

NOTE FROM IACPM'S EXECUTIVE DIRECTOR

Dear Members,

New rules and regulations that affect credit portfolio managers continue to dominate the headlines in 2016. The issuance of consultative documents continued throughout the year but the pace appears to be slowing globally. In fact, as we approach year-end, the focus is shifting towards the implementation of these new rules and regulations in 2017 and beyond.

The IACPM remains active in a range of regulatory advocacy efforts. We held numerous meetings with regulatory and supervisory agencies around the world to discuss topics important to credit portfolio managers. We continue to engage in discussions with global regulators on topics including Standardized Credit Approaches, IFRS9 and CECL Expected Credit Loss Provisions, Synthetic Securitisation and No Restructuring CDS. Our members also completed several surveys on these important topics that were of interest to many global agencies.

Attached is a brief summary of some of the actions taken by the IACPM and our members in 2016. Please feel free to share the summary with others at your firm.

My thanks to the Regulatory Committee, the Board, the working groups and the many IACPM members who provide leadership, time and support for our initiatives. The Regulatory Committee meets monthly to set the agenda and direction for the IACPM's advocacy efforts. Please let me know if you would like to be involved and I will ensure that you receive information about future calls and meetings.

As always, we value your support for the IACPM. Feel free to contact me to discuss our advocacy efforts in more detail or to provide comments on current issues and future initiatives.

Regards,



Som-lok Leung | Somlok@iacpm.org | +1 646 289 5434

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IACPM COMMENT LETTERS TO GLOBAL REGULATORS

Revisions to the Standardized Approach for Credit Risk (BCBS D347)

ISSUE The Basel Committee issued a second consultative document that focused on addressing many of the issues raised in their first consultative document, while also balancing risk sensitivity with the objective of reducing variability in risk assets within banks and jurisdictions. While the first consultative document recommended eliminating the use of external ratings, the second paper reintroduces the ability of banks to use external ratings. Once again, the credit risk mitigation section was of particular interest to credit portfolio managers in North America. Originally, the Basel Committee had recommended that a credit default swap (CDS) that does not specify Restructuring as a Credit Event would no longer be recognized as a credit risk mitigant for regulatory capital purposes and therefore receive no capital relief. In this new letter, the recommendation is to return to the current status quo, which is a 40% haircut in capital relief for this CDS product.

IACPM ACTIONS Similar to 2015, IACPM submitted two letters related to the Standardized Approach proposal: a comment letter prepared jointly with the Institute of International Finance, Global Financial Markets Association and the International Swaps and Derivatives Association on global risk measurement issues; and a separate letter related to the treatment of credit default swaps without restructuring for capital relief. **Joint Industry Response Letter:** The joint industry response letter again reiterated concern with the sweeping changes proposed within the new standardized approach, emphasizing that, as drafted, the approach could potentially have unintended consequences such as the reduction of risk management, reduced credit extensions to borrowers, and/or the assumption of risks in other sectors that may be more risky but receive favorable treatment.

STATUS **Outstanding.** Discussions are continuing with the Basel Committee.

IACPM Letter on Credit Risk Mitigation (Section 2.3 of the Revisions to the Standardized Approach for Credit Risk)

ISSUE The IACPM submitted a separate **comment letter** that provided the rationale for 100% regulatory capital relief on United States CDS contracts, which typically trade without Restructuring as a Credit Event. The Basel Committee had expressed concern that this issue only applied to U.S. banks. Our members participated in a survey that provided useful data to express that NoR CDS is in fact a global bank issue. The letter reiterated that trigger events require a 100% vote under the terms of the hedged instrument and that there is a well established framework for bankruptcy/reorganization in the jurisdiction. This is different than other jurisdictions, as in Europe, for example, a restructuring credit event is more probable in insolvency proceedings and therefore “Modified-Modified Restructuring” (MMR) is the European CDS contract standard. Removing the 40% penalty for these contracts would provide for global uniform treatment and align incentives globally for those credit portfolio managers who manage risk by using CDS.

STATUS **Outstanding.** Discussions are continuing with the Basel Committee.

Reducing Variation in Credit Risk - Weighted Assets – Constraints on the Use of Internal Model Approaches (BCBS D362)

ISSUE In this consultative document, the Basel Committee focused on banks’ internal models that are used in rating exposures and determining regulatory capital requirements. The Committee proposed changes to the advanced and foundation internal ratings model approaches. Specifically, the guidelines set forth within the document recommended that global banks not use the advanced approach for exposure to banking clients, insurance companies and corporates with assets over €50 billion. This type of exposure would be subject to the standardized approach. For the corporates that have assets less than €50 billion but revenues larger than €200 million, the foundation approach would be applied. The advanced approach would apply to the remaining corporate exposures. Additionally, Basel asked for comments around output floors while a more comprehensive study was conducted simultaneously with many global banks to determine the impact on capital. Credit portfolio managers are concerned with the removal of risk sensitivity, which could certainly impact capital, origination decisions and pricing for bank products.

IACPM ACTIONS Together with the Global Financial Markets Association, the International Swaps and Derivatives Association, and Japan Financial Markets Council, IACPM submitted a **joint response letter** commenting on the principles within the document. The joint letter pointed out that there has been a “piecemeal approach” with various consultative documents that impact the capital framework as well as tight timelines to respond to the various proposals. The response letter suggested that a comprehensive analysis was needed in order to understand the potential impact to capital. The letter also highlighted the wealth of data available covering various exposure categories and that therefore, internal modelling should continue to be permitted as it allows banks to make better risk sensitive and capital allocation decisions. For example, banks and financial institutions would be allowed to use a constrained internal ratings based model while internal models can be used for large corporate exposures when firms can prove enough data (internal or external) exists.

STATUS **Outstanding.** The IACPM continues to work with these associations to ensure that these messages are received by regulators and members of the Basel Committee. A QIS study was also undertaken over the summer to highlight the potential capital impact these changes would have on global banks.

Capital Treatment for “Simple, Transparent and Comparable” Securitisations (D343)

ISSUE The Basel Committee proposed guidelines for incorporating the “simple, transparent and comparable, (STC)” criteria into the capital framework. Synthetic securitisations were once again not considered in the scope of the simple, transparent and comparable (STC) framework in this document. The Basel Committee requested thoughtful responses around four main topics: introduction of STC into a capital framework, additional criteria requirements, compliance oversight once implemented, and views on alternative capital requirements.

IACPM ACTIONS The IACPM joined with the Global Financial Markets Association, Association for Financial Markets in Europe, Securities Industry and Financial Markets Association and the Asia Securities Industry and Financial Markets Association in submitting a **response letter**. The joint paper provided support for the incorporation of STC criteria into the bank capital framework and stressed that implementation in various jurisdictions must be aligned. The joint letter addressed the four key topic areas requested by the Basel Committee. Additionally, the letter argued that appropriately designed synthetic securitisations should be included in the STC framework, or that a specially designed framework be created.

STATUS **Outstanding.** Discussions are continuing with the Basel Committee.

APRA's Revisions to the Prudential Framework for Securitisation

ISSUE The Australian Prudential Regulatory Authority published this consultative document, which mainly focused on true sale transactions. However, there was a dedicated section in the letter that suggested no regulatory capital relief should be given for synthetic securitisation deals. The concerns listed within the document highlighted that these deals are too complex, the protection buyer is exposed to counterparty credit risk and that the true sale nature of credit exposure could be compromised.

IACPM ACTIONS The IACPM submitted a **comment letter** to APRA. The letter highlights the differences between balance sheet synthetic transactions and the arbitrage synthetic deals that caused problems leading up to the financial crisis. Credit portfolio managers use balance sheet synthetic transactions as an effective tool to manage risk within the portfolio. Since legal or relationship challenges often prevent loan asset transfer, synthetic securitisation transactions effectively transfer the risk and thereby can help free up capital which can then be deployed in the real economy.

While these deals are not a common feature within the Australian market, the goal of the letter was to highlight current work being done within the global framework. In fact, the IACPM response noted that many jurisdictions continue to recognize balance sheet synthetic securitisations. Therefore, the letter suggested that these transactions could be subject to approval by APRA to ensure that the proper risk transfer protocol is followed and counterparty credit risk is mitigated.

STATUS **Outstanding.** Discussions are ongoing with the Australian Prudential Regulatory Authority. Additionally, the IACPM working group continues to promote a consistent message globally highlighting the benefits of balance sheet synthetic securitisations to various regulators. IACPM remains focused on coordinating with other industry associations and member banks in pursuing this initiative.

IACPM REGULATORY COMMITTEES AND REGULATORY DISCUSSIONS

With the guidance of the IACPM's Board and the Regulatory Committee, the IACPM has continued to expand topic-focused regulatory discussions with members and regulators. During 2016, IACPM met with regulatory agencies and central banks including EBA (Europe), HKMA (Hong Kong), MAS (Singapore), Fed, OCC and FDIC (United States), Central Bank of Ireland (Ireland), Bank Negara Malaysia (Malaysia), JFSA (Japan), Bank of Japan, Banque de France, and the PRA (United Kingdom).

Additionally, we have invited regulators to speak or attend various global regional roundtable discussions this year including PRA, OCC, HKMA, Fed, APRA, JFSA, and the EBA. The IACPM maintains an active dialogue with global regulators on topics such as Securitisation, No Restructuring CDS and IFRS9/CECL expected credit loss. The IACPM will continue to host a number of informal, regional roundtable discussions with members and regulators on a range of topical issues in 2017.

Committees and Working Groups

Regulatory Committee

The Regulatory Committee meets monthly to discuss current regulatory developments globally and to make recommendations on the issues that the IACPM should address in its advocacy efforts with regulators. All members are invited to participate.

Accounting Working Group

The Accounting Working Group has been focused on IFRS9 and the recently released CECL rules this year. These topics have been actively discussed at IACPM's meetings and conferences. The working group has begun discussions (both as a group and with regulators) around a potential IFRS9 survey in 2017 that would be followed by a CECL survey. Next year, this group will be active as the implementation of IFRS9 becomes a reality in 2018.

Volcker Working Group

Members met in June this year to provide updates on the Volcker Rule implementation now that the rules have been in effect for a year. The in-person discussions allowed members to share best practices and also raise continuing implementation concerns that affect CPM policies.

Securitisation Working Group

The Securitisation Working Group was active this year with focus on the Australian Regulatory Prudential Regulatory Authority (APRA) response letter as well as the Basel Committee Consultative Document "Capital Treatment for Simple, Transparent and Comparable transactions" (d343). The group participated in a number of discussion forums at IACPM Conferences and with regulators. The IACPM continues to work with other associations and banks ahead of the expected final rules from the European Union on securitisations this year. We expect that synthetic securitisations will be addressed in 2017 within the EU legislature.

Credit Risk Mitigation Working Group

The Credit Risk Mitigation Working Group was again active in responding to the standardized approach section that deals with NoR CDS in the United States. The group met frequently this year to shape content for IACPM's second comment letter on the subject. The members participated in a survey on NoR CDS and the data was used in the the IACPM response letter to support the argument that NoR CDS is actively used by global banks.

LINKS TO ADDITIONAL INFORMATION

Revisions to the Standardized Approach for Credit Risk (BCBS D347)

Consultative Document	http://www.bis.org/bcbs/publ/d347.pdf
IACPM Comment Letter	http://iacpm.org/dotAsset/70285.pdf
Joint Associations Letter	http://iacpm.org/dotAsset/70291.pdf

Reducing Variation in Credit Risk-Weighted Assets (BCBS D362)

Consultative Document	http://www.bis.org/bcbs/publ/d362.pdf
Joint Associations Comment Letter	http://iacpm.org/dotAsset/72145.pdf

Securitisation Letters

Consultative Document	http://www.bis.org/bcbs/publ/d343.pdf
Joint Associations Comment Letter	http://web.iacpm.org/dotAsset/69926.pdf
Consultative Document	http://web.iacpm.org/dotAsset/73265.pdf
IACPM Comment Letter	http://web.iacpm.org/dotAsset/70225.pdf

FOR MORE INFORMATION ABOUT IACPM'S ADVOCACY

IACPM Monthly Regulatory Committee (*by conference call*)

Contact Alison Christensen at IACPM to be added to the distribution list (alison@iacpm.org)

CONTACT US

Please contact us with comments and suggestions, and if you or colleagues at your firm would like to participate in IACPM's advocacy efforts.

Som-lok Leung
Executive Director
somlok@iacpm.org
+1 646 289 5434

Marcia Banks
Deputy Director
marcia@iacpm.org
+1 646 289 5432

Jennifer Bearden
Associate Director
Jennifer@iacpm.org
+1 646 289 5441