Counterparty

Background

The firm-wide application of netting and collateral benefits for counterparty exposure measurement will be centrally managed in Counterparty Credit Risk. The go-forward approach being adopted by the combined firm will be to require a netting and collateral enforceability opinion prior to recognizing the benefits of netting and collateral for credit, accounting or capital purposes. Applying the benefits of netting and collateral in a consistent and accurate manner across the firm provides benefits to Counterparty Credit Risk exposure management, Finance (Fin 39 netting), Risk Officers, Front Office (CVA/credit reserve process), and the Basel capital allocations. A new position was created last year within Counterparty Credit Risk to manage this process. The position is filled by Anne Doenias, Netting Specialist.

To aid in the application of netting and collateral benefits across the firm, a central repository of Netting or Collateral Enforceability Opinion ("Opinion") information has been created and will be maintained by Counterparty Credit Risk. The Netting Specialist will work with Pam Hutson, Senior Counsel ("Legal"), to ensure that Opinions are prioritized and applied appropriately within the counterparty exposure aggregation.

Netting and Collateral Opinion Request Procedures

In the normal course of business, Counterparty Credit Risk will work to ensure that the Bank's largest exposures are receiving the most favorable netting or collateral status. When a new counterparty is identified that needs an Opinion, the following procedures should be followed to ensure that your request is being processed efficiently.

1. All Opinion requests
   Each request should include:
   a. Counterparty full legal name
   b. Pending trade detail (if any)
   c. Special circumstances or other pertinent counterparty information

2. Opinion request will be reviewed, prioritized and tracked with all other requests in a consolidated manner.

3. Netting Specialist will work with Derivatives Documentation to identify the executed final version of the ISDA Master and CSA (if applicable), which will be included in the Opinion request.

4. Opinion requests will be submitted to Legal by Netting Specialist.

5. Legal will provide Opinions and post to the Master Agreement Legal Opinion SharePoint site.

6. Netting Specialist will review the Opinion. If the Opinion is "unqualified" (or clean), netting (NET) or netting / collateral (CollNet) is applied to the Counterparty exposure (see below for explanation). If Opinion is "qualified", netting (NET) or netting / collateral (CollNet) is *not* applied and Netting Specialist will discuss qualifications with Front Office, Legal and the Risk Officer.

7. Adaptiv is the repository for all aggregation exposure information and the Netting Specialist will populate applicable ISDA documentation terms and Opinion terms in order to ensure appropriate methodology has been applied to the portfolio-level exposure. When Counterparty's aggregation methodology is updated in Adaptiv, Netting Specialist will communicate this change to all interested parties.

8. The application of netting (NET) or collateral / netting (CollNet) to exposure calculations will impact the amount of the portfolio-level Maximum Potential Exposure (MPE); however, it does not change the need for obtaining credit (limit and transaction) approval through the appropriate risk management process.

<u>Aggregation Methodology Summary</u>

portfolio-level aggregation framework has four (4) separate methodologies:

- **Sum of MPE**: This is not a portfolio-level approach, but rather a trade-level aggregation approach that sums individual MPEs without considering offsetting exposures or the distribution of exposures over time. The aggregated exposure for the counterparty is simply the sum of all the individual trade-level MPEs.
  - Requires no ISDA or Netting Opinion or Collateral Opinion

- **Gross**: A portfolio-level aggregation approach that takes into account the directionality and time profile of exposure, but does not account for the benefits of netting. The aggregated portfolio-level exposure for the counterparty is the peak of the sum of all the positive trade profiles at discrete forward-looking time intervals over the life of the portfolio.
  - Requires ISDA (CSA optional). No Netting Opinion or Collateral Opinion required.

- **Net**: A portfolio-level aggregation approach that sums profiles by including negative offsets and considering distribution of exposures over time. The aggregated portfolio-level exposure for the counterparty is the peak of the sum of all the positive (in favor and negative (in favor of Counterparty) trade profiles at discrete forward-looking time intervals over the life of the portfolio.
  - Requires ISDA (CSA optional) and a clean Netting Opinion

- **CollNet**: A portfolio-level aggregation approach that sums profiles by including negative offsets and considers the effects of daily collateral margining by calculating the distribution of exposures over a shorter time horizon. The aggregated portfolio-level exposure for the counterparty is the sum of all the positive and negative (in favor of Counterparty) trade profiles at discreet forward-looking time intervals over a two week time horizon.
  - Requires ISDA, CSA, clean Netting Opinion and clean Collateral Opinion

Note: When considering moving a counterparty to the CollNet methodology, it should be noted that the formula for CollNet includes total potential unsecured risk (i.e., Threshold + Minimum Transfer Amount). At a minimum, the counterparty CollNet exposure will be equal to the Threshold + Minimum Transfer Amount + 2 week MTM change. For counterparties with larger thresholds and small portfolios of trades, the formula could result in the CollNet exposure being greater than the portfolio-level Net exposure.

Methodology (by Legal Entity)	ISDA	CSA	Netting Opinion	Collateral Opinion	Description
Portfolio Level - CollNet	Yes	Yes	Yes	Yes	▪ Collateral held/posted used in exposure calculation. ▪ Negatives utilized in aggregation. ▪ Shortened 2wk time horizon to reflect daily margining in CSA.
Portfolio Level - Net	Yes	Optional	Yes		▪ Negatives utilized in aggregation. ▪ Time distribution of exposure is taken into account in aggregation.
Portfolio Level - Gross	Yes	Optional			▪ Negatives set to zero in aggregation. ▪ Time distribution of exposure is taken into account in aggregation.
Trade Level - Sum of MPE					▪ Sum of peak exposure on each trade, regardless of the direction of the risk or the duration of risk. ▪ Time distribution of exposure taken not into account in aggregation.