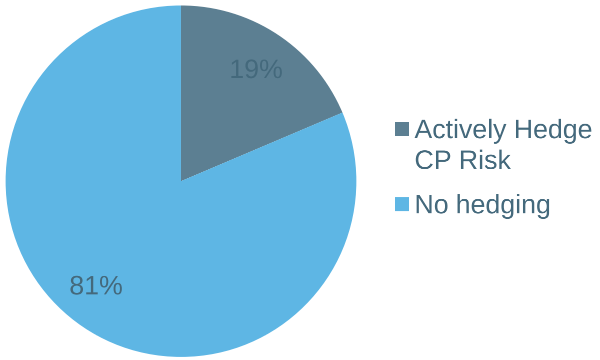
FitchSolutions

Global Credit and Counterparty Risk Survey

Counterparty Risk Management Survey 2009

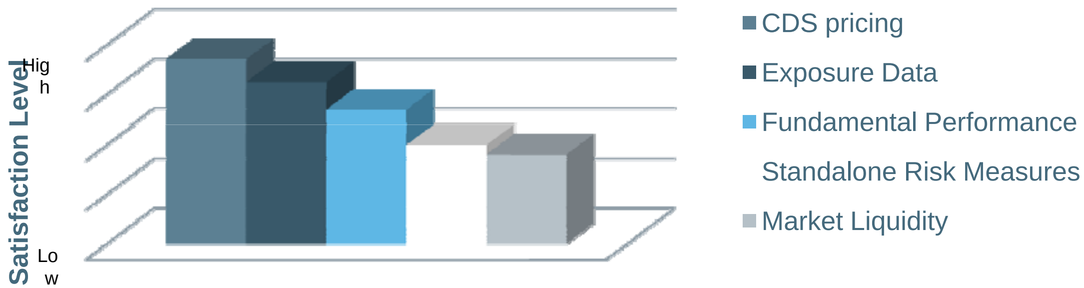
- 2009 Survey shows most buy-side firms do not hedge counterparty risk
- Those surveyed cited hedging as too expensive
- ‘manage’ counterparty risk by other means
  - Limits and collateral
  - Calculating exposure
  - Monitoring for ‘early warning’



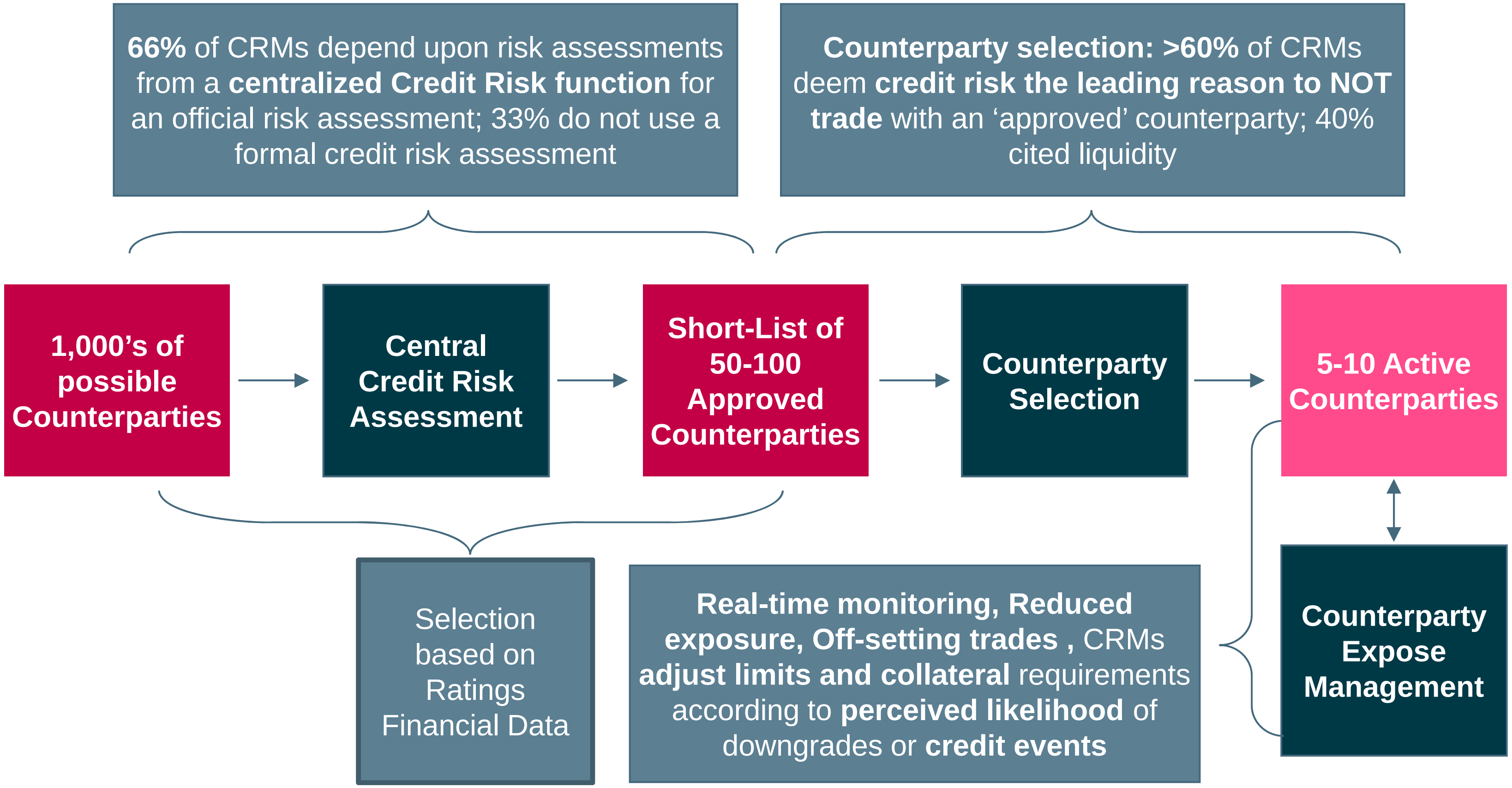
- 75% of respondents are not set-up to trade on CCPs

2009 Survey shows increased efforts on monitoring CP credit quality

- 63% of respondents deal with fewer counterparties today than before Lehman defaulted
- Respondents did not see benefit of counterparty diversification due to nature of derivatives, correlation of derivatives and FI credit risks
- Fewer counterparties allows for better monitoring and enforcement of credit quality standards
- Market participants were least satisfied with counterparty credit risk monitoring and Market Liquidity



2009 Survey Typical Counterparty Risk Work Flow



The Changing Landscape
Credit Risk Survey 2009 VS 2012

2009 → 2012

- Establishing a process
  - Lehman Brothers and what went wrong with their counterparty risk process very much the key driver for change
  - Having a proper counterparty workflow in place was a priority
  - CDS hedges only used by the bigger firms

- Integration and regulation
  - Counterparty risk management has advanced considerably since 2009
  - Increased focus on regulation and complex risk management strategies like CVA, DVA, FVA
  - Move to enterprise wide risk management

Introduction into 2012 Survey Data

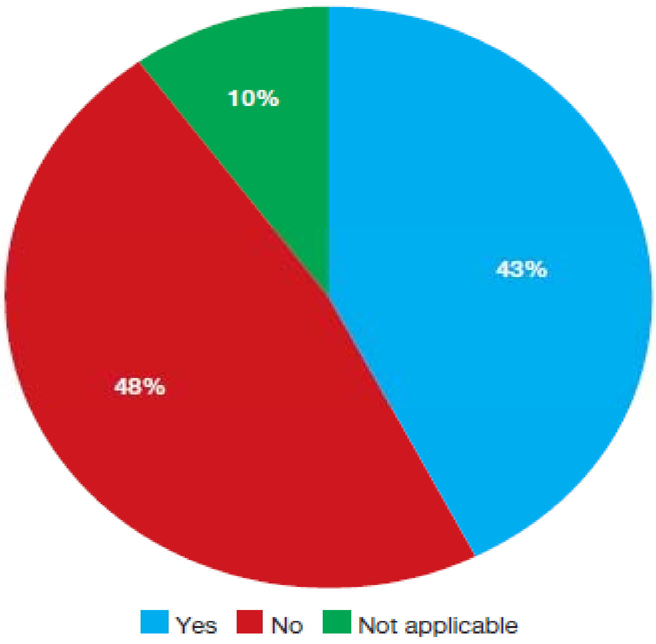
- The key finding of the survey is that Regulation is driving change with Basel 3 and Dodd-Frank leading the charge.
- Institutions both buy and sell sides are investing significant time and resources to strengthen their risk management infrastructure.
- Capital optimisation is priority. Almost every institution is looking at CVA methodologies.
- It is difficult to evaluate the credit risk on small institutions, which may lead to smaller credit limits or even difficultly in finding someone to trade with.

CVA Challenges and Comments

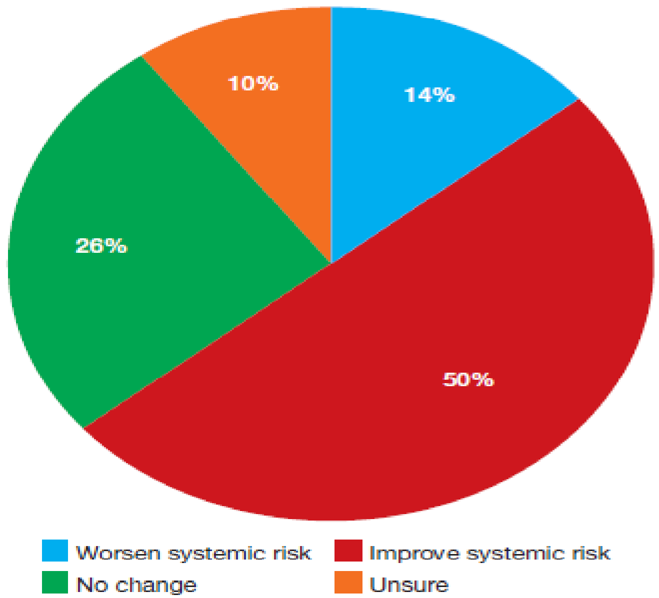
- CVA, DVA and now FVA (Funding Valuation Adjustment) the new goal is to isolate funding and credit risk components to allow hedging or reversing against a risky portion.
- FVA is still in its infancy and no standards have been established (complex)
- Under FAS157 all banks have to account for DVA in less than two years time; unclear how small institutions that cannot use CDS indices as self proxy will manage this.
- ISDA CSA (Standard Credit Support Annex) should help FVA with a standard approach to valuing collateral positions.

Central Counterparties

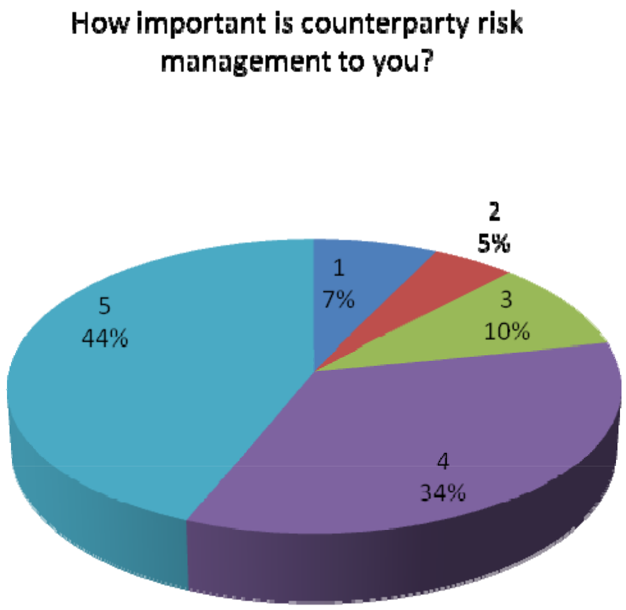
Do you measure your exposure to central counterparties?

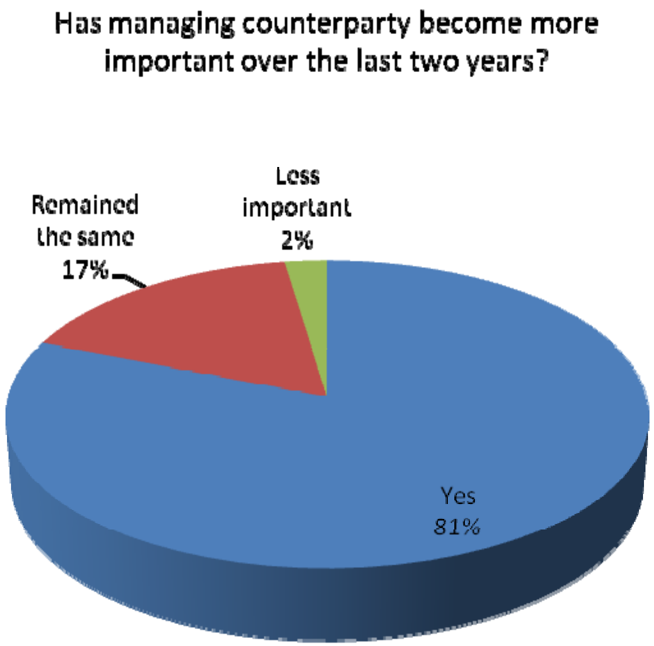


What impact will central clearing of OTC derivatives have on systemic risk?



How important is managing counterparty risk to your institution?



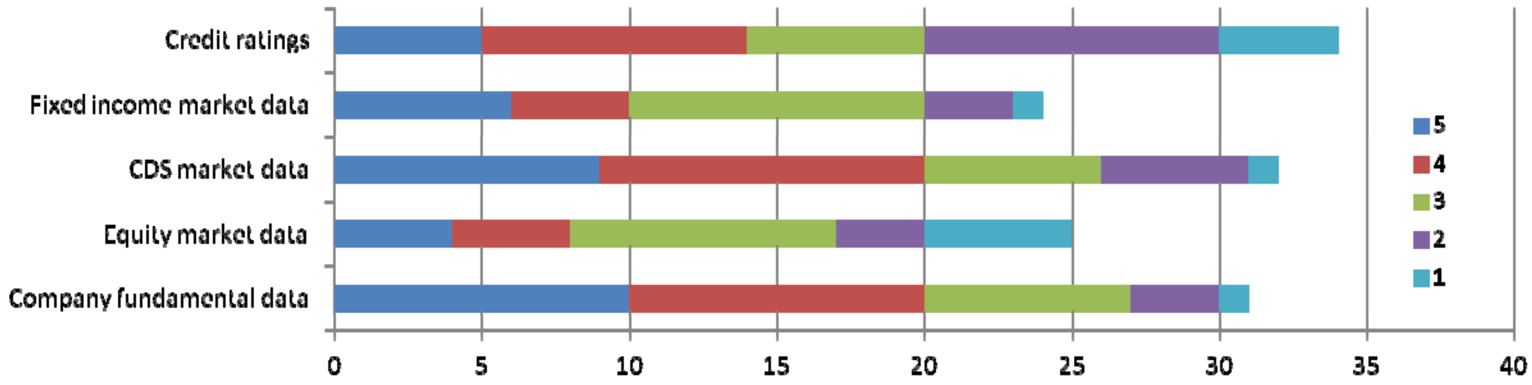


5 being the most important

Poll 1

Which Risk Indicators are most important in terms of managing counterparty risk and how reliable are they?

How reliable are the following risk indicators (with 5 being the most important)?



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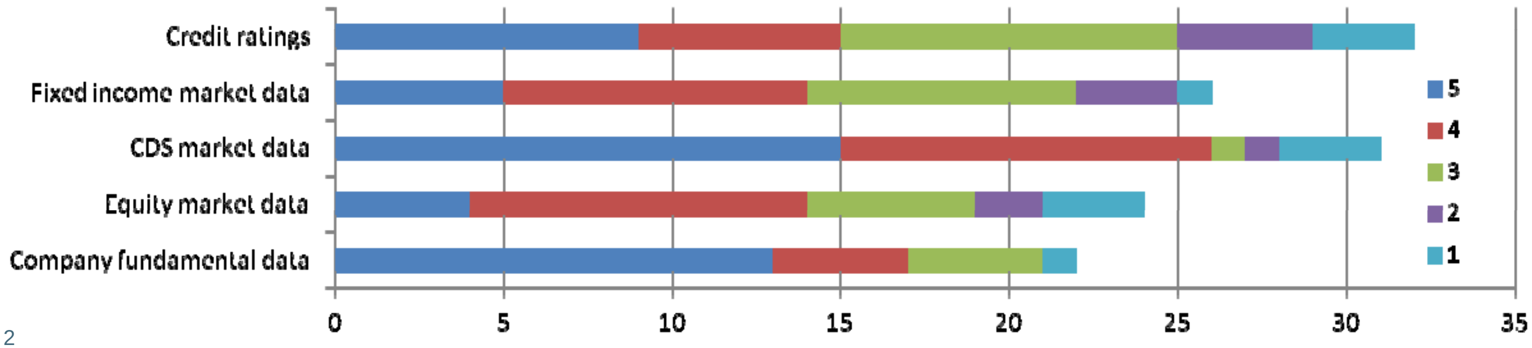


Poll 2

Does your institution operate its own rating model or process and if so how is the reliability of the model/process validated?

- Over 50% said they had an internal rating process
- In particular they rely on internal rating models for non-rated entities
- Some companies will only deal with non-rated entities if guarantees are in place
- Internal model validation - back testing, monitoring by independent validation group or risk management committee
- Compare with Agency rating – acceptable tolerance

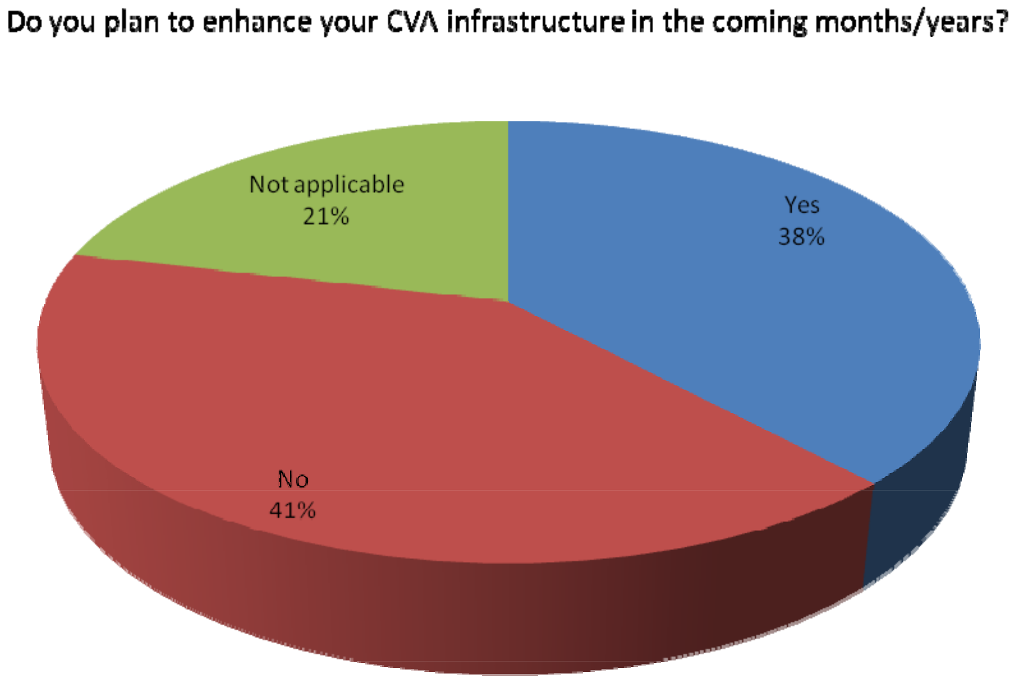
Poll 3

Does your institution have an internal CVA desk and/or conduct in-house CVA modelling?

- Fifty-Fifty split among yes and no
- The majority with a internal CVA desk do not use external CVA modelling service providers
- Aggregated trade data, internal credit evaluation and CDS data the most important data sets to them.
- Some banks are starting to use CVA as a tool in credit risk and treasury groups

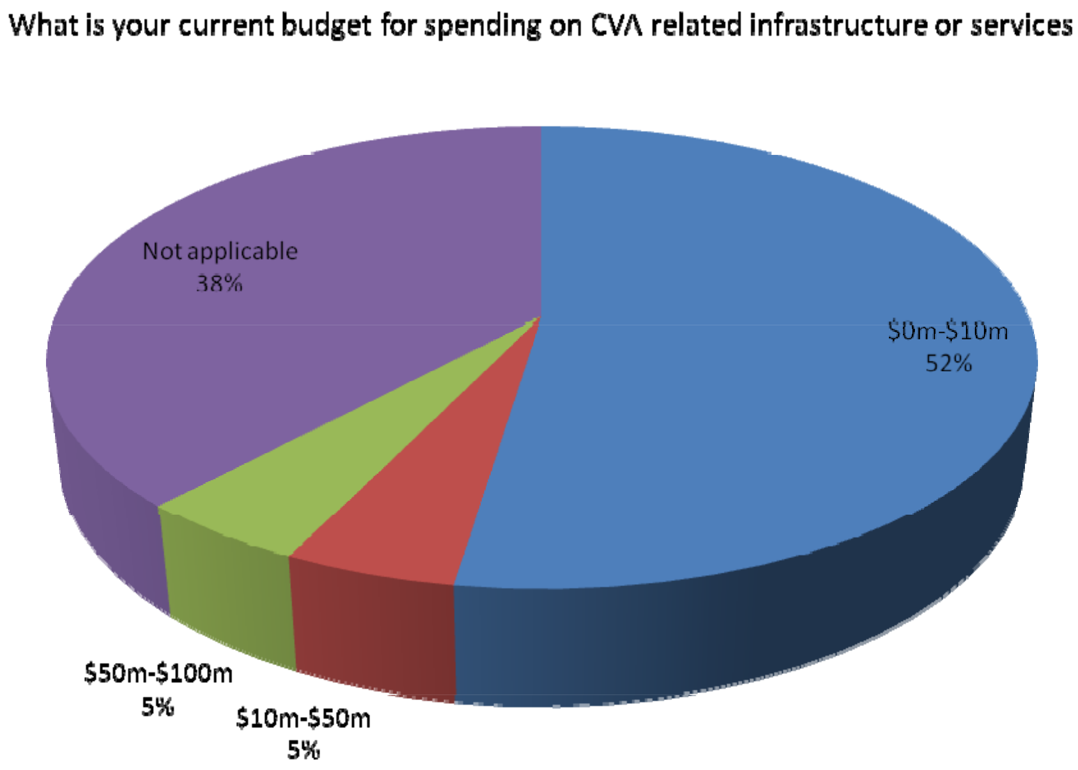
Poll 4

Does your institution plan to enhance its CVA infrastructure in the near future?



Poll 5

What is your current budget for spending on CVA related infrastructure or services



Poll 6

Market Based Indicators & Ratings can be Combined to Create a Powerful Measure of Credit Risk for Rated and Unrated Entities