5. COUNTERPARTY CREDIT RISK

The counterparty credit risk translates the risk of counterparties being unable to meet their liabilities resulting from securities contracts such as derivatives for instance.

The total exposure limit for counterparties that are not financial institutions in contracts subject to this type of risk is divided into two components: one for traditional credit operations (financial and/or signature) and another for treasury products.

The Bank gives preference to the definition of exposure limits to counterparty credit risk, bilateral contracts to guarantee exposures resulting from derivatives and the creation of collaterals within the scope of these agreements as preferred tools to mitigate counterparty credit risk.

The manual Credit Regulations for Sovereigns and Financial Institutions defines the way in which the consumptions of the counterparty credit risk limits are determined. This calculation is regularly made based on the market value of the operations, to which a factor arising from the future potential variation of that same value is added, adjusting for the volatility and deadline of each operation.

The Bank has a policy of closing bilateral contracts to guarantee exposures resulting from OTC derivatives contracted with Banks under the ISDA Master Agreement (ISDA - International Swaps and Derivatives Association).

In addition, an ISDA Master Agreement may frame the creation of collateral using an annex or ISDA Credit Support Document. As a template for the Credit Support Document, the Bank chose the Credit Support Annexes (CSA) contracts to guarantee the constitution, by the entity with net values payable in the future, of financial collaterals from the other party to guarantee the payment of these contractual obligations. In these contracts, the Bank (almost exclusively) accepts deposits in Euros as collateral.

Generally speaking, the Bank does not use netting as a technique for credit risk mitigation/reduction under RWA/capital requirements calculation; only in accounting, non-prudential terms, netting is used for interest rate swaps, per operation. The exception to this are the approved ISDA Master Netting Agreements (MNA) celebrated with 5 entities form the “Institutions” risk class that effectively provide prudential credit risk mitigation.

Finally, the Bank uses a framework agreement model of TBMA/ISMA (The Bond Market Association/International Securities Market Association) within the scope of the repo operations it carries out. This framework agreement, the Global Master Repurchase Agreement (GMRA), defines the repo transactions between the parties and regulates the creation of the collateral that guarantees the exposure.

Both in 2017 and in 2016, for the purposes of reducing counterparty credit risk, the Group used the financial collateral comprehensive method, as established in article 223, Section 4, Chapter 4, Title II, Part III of the CRR, and the mark-to-market method to calculate the future exposure in the relevant positions with credit risk, as defined in article 274, Section 3, Chapter 6, Title II, Part III of the CRR.

After estimating the exposures as at 2016 and 2017, the own funds requirements were computed, on one hand, according to Chapter 2, Title II, Part III of the CRR, for risk scores and portfolios that followed the standardised approach, and, on the other hand, according to Chapter 3, Title II, Part III of the CRR, for the portfolios for which the Supervisor has authorised the IRB Approach.

According to the mark-to-market method, the necessary values to calculate the exposure in the relevant positions have two components: (i) the market value of each operation and (ii) the percentage of the nominal to be applied as an add-on to that market value.

The market values of the operations are directly collected from the Bank’s front-end application (namely Kondor+), in which the management and evaluation of the operations is carried out, whilst the add-on values to be applied are directly identifiable in table I of paragraph c) of article 274, Section 3, Chapter 6, Title II, Part III of the CRR.

Regulation (EU) No. 648/2012 of the European Parliament and of the Council, of 4 July 2012, on OTC derivatives, central counterparties and trade repositories - commonly referred to as EMIR (European Markets Infrastructure Regulation) - has introduced legal obligations with the aim of improving post-trade transparency and reducing the risks associated with the derivatives market, in particular through the need to bring in a central counterparty or the adoption of risk mitigation techniques for derivatives not centrally cleared.

Taking into account the regulations applicable to its category, the Group became obliged to carry out the clearing of the OTC derivatives portfolio within the criteria defined by the EMIR, with a qualified CCP. This clearing obligation is, in a first stage, applicable to the simpler derivatives, namely, those relating to interest rate (IRS and FRA) and in the most common currencies (EUR, GBP, JPY, USD). Afterwards, there will be a phased extension of these obligations to a broader set of derivatives.

The Bank’s negotiating policy for ISDA CSA clauses privileges bilateral conditions, without any terms associated with the counterparties’ ratings. Moreover, after the implementation of the last phase of EMIR, the conditions defined for OTC collateral contracts cannot be linked to credit ratings. In this context, there is currently no relation between the collateral requirements for OTC derivatives and the rating of the Bank.

As at December 2017, the Group did not have any formal counterparty credit risk coverage operation in force.

Table 39 shows the counterparty credit risk for exposures subject to the standardised approach, computed as at the end of 2017 and 2016.

TABLE 39 – TEMPLATE EU CCR1 – ANALYSIS OF CCR EXPOSURE BY APPROACH

(Thousand euros)

	Notional	Replacement cost / Current market value	Potential future credit exposure	EEPE	Multiplier	EAD post CRM	RWA
Mark to market		759,726	453,472			963,758	519,686
Original exposure							
Standardised approach							
Internal Model Method - IMM (for derivatives and SFTs)							
Of which: securities financing transactions							
Of which: derivatives and long settlements transactions							
Of which: from contractual cross-product netting							
Financial collateral simple method (for SFTs)							
Financial collateral comprehensive method (for SFTs)							
VaR (Value at risk) for SFTs							
TOTAL							**519,686**

The own funds requirements for CVA risk, computed as at the end of 2017 and 2016 are broken down in Table 40.

TABLE 40 – TEMPLATE EU CCR2 – CVA CAPITAL CHARGE

(Thousand euros)

	Exposure value	RWA
Total portfolios subject to the advanced method		
(i) VaR component (including the 3x multiplier)		
(ii) SVaR component (including the 3x multiplier)		
All portfolios subject to the standardised method	476,062	238,668
Based on the original exposure method		
Total subject to the CVA capital charge	**476,062**	**238,668**

TABLE 41 – TEMPLATE EU CCR8 – EXPOSURES TO CCPs

(Thousand euros)

	EAD post CRM	RWA
EXPOSURES TO QCCP (TOTAL)		4,398
Exposures for trades at QCCP (excluding initial margin and default fund contributions); of which:		
(i) OTC derivatives	119,207	4,398
(ii) Exchange-traded derivatives		
(iii) SFT		
(iv) Netting sets where cross-product netting has been approved		
Segregated initial margin	222,091	
Non-segregated initial margin		
Prefunded default fund contributions		
Alternative calculation of own funds requirements for exposures		
EXPOSURES TO NON-QCCP (TOTAL)		
Exposures for trades at non-QCCP (excluding initial margin and default fund contributions); of which:		
(i) OTC derivatives		
(ii) Exchange-traded derivatives		
(iii) SFT		
(iv) Netting sets where cross-product netting has been approved		
Segregated initial margin		
Non-segregated initial margin		
Prefunded default fund contributions		
Unfunded default fund contributions		

TABLE 42 – TEMPLATE EU CCR3 – STANDARDISED APPROACH – CCR EXPOSURES BY REGULATORY PORTFOLIO AND RISK

(Thousand euros)

Exposure classes	Risk weight											Total	RWA
	0%	2%	4%	10%	20%	50%	70%	75%	100%	150%	Others		
Central Governments or Central Banks	13,212											**13,212**	
Regional Governments or Local Authorities													
Public Setor Entities	41,127				0							**41,127**	0
Multilateral Development Banks													
International Organisations													
Institutions					188,436	266,429			10,596		114,809	**580,270**	183,794
Corporates									121,573			**121,573**	121,124
Retail								1				**1**	0
Institutions and corporates with a short-term credit assessment													
Other items													
TOTAL	**54,339**				**188,437**	**266,429**		**1**	**132,169**		**114,809**	**756,183**	**304,918**

TABLE 43 – TEMPLATE EU CCR4 – IRB APPROACH – CCR EXPOSURES BY PORTFOLIO AND PD SCALE - CORPORATES

(Thousand euros)

	PD scale	EAD post CRM	Average PD	Number of obligors	Average LGD	Average maturity	RWA	RWA density
CORPORATES	0.01% to 0.05%							
	0.05% to 0.07%							
	0.07% to 0.14%	6	0.10%	1	42.26%	365	1	18.6%
	0.14% to 0.28%	68	0.20%	3	42.26%	365	20	29.9%
	0.28% to 0.53%	359	0.40%	3	42.26%	365	165	45.8%
	0.53% to 0.95%	461	0.70%	4	42.26%	633	338	73.3%
	0.95% to 1.73%	3,899	1.30%	7	42.26%	747	3,405	87.3%
	1.73% to 2.92%	6,014	2.30%	7	42.26%	1,037	8,058	134.0%
	2.92% to 4.67%	86	3.70%	2	42.26%	365	101	117.5%
	4.67% to 7.00%	69	5.90%	1	42.26%	365	97	140.2%
	7.00% to 9.77%							
	9.77% to 13.61%	77	11.50%	1	34.68%	1,080	124	161.3%
	13.61% to 100.00%							
	100.00% (default)							
	SUBTOTAL	**11,040**	**1.90%**	**29**	**42.21%**	**703**	**12,309**	**111.49%**
SME	0.01% to 0.05%							
	0.05% to 0.07%							
	0.07% to 0.14%							
	0.14% to 0.28%	126	0.20%	8	38.68%	369	26	20.4%
	0.28% to 0.53%	53	0.40%	7	42.95%	365	17	31.9%
	0.53% to 0.95%	84	0.70%	9	41.16%	842	37	43.3%
	0.95% to 1.73%	152	1.30%	9	40.26%	608	88	57.7%
	1.73% to 2.92%	63	2.30%	6	39.50%	365	38	60.1%
	2.92% to 4.67%	73	3.70%	8	40.83%	787	66	90.3%
	4.67% to 7.00%	215	5.90%	7	39.79%	365	207	96.3%
	7.00% to 9.77%	108	8.30%	5	44.40%	365	141	131.2%
	9.77% to 13.61%	479	11.50%	7	42.21%	873	717	149.7%
	13.61% to 100.00%							
	100.00% (default)	265	100.00%	1	49.62%	485	17	6.3%
	SUBTOTAL	**1,618**	**21.55%**	**67**	**42.59%**	**623**	**1,352**	**83.58%**
TOTAL		**12,658**	**-**	**96**	**-**	**-**	**13,661**	**107.9%**

NOTE: These data do not include the exposures on Derivatives and Specialised Lending.

TABLE 44 – TEMPLATE EU CCR4 – IRB APPROACH – CCR EXPOSURES BY PORTFOLIO AND PD SCALE - RETAIL

	PD scale	EAD post CRM	Average PD	Number of obligors	Average LGD	Average maturity	RWA	RWA density
RETAIL SME	0.01% to 0.05%							
	0.05% to 0.07%							
	0.07% to 0.14%							
	0.14% to 0.28%	44	0.20%	7	0.04%		6	12.5%
	0.28% to 0.53%	11	0.40%	4	0.05%		2	23.5%
	0.53% to 0.95%	12	0.70%	2	0.05%		4	32.1%
	0.95% to 1.73%	6	1.30%	1	0.03%		2	28.3%
	1.73% to 2.92%							
	2.92% to 4.67%	12	3.70%	3	0.04%		5	43.8%
	4.67% to 7.00%							
	7.00% to 9.77%							
	9.77% to 13.61%	336	11.50%	7	0.03%		148	44.1%
	13.61% to 100.00%							
	100.00% (default)							
	SUBTOTAL	**421**	**9.36%**	**24**	**32.71%**		**167**	**39.67%**
RETAIL NON-SME	0.01% to 0.05%							
	0.05% to 0.07%							
	0.07% to 0.14%							
	0.14% to 0.28%							
	0.28% to 0.53%							
	0.53% to 0.95%							
	0.95% to 1.73%							
	1.73% to 2.92%	4	2.30%	1	36.62%		2	51.7%
	2.92% to 4.67%							
	4.67% to 7.00%							
	7.00% to 9.77%							
	9.77% to 13.61%							
	13.61% to 100.00%							
	100.00% (default)							
	SUBTOTAL	**4**	**2.30%**	**1**	**36.62%**		**2**	**51.66%**
TOTAL		**425**	**-**	**25**	**-**	**-**	**169**	**39.8%**

NOTE: These data do not include the exposures on Derivatives and Specialised Lending.

TABLE 45 – TEMPLATE EU CCR5-A – IMPACT OF NETTING AND COLLATERAL HELD ON EXPOSURE VALUES

(Thousand euros)

	Gross positive fair value or net carrying amount	Netting benefits	Netted current credit exposure	Collateral held	Net credit exposure
Derivatives	687,178	62,276	624,902	199,445	441,512
Value of collateral held without impact				16,055	
SFT					
Cross-product netting					
TOTAL	**687,178**	**62,276**	**624,902**	**199,445**	**441,512**

TABLE 46 – TEMPLATE EU CCR5-B – COMPOSITION OF COLLATERAL FOR EXPOSURES TO CCR

(Thousand euros)

	Collateral used in derivatives transactions				Collateral used in SFTs	
	Fair value of collateral received		Fair value of posted collateral		Fair value of collateral received	Fair value of posted collateral
	Segregated	Unsegregated	Segregated	Unsegregated		
Cash	3,259	231,833	14,315	297,694	11,207	51,990
Bonds			211,035			
TOTAL	**3,259**	**231,833**	**225,350**	**297,694**	**11,207**	**51,990**

TABLE 47 – TEMPLATE EU CCR6 – CREDIT DERIVATIVES EXPOSURES

(Thousand euros)

	Credit derivative hedges		Other credit derivatives
	Protection bought	Protection sold	
NOTIONALS			
Credit default swaps	319,000	19,510	-7,300
Total return swaps			
Credit linked notes			135,350
Other credit derivatives			
TOTAL NOTIONALS	**319,000**	**19,510**	**128,050**
FAIR VALUES			
Positive fair value (asset)	3,470		
Negative fair value (liability)	3,068		21,607