Pills

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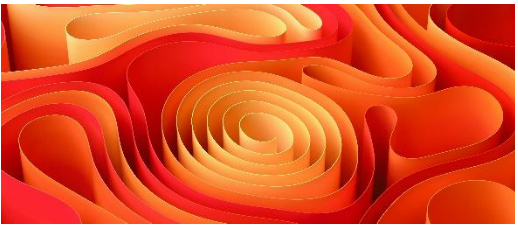

TOPICS:

Market risk

SOURCE

European Central Bank

ECB: Counterparty Credit Risk Exploratory Scenario Exercise

- The ECB conducted a **2025 exploratory scenario exercise to assess counterparty credit risk (CCR)** among 15 euro area banks with material exposures. **CCR**, which arises primarily from derivatives and securities financing transactions, **represents around €340 billion (4%) of significant institutions' risk-weighted assets** as of June 2024. **The exercise focused on vulnerabilities** linked to exposures **to non-bank financial institutions (NBFIs)** and evaluated **banks' stress-testing capabilities under multiple adverse scenarios**.
- **Three scenarios were used**: the EBA's 2025 EU-wide adverse market risk scenario, a further interest rate decline (scenario 1), and euro depreciation due to geopolitical tensions (scenario 2). Unlike the EBA stress test, the CCR exercise had no direct capital impact but informed supervisory dialogue.
- Key findings include: 1) **Exposure Composition**: Total gross CCR exposure was €96 billion, with €55 billion attributed to NBFIs—mainly insurance companies and pension funds. Net exposure stood at €38 billion, with collateralisation levels ranging from 9% to 95%; 2) **Risk Concentration**: Hedge funds, private equity and credit funds, and family offices showed the highest default probabilities and leverage. In contrast, insurance and pension funds had lower risk profiles. NBFI exposures were geographically concentrated in the Netherlands (gross) and the US (net); 3) **Stress Test Impact**: Scenario 2 had the largest effect, significantly increasing CCR exposures due to FX-driven valuation changes. Scenario 1 showed more limited impacts. Collateral effectiveness varied by counterparty type; 4) **Wrong-Way Risk & Liquidity**: Specific wrong-way risk (SWWR) was found to be marginal (<4%), but liquidity vulnerabilities were notable for some banks under severe stress conditions. Margin calls under adverse conditions could materially affect banks' liquidity positions; 5) **Interconnectedness**: A fragility index was introduced to measure systemic CCR interlinkages, revealing that some banks with modest exposures may still face elevated systemic risk through shared counterparties.
- Banks' modelling practices varied widely, especially regarding leverage and SWWR estimation. Most lacked dedicated stress-testing for NBFIs, highlighting an area for supervisory attention. Overall, **the exercise underscored the need for enhanced CCR governance, stress-testing, and systemic risk awareness**.