



Exposure value for internal models method counterparty risk

Overview

We are aware that some firms have recently experienced significant moves in Counterparty Credit Risk (CCR) exposures. In part this is attributable to large margin calls following significant intraday market price movements, which can lead to material but temporary overnight unsecured exposures on collateralised portfolios. The Capital Requirements Regulation (CRR) does not preclude firms using the Internal Models Method (IMM) to measure the exposure value including collateral which has not yet settled at the time of calculation. Where a shortfall between the collateral for which a firm has called and the collateral which has settled arises as a result of the ordinary collateral settlement cycle, including this shortfall in the calculation of exposure may lead to unwarranted volatility in the exposure value and therefore unwarranted volatility in RWAs.

Scope

This statement is relevant to firms using the IMM to calculate CCR exposure.

Implementation

Firms with permission under CRR Article 285 are required to capture the effects of margining within the calculation of Effective Expected Positive Exposure, which is derived from the profile of estimated Expected Exposure (EE). The PRA considers that firms are not required to estimate the initial EE recognising only collateral which has settled at the time of calculation. One example where it could, depending on circumstances, be appropriate to calculate initial EE on the basis of collateral called for but not yet settled, is where the delay in settlement of collateral arises as a result of the ordinary collateral settlement cycle. A firm which calculates the initial EE on the basis of collateral which has not yet settled would be expected to monitor the impact of this modelling choice on an ongoing basis and hold capital against any understatement of economic risk. Firms would not be expected to recognise collateral in the initial EE which has been called for but disputed by the counterparty.

Please note that if a firm makes a change to any IMM model as a result of this guidance then this would constitute a post-approval model change requiring post-notification as per Section 6.16 of PRA Supervisory Statement SS12/13, unless the impact of that change exceeded the materiality threshold as set out in Section 6.10(b) of the statement, in which case it would require pre-notification as set out in Section 6.15.

If you have any questions, please contact the PRA via your normal supervisory contacts.

30 March 2020