist only in the prime brokerage business, but also in other business areas, such as those where leverage is provided or less liquid collateral might be accepted.	No

	Section	Respondent	Comment	ECB response and analysis	Amendment
8	Stress testing and WWR (5)	GLEIF	The respondent suggested that institutions use the ISO 17442 Legal Entity Identifier (LEI) as an unequivocal identification means to identify and monitor their clients.	It is acknowledged that ISO 17442 Legal Entity Identifier (LEI) as an industry standard could ease the internal process across legal entities. However, an institution (single entity or group) can also choose another setup to unequivocally identify its clients.	No
9	Stress testing and WWR (5.2.25-26)	ISDA	The respondent asked for further clarification regarding the ECB's expectations related to sound practices #25 and #26, as some banks believed they had already performed activities which addressed the concerns of the ECB.	<p>It is acknowledged that the industry may already have addressed a number of sound practices in general. However, it was also observed that this does not hold true for all banks for which the ECB considers the practices relevant. A lack of consistent exposure stress testing in ICAAP scenarios was observed for a number of banks, where PDs were stressed, for instance, but the exposures affected by the worsening of the market risk factors were not. Consistent stress testing of all risk parameters, in line with the scenario assumptions, is considered a sound practice.</p> <p>It was observed that it was left solely to the client relationship managers to identify and monitor potential risk drivers for high-risk clients. It is sound risk management to complement the knowledge of staff by additional means, such as stress tests or other analyses, to identify exposure tail events.</p> <p>Background information on these practices was already provided in paragraphs 3 and 4 of Section 5.1. These paragraphs have been amended to provide more insight.</p>	Yes

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For specific terminology please refer to the [SSM glossary](#) (available in English only).