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The CCR alignment call for banks

Implementing the BCBS December advisory

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Introduction

In this paper, we outline a comprehensive roadmap for managing counterparty credit risk (CCR) in alignment with latest Basel Committee on Banking Supervision (BCBS) guidelines. It presents a structured approach to strengthening due diligence, credit risk mitigation, exposure measurement, stress testing, and infrastructure, while leveraging CRISIL's expertise, proprietary tools, and technology solutions. Designed for investment banks and financial institutions, this paper provides actionable insights and strategies to enhance CCR frameworks, ensure regulatory compliance, and drive operational efficiency. By following this roadmap, clients can navigate the complexities of CCR management with confidence and achieve risk reporting and mitigation objectives.

In December 2024, the BCBS issued guidelines to emphasise certain fundamental practices in counterparty credit risk (CCR) remain inadequate. They followed the Archegos Capital collapse, bouts of market volatility due to geopolitical uncertainties and the 2022-23 gilt market disruption.

The guidelines intend to address weaknesses across multiple areas, such as due diligence, risk mitigation and measurement practices, and stress testing.

They are applicable to all banks, and more so for those having non-banking financial institutions (NBFIs), including highly leveraged ones, as counterparties.

The guidelines ask banks to tailor risk management applications based on their counterparty profiles and risk complexity as well as focus on dynamic monitoring, pinned to a risk-based approach.

1. Due diligence, information disclosure, onboarding and ongoing credit assessment

- Due diligence should not be strong only at inception but also as an ongoing process, and include devising stress scenarios
- Both financial and non-financial risks should be assessed during onboarding and on an ongoing basis, identifying all material developments
- Disclosure from counterparties should be accurate and transparent. Counterparty-risk profiles should be monitored for changes
- Sufficient information should be collected about clients and vetted at all levels on an ongoing basis
- Apart from sound onboarding principles, banks should control the exposure to counterparties based on risk assessment. Margining should be used to control exposure
- Rigorous review of current and future exposure, maintaining metrics and incremental impact of all factors
- Credit assessment should be ongoing as well, measuring deviations against expectations

2. Credit risk mitigation

- Sound margining practices and use of guarantees, including the need for legal contracts/agreements with a clear understanding of contractual terms
- For derivatives, margining should be consistent across products and sensitive to counterparty-risk profiles
- Margining framework should be robust (covering Initial and Variation margins), transparent and flexible, with formalised documentation.

- For securities financing transactions (SFTs), regular assessment of collaterals against exposures, including applicable haircuts
- Where a counterparty has both collateral and margins, wrong way risk (WWR) should be addressed

3. Exposure measurement

- Exposure metrics, including potential future exposure (PFE), should be comprehensive and actionable, computed periodically and in a timely manner
- Internal governance around the use of metrics and relevance, including a clear taxonomy
- Focus on quantifying risk pertaining to concentration, material dispersion, illiquidity, tail risks, and WWR (both GWWR and SWWR)
- PFE should be backtested using real or hypothetical portfolios

4. Stress testing, scenario analysis and governance

- Stress-testing frameworks should simulate adverse conditions to evaluate counterparty vulnerabilities, including portfolio wind-downs, illiquid collateral netting sets
- Adequate documentation and periodic review of coverage of stress scenarios for the portfolios, ensuring granularity and relevance
- Integrate findings into internal management reporting and ensuring governance across three pillars — people, strategy (including limit governance and exception management), and management reporting

5. Infrastructure, data and risk systems

- Risk systems and data management capabilities should be commensurate to the size and complexity of counterparties
- Routine oversight and data management protocols, processes, and controls should be in place
- Reliable data aggregation ad advanced risk systems for accurate CCR assessment
- Watch-list practices and default management processes should be sound and well-governed

Current state of banks and key challenges

These guidelines appear to be a continuation of the targeted review of CCR processes for large banks, issued about a year ago. The regulator had highlighted key bottlenecks and we had explained them in a previous note. While the above recommendations appear straightforward, we see some challenges in both implementation and adaptation of these guidelines:

- The strategic intent has been clear in general, but what translates into supervisory duty always had implementation gaps, especially from a controls' standpoint
- Adaptation of M&A-related guidelines by banks is lagging, as most large banks continue to talk about legacy systems and migration to strategic tools that get outdated over time
- Cross-functional interactions appear to be lagging, as quant teams seldom talk to risk-reporting teams directly on the issues, unless there is a business need to know
- Several technology bottlenecks remain, as teams were originally organised by the product class and eventually struggled to understand the larger themes at an asset/risk class level, leading to multiple gaps

Potential roadmap for banks

	Due diligence, information disclosure, onboarding and ongoing credit assessment	Credit-risk mitigation	Exposure measurement	Stress testing, scenario analysis and governance	Infrastructure, data, and risk systems
Objectives	Strengthen counterparty onboarding, due diligence, and ongoing credit assessment processes	Optimie collateral management and other credit risk mitigation techniques.	Accurately measure and monitor CCR exposures	Strengthening stress testing and governance frameworks for CCR	Upgrade technology and data infrastructure to support CCR processes
Key activities	• Develop standardised due diligence frameworks for counterparty onboarding • Enhance information disclosure requirements • Implement automated tools for ongoing credit monitoring • Integrate external data sources for holistic credit assessment	• Align collateral management practices with BCBS margin requirements for non-cleared derivatives • Implement collateral optimisation tools • Enhance dispute resolution mechanisms for margin calls • Explore risk mitigation techniques such as netting agreements and credit derivatives	• Implement the Standardized Approach for Counterparty Credit Risk (SA-CCR) or refine internal models • Enhance exposure measurement frameworks for derivatives and securities financing transactions • Develop real-time dashboards for exposure monitoring and reporting	• Develop stress testing scenarios tailored to counterparty credit risk (e.g., market shocks, counterparty defaults) • Integrate stress testing results into risk appetite frameworks and capital planning • Establish robust governance frameworks for CCR, including clear roles and responsibilities	• Implement integrated risk management systems for CCR data aggregation and reporting • Enhance data governance frameworks to ensure data accuracy and completeness • Automate regulatory reporting processes for CCR metrics (e.g., EAD, CVA, PFE) • Explore advanced technologies for predictive analytics
Crisil Integral IQ's role	• Provide best practices for due diligence and credit assessment • Offer proprietary tools and analytics for credit risk monitoring • Conduct training workshops for risk teams on advanced credit assessment techniques	• Provide advisory services on collateral optimisation and margin management • Develop customised solutions for dispute resolution and process automation • Offer insights into innovative credit risk mitigation strategies	• Assist in the implementation of SA-CCR or validation of internal models • Provide exposure measurement tools and analytics for real-time monitoring • Conduct independent reviews of exposure measurement frameworks.	• Provide scenario design expertise and stress testing tools • Conduct independent validation of stress testing models and results • Develop governance frameworks and policies aligned with BCBS guidelines	• Provide advisory services on risk system selection and implementation • Develop data governance frameworks and data quality improvement plans • Offer technology solutions for automation and advanced analytics

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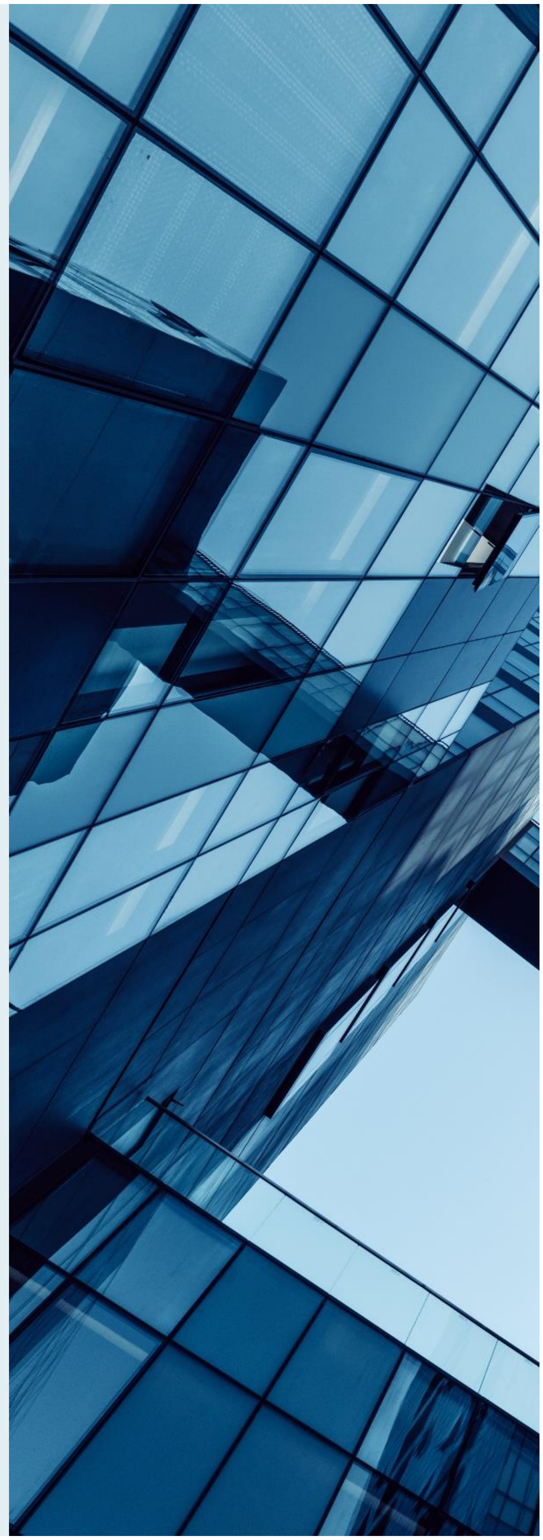
Crisil Integral IQ empowers clients to uncover critical insights that drive their confident decision-making. We serve as a strategic partner to traditional and alternative investment firms for driving agility, enhancing operational alpha, reducing reputational risk, while reducing ownership costs and increasing returns on investment.

Key differentiators

- Rich history of working with top financial institutions across the globe
- Expertise across multiple functions starting from Risk to providing bespoke solutions for ad-hoc challenges
- Experts are able to relate to the guidelines keeping in mind the challenges that a financial institution will face to root to the same.
- Our Traded Risk vertical is a widespread and matured team focussing on delivering value to clients focussing on key bottlenecks
- Expertise and working knowledge of risk data flow and how controls at every step influence a bank’s risk weighted assets and related disclosures — both quality and veracity

What we do

- Investment research and middle office solutions
- Investment banking and broker research
- Sustainability
- Data analytics and artificial intelligence
- Leading operations and credit risk solutions
- Quantitative and business transformation solutions



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Crisil Integral IQ delivers solutions and actionable intelligence to top financial institutions, driving strategic transformation, risk optimisation, and operational excellence. Our offerings across research, risk, lending, analytics and operations have empowered clients to navigate complex markets, mitigate risks and unlock new opportunities. Our domain expertise, innovative solutions, future-ready technologies such as AI and data science give clients the confidence to accelerate growth and achieve sustainable competitive advantage. Our globally diverse workforce operates in the Americas, Asia-Pacific, Europe, Australia and the Middle East.

For more information, visit IntegralIQ.Crisil.com

About Crisil

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Large and highly respected firms partner with us for the most reliable opinions on risk in India, and for uncovering powerful insights and turning risks into opportunities globally. We are integral to multiplying their opportunities and success.

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Founded in 1987 as India's first credit rating agency, our expertise today extends across businesses: Crisil Ratings, Crisil Intelligence, Crisil Coalition Greenwich and Crisil Integral IQ.

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