



EUROPEAN CENTRAL BANK
BANKING SUPERVISION

Template for comments

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

Institution/Company

Deutsche Börse Group

Contact person**Mr/Ms**

Mr

First name

Marco

Surname

Winteroll

Email address

marco.winteroll@deutsche-boerse.com

Telephone number

0049 6921111634

Please tick here if you do not wish your personal data to be published.

General comments



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The collapse of Archegos Capital Management exposed a range of weaknesses in counterparty credit risk management. While there are many learning points from the incident, non-bank financial institutions (NBFIs), hedge funds and family offices remain vitally important participants in supporting market functioning and it is imperative that they continue to be supported by the regulated banking sector. The recommendations identified in the ECB SSM's Sound practices in counterparty credit risk governance and management strike the right balance in addressing the lessons learned, while maintaining an appetite to support the broad base of financial market participants necessary for efficient market functioning. Notwithstanding, there are elements which we don't feel have received adequate attention in the recommendations and we welcome the opportunity to highlight these as part of the consultation process for the document.

Due diligence on liquidity risk

While hedge funds, family offices and a subsection of other NBFIs remain unregulated, there is an indirect oversight role to play for the banking institutions who trade with them, through the client due diligence activities. Given the robust CCR management requirements and standards expected of regulated banking institutions, one would expect that the banks themselves should be imposing similar standards on their clients as a condition of the trading relationship. 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. We are encouraged by the strong focus in the document on due diligence of clients as part of the broader CCR management framework. However, the numerous heatmaps in the document clearly illustrate the divergence of CCR management practices across the large banking institutions surveyed, and due diligence may mean different things to different institutions. We would challenge whether the due diligence conducted by many institutions has sufficient breadth and depth to provide a practical, real-world view not only of the client's solvency position and financial resources, but also its operational capability to manage and mobilize those resources in times of market stress.

Considering liquidity risk as an example, since the implementation of clearing mandates and the more recent implementation of the uncleared margin rules, CCR and liquidity risk have become inextricably linked. A banking institution's due diligence may verify that a client has a sufficient liquid asset buffer, but may pay scant attention to the client's access to tools to actively manage the buffer and the capabilities to mobilize those assets in times of stress. The client should have to demonstrate as part of due diligence that it has a suite of management and mobilization solutions available and that it has regularly tested those capabilities. Centrally-cleared repo funding and financing markets, as an example, have shown themselves to be remarkably resilient in periods of stress. With the latest innovations in direct access clearing models for repo, specifically designed for the buy side, we would expect such solutions to be high on the agenda of clients (Eurex Repo GmbH, "Capital efficiencies through direct access repo clearing models for the buy-side"; available here: <https://www.eurex.com/resource/blch/2714814/de334e664hcf2870f2e4c2710906bb9e/data/download-isa-direct-whitepaper.pdf>)



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