

International Association of Credit Portfolio Managers

2017

*Principles and Practices*

THE EXPANDING ROLE OF CREDIT PORTFOLIO  
MANAGEMENT WITHIN THE FIRM

SURVEY GOAL

*IACPM Members share their views on the state of CPM today, their priorities, goals and objectives, and how the practice is evolving and expanding in terms of structure, reporting, tools and its role in the enterprise.*



## Executive Summary

The International Association of Credit Portfolio Managers (IACPM) recently conducted its *2017 Principles and Practices Benchmarking Survey*. This Survey, conducted every other year, looks at the evolution of credit portfolio management (CPM), organizational structures, mission and mandate, tools, and outlook for the future. The goal of the Survey is to allow firms to benchmark their practices versus those of other leading financial firms. Fifty-three member firms globally participated in the 2017 Survey.

The 2017 data shows a **widening range of CPM business models. As in the past, there is no “one size fits all” model.** Approaches range from enterprise-level CPM functions, with linkages across the firm, to units that are focused more narrowly on specific portfolio mandates. In addition to drivers such as the firm’s size, portfolio, culture, geography and specific mandate for the function, CPM business models are also evolving to meet the firm’s strategic and enterprise-level goals and to implement holistic approaches to risk management.

## SURVEY FINDINGS

**The scope of CPM responsibility continues to expand across a number of areas**, with linkages to strategic and governance functions such as risk appetite, limit setting, and stress testing. In addition, there has been an extension of coverage to a wider array of portfolio assets such as SME, real estate, project/object finance, workout and retail/consumer.

**CPM business models reflect the firm’s lines of defense and the functional requirements of the mandate.** Respondents are split almost evenly between first line and second line of defense within the firm, with reporting to line of business or risk accordingly. A deeper look at the data for *banks only by asset size* shows that for the majority of larger banks (asset size greater than USD 500 billion) CPM units are in the first line of defense while for the majority of smaller banks CPM units are part of the second line of defense.

**CPM remains a senior function within the firm.** More than three quarters of respondents show CPM groups at three reporting levels or fewer below the CEO.

**Risk/Return objectives and portfolio structure are among top areas of focus for CPM with slight declines in goals focused on managing regulatory change.** Survey data shows primary objectives include addressing concentrations, providing portfolio information and guidance to origination, and optimizing risk/return. There are also slight increases in areas such as scenario analysis and stress testing.

**Key Performance Indicators (KPIs) for CPM show primary quantitative metrics include risk adjusted return on capital (RAROC), return on risk-weighted assets (RORWA), and concentration limits.** Importantly, however, respondents cite a mix of both quantitative and qualitative factors that are important in performance measurement.

**Origination-focused tools for credit portfolio management have grown in focus for CPM since the financial crisis. Market tools (CDS, securitization, loan sales) remain important but are more limited in use.** Lower market liquidity for CDS and evolving regulation are likely drivers of the continuing shift in balance between “front-end” and “market based/secondary” tools, as well as the expansion of CPM coverage of a wider range of credit assets within the firm.

It is also important to note that the environment in which CPM operates today **has revenue generation as the top strategic objective for the firm over the next 12 to 24 months.** Over the past two years since the most recent IACPM *Principles and Practices Survey* in 2015, other corporate-level goals such as meeting capital targets, defining risk appetite etc. moved slightly lower as new risk and regulatory approaches have been implemented although some regulatory uncertainty clearly remains.

## *Table of Contents*

I. INTRODUCTION .....	5
II. DEFINING THE PORTFOLIO .....	6
III. ORGANIZATIONAL STRUCTURE, REPORTING AND GOVERNANCE .....	8
IV. CPM OBJECTIVES AND KEY PERFORMANCE INDICATORS (KPIs) .....	10
V. IMPLEMENTING THE CPM MANDATE: TOOLS AND EXECUTION .....	12
VI. CPM IN THE FUTURE: EVOLUTION AND PRIORITIES .....	14
ABOUT THE IACPM .....	14
APPENDIX: DEMOGRAPHICS AND SURVEY PARTICIPATION .....	15

*“The post-crisis regulatory framework has shifted from a framework which was centred on a single regulatory constraint – the risk-weighted capital ratio – to one with multiple constraints. In addition to the risk-weighted ratio, the post-crisis framework also includes a leverage ratio, large exposure limits and two liquidity standards (i.e., the Liquidity Coverage Ratio and the Net Stable Funding Ratio). And supervisory stress testing is playing an increasingly important role across a number of jurisdictions...further research is warranted on the interactions and impact of multiple regulatory constraints on banks’ investment and pricing strategies.”*

Mr. Stefan Ingves,  
Chairman of the Basel Committee and Governor of Sveriges Riksbank  
“Finalising Basel III: Coherence, Calibration and Complexity,” Second  
Conference on Banking Development, Stability and Sustainability  
2 December 2016, Santiago, Chile

## I. Introduction

Credit risk measurement and management are evolving within financial institutions, and the current environment – which includes low defaults, low interest rates, and changing regulations for financial services – continues to drive further shifts in organizational approaches for Credit Portfolio Management (CPM) and its mission and mandate. Against that backdrop, CPM is taking on a growing range of responsibilities within the firm. The IACPM conducted the *2017 Principles and Practices in CPM Survey* to provide benchmarking on the evolution of firms' credit risk management and CPM practices. The goal of the Survey, which IACPM has conducted every other year since 2009, is to provide a snapshot of current practices and issues for the future, and to allow firms to benchmark their organizational structure, mandate and tools against those of leading financial institutions around the world.

Among the topics addressed in the *Survey* are:

- Defining the Portfolio
- Organizational Structure, Reporting and Governance
- CPM Objectives and KPIs
- Implementing the Mandate: Tools and Execution
- CPM in the Future: Evolution and Priorities

*Note on the survey demographics:*

The IACPM *2017 Principles and Practices in CPM Survey* results include responses from 53 firms globally: 44 banks, as well as 9 re-insurance firms, multilateral development banks, and export credit agencies with a range of balance sheet sizes. Most observations on the survey results contained in this paper reflect the aggregate data across all respondents; in some instances, however, “bank only” data by size of balance sheet and geography provides specific insights on industry practices for those firms. The text distinguishes references to the “bank only” results, where applicable. *See appendix for full demographics.*

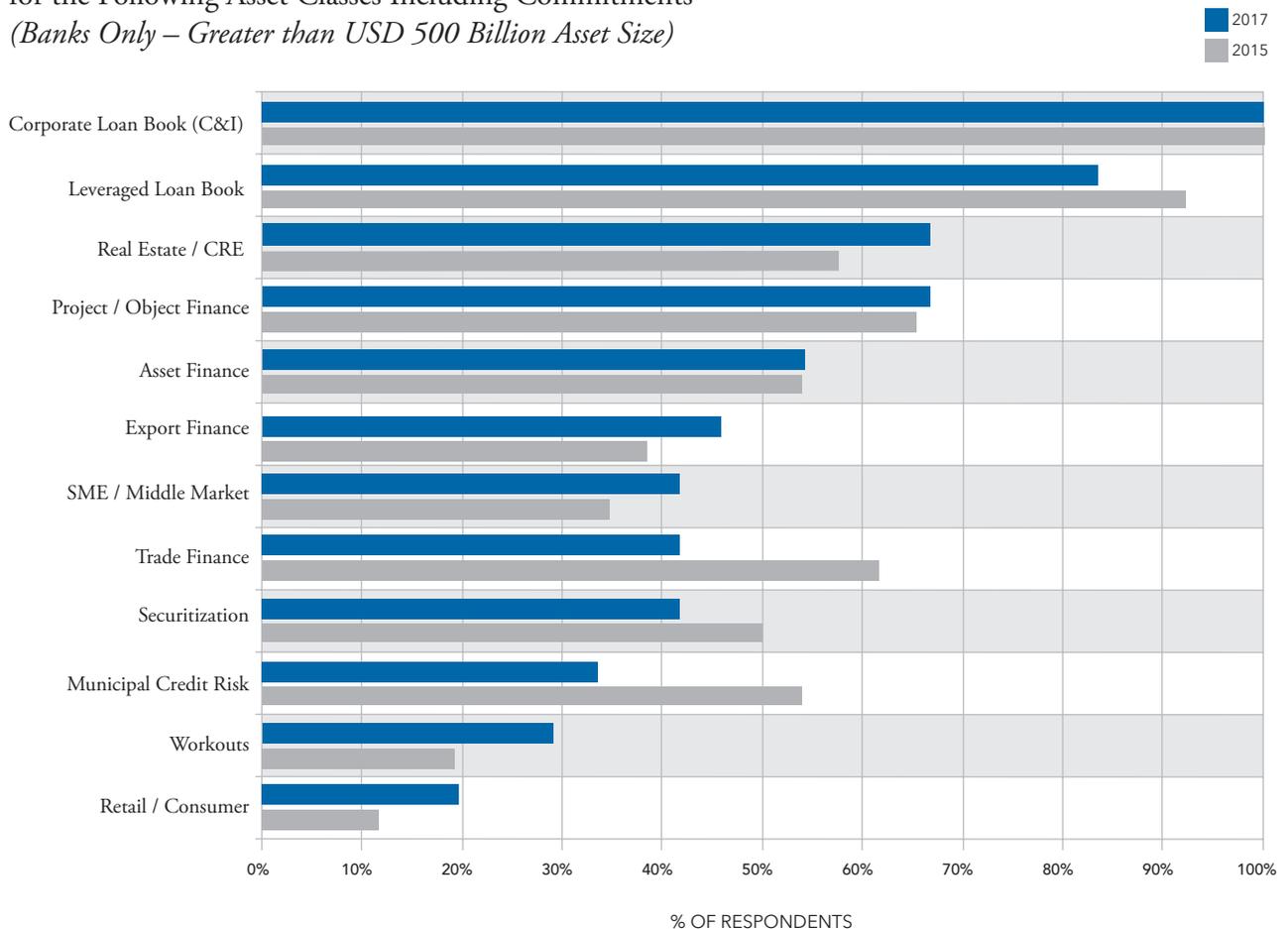
## II. Defining the Portfolio

The assets covered by CPM within the firm show **consistent coverage of areas such as the corporate and leveraged portfolios over the past eight years for which survey data exist**, but there are also additions in a number of sectors and reductions in a few others according to firms and CPM mandates. Bank only data on the portfolio provides a useful overview in this regard. The top five asset coverage areas at bank respondents include: corporate, leveraged, commercial real estate, project/object finance and asset finance/asset based.

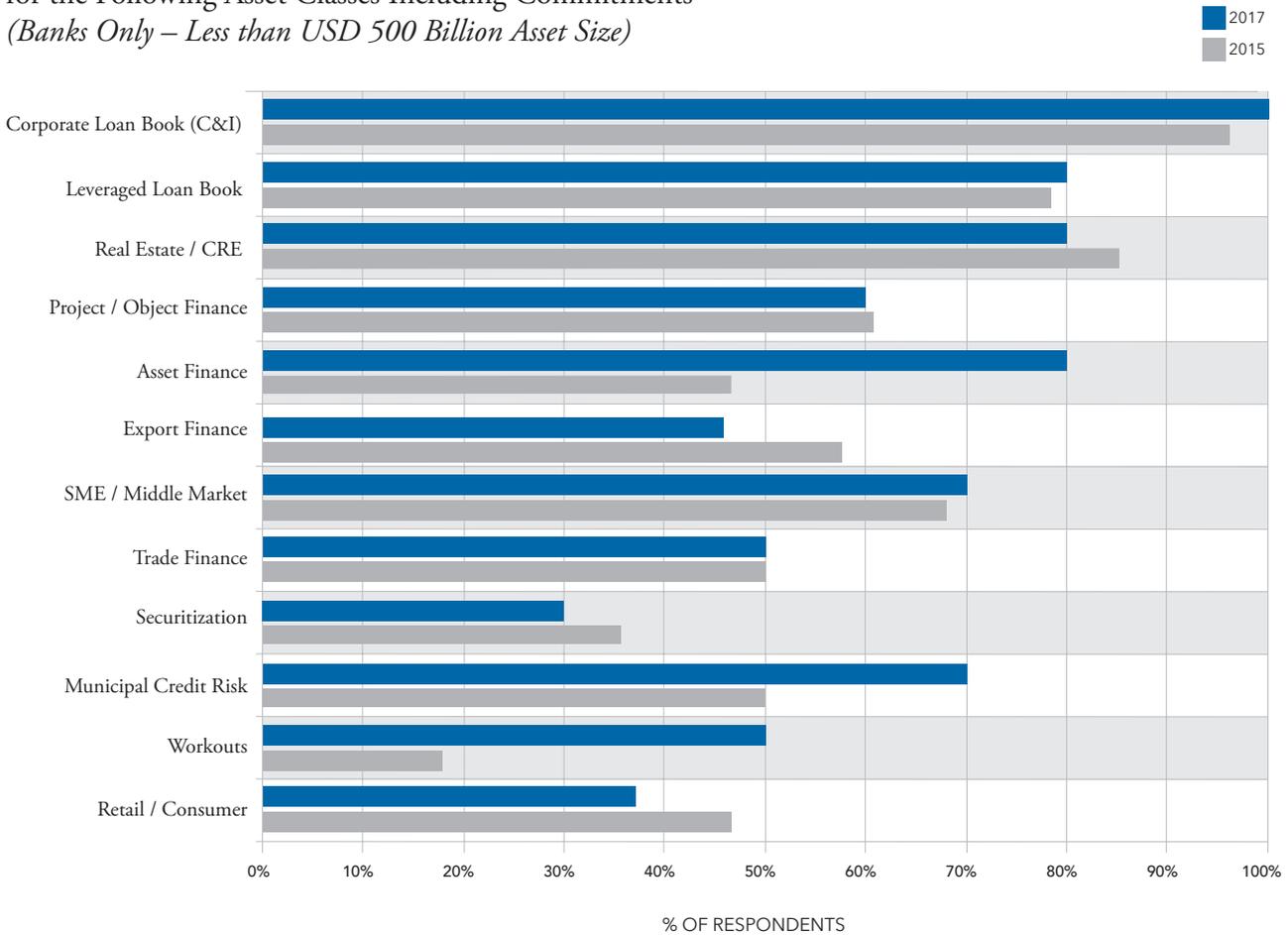
Further, there are some distinct differences between 2017 and 2015 – especially when looking at banks with greater than USD 500 billion in asset size and those below USD 500 billion. Among the greater than USD 500 billion group, the “top five” coverage sectors were consistent with the aggregate universe, but there were increases in coverage for: CRE, project/object finance, SME, and workout. Coverage declined for trade finance and municipal risk. For the less than USD 500 billion respondents, the top five areas included SME and municipal credit risk and coverage increases were more notable for asset finance/asset based and workouts.

*Figure 1a*

Percentage of Firms with Risk Management Responsibilities for the Following Asset Classes Including Commitments  
(Banks Only – Greater than USD 500 Billion Asset Size)



*Figure 1b*  
 Percentage of Firms with Risk Management Responsibilities  
 for the Following Asset Classes Including Commitments  
 (Banks Only – Less than USD 500 Billion Asset Size)



### III. Organizational Structure, Reporting and Governance

#### LINES OF DEFENSE AND REPORTING

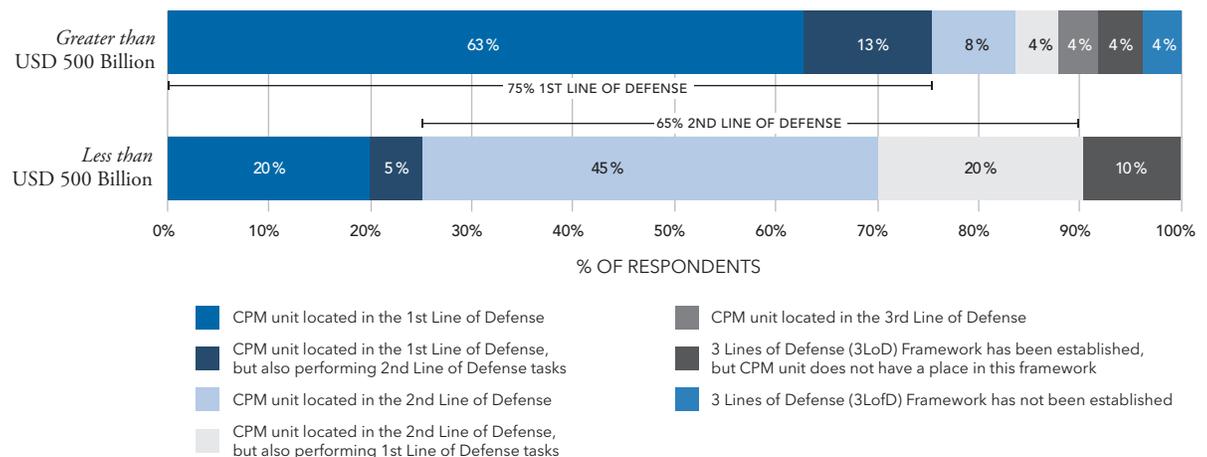
Organizational structures and reporting lines showed continuing evolution related to Lines of Defense especially within “bank only” respondents. Line of defense structures were a key factor in organizational discussions internally and with regulators.

The data shows distinct differences between the balance sheet size peer groups for banks. The greater than USD 500 billion size group reports that 75% are located in the First Line of Defense (*Figure 2*) and similarly have a reporting relationship within the Line of Business (71%). (*Figure 3*) Data for the less than USD 500 billion size group shows 65% in the Second Line of Defense with a related reporting relationship of Risk (70%). A small percentage of both First Line and Second Line respondents report some “crossover” functions (i.e., a minority of First Line respondents also have a few Second Line functions and vice versa).

#### CENTRALIZATION

The CPM function has moved toward greater centralization in 2017 from 2015 – either via a single portfolio coverage location for global firms, or through multiple geographic locations with a single global reporting line. The data shows 61% of the firms that cover a global portfolio report a CPM function centralized in the head office (up from 55% in 2015) and 35% have regional coverage of the portfolio with a single global head of CPM (up from 32% in 2015).

*Figure 2*  
Line of Defense  
(Banks Only - by Balance Sheet Asset Size)



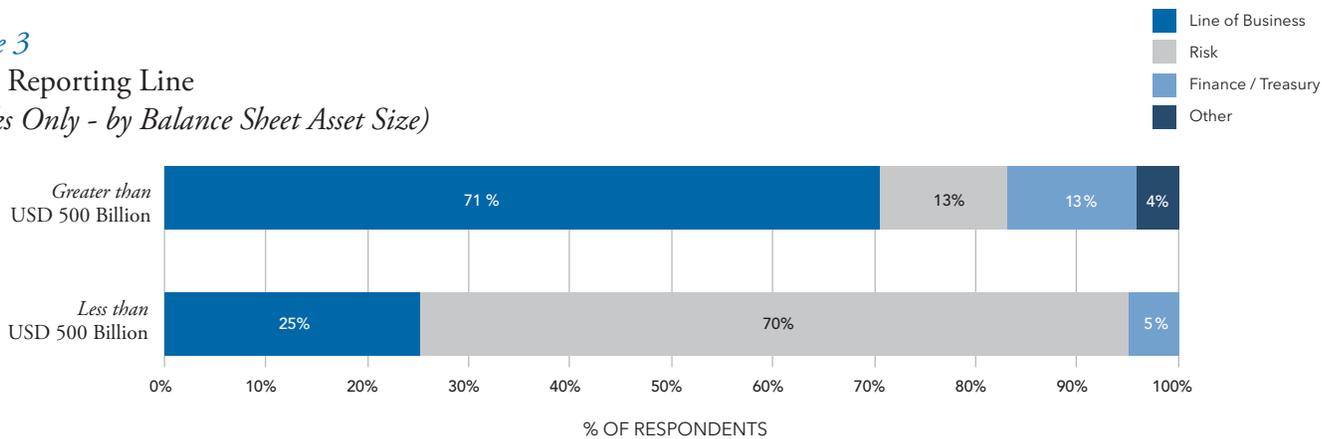
### GOVERNANCE, COMMITTEES AND SENIORITY

CPM is represented on a range of committees within the governance structure of the enterprise. Although terminology related to governance and committee names varies across firms, the breadth of committee involvement for CPM highlights the myriad of expanding linkages within firms. Among the most frequently cited is a role for CPM on the Commitments or Credit Approval Committee (64%

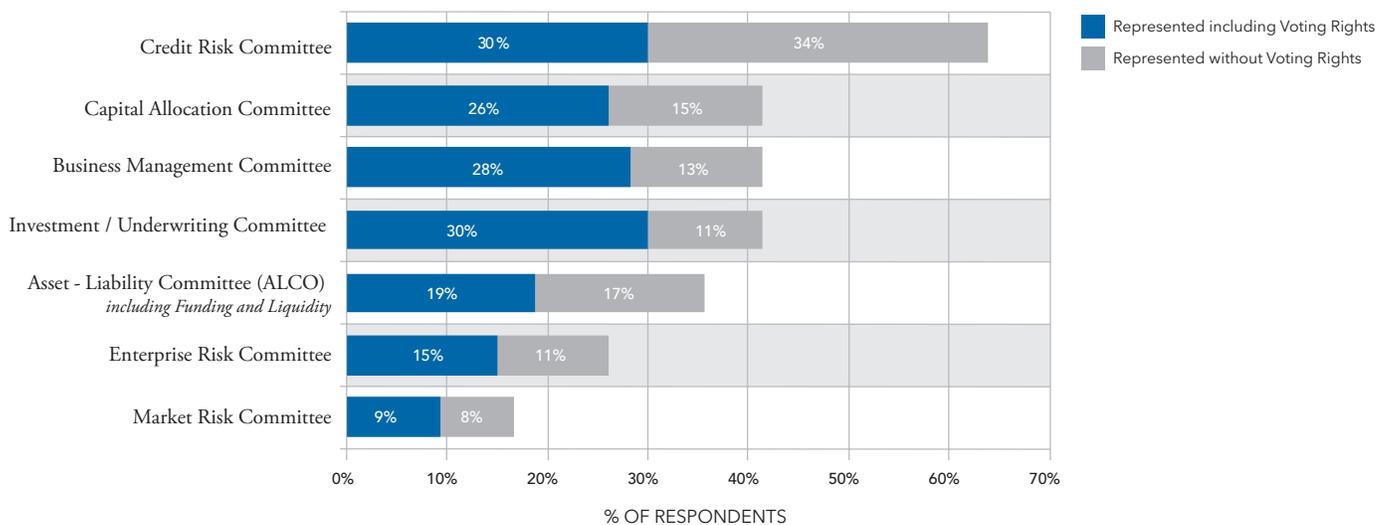
represented), the Capital Allocation Committee (42% represented) and the Investment/Underwriting Committee (42% represented). (Figure 4)

Further, CPM is a senior function within the firm, according to respondents' data. A large majority of respondents – some 75% - are located at three reporting levels or fewer from the CEO.

*Figure 3*  
CPM Reporting Line  
(Banks Only - by Balance Sheet Asset Size)



*Figure 4*  
CPM's Current Committee Representation



## IV. CPM Objectives and Key Performance Indicators (KPIs)

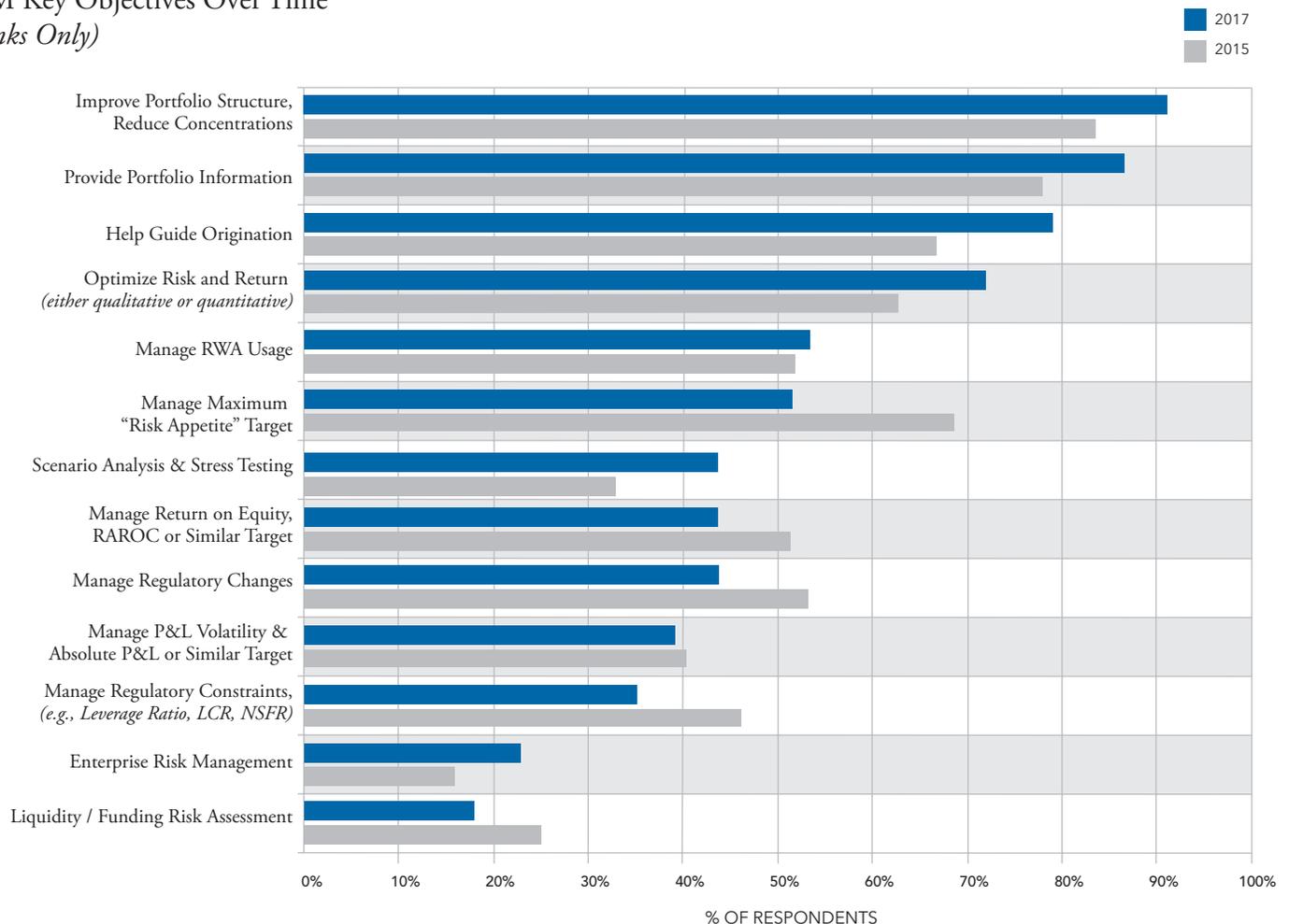
### ROLE AND OBJECTIVES

Survey data regarding CPM objectives suggests continued strong emphasis on addressing the structure of the portfolio and risk identification, and also shows a slightly lower emphasis on managing regulatory change and specific regulations. Objectives cited by more than 50% of bank respondents include addressing portfolio risks through portfolio structure/concentrations and limits (91%), portfolio risk identification and information (86%), helping guide origination (79%), optimizing risk/return – quantitative

or qualitative (72%), managing RWA usage (53%), and managing a maximum risk appetite target (51%). There were small declines in objectives related to managing regulatory changes and specific regulations such as leveraged ratio, LCR, NSFR. (Figure 5)

Qualitative comments about CPM objectives highlighted CPM's role in identification of deteriorating risk, risk tracking and identification for use across the enterprise, and control of pricing and risk/return related tools.

*Figure 5*  
CPM Key Objectives Over Time  
(Banks Only)



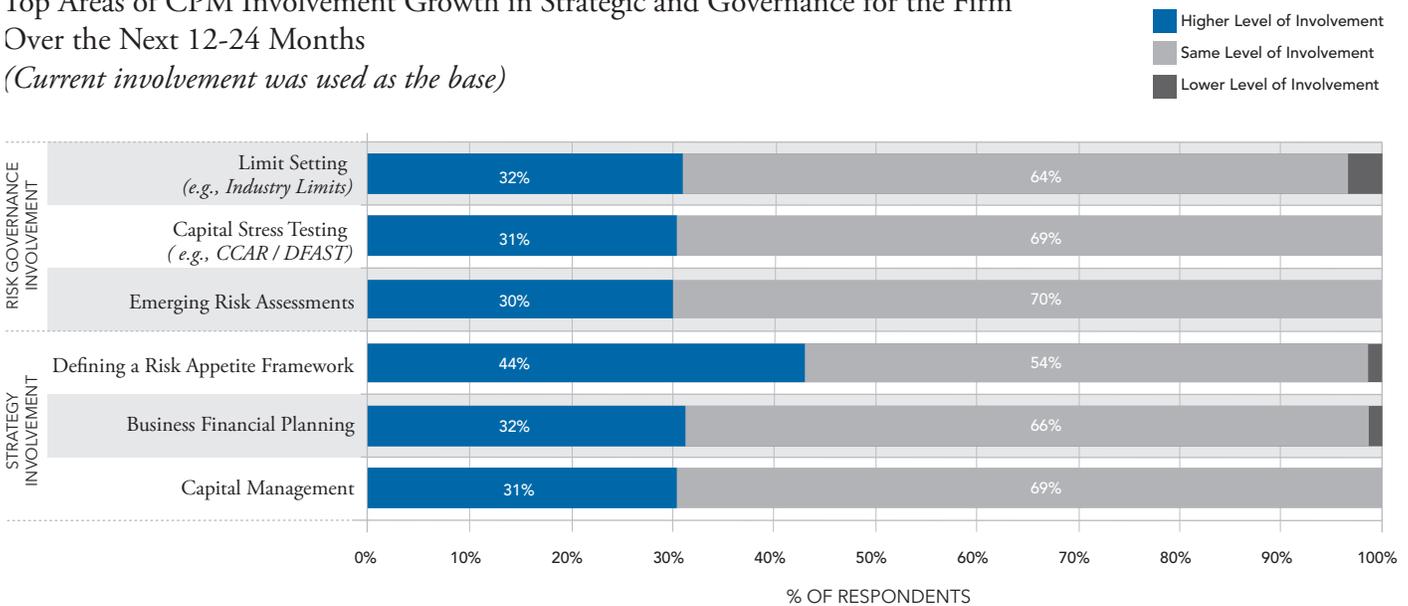
### STRATEGIC AND GOVERNANCE ROLE

It is worth noting that most CPM units also see stable to growing involvement with strategic and government functions for the firm over the next 12-24 months. These areas include linkages at the enterprise level on functions such as: limits framework; capital stress testing; defining risk appetite frameworks and financial business planning. (Figure 6)

### KEY PERFORMANCE INDICATORS (KPIs)

KPIs show a focus on both quantitative and qualitative factors and specifically risk identification and risk/return. Among quantitative measures, the KPI data shows top metrics (greater than 40% of firms reporting) of: risk adjusted return on capital (RAROC), return on risk-weighted assets (RORWA), and concentration limits (single name, industry). Qualitative comments were also useful for this question, as many respondents highlighted additional metrics/criteria related to risk appetite implementation and cascading of limits, as well as aspects of concentration and sector risk management.

**Figure 6**  
 Top Areas of CPM Involvement Growth in Strategic and Governance for the Firm Over the Next 12-24 Months  
 (Current involvement was used as the base)



## V. Implementing the CPM Mandate: Tools and Execution

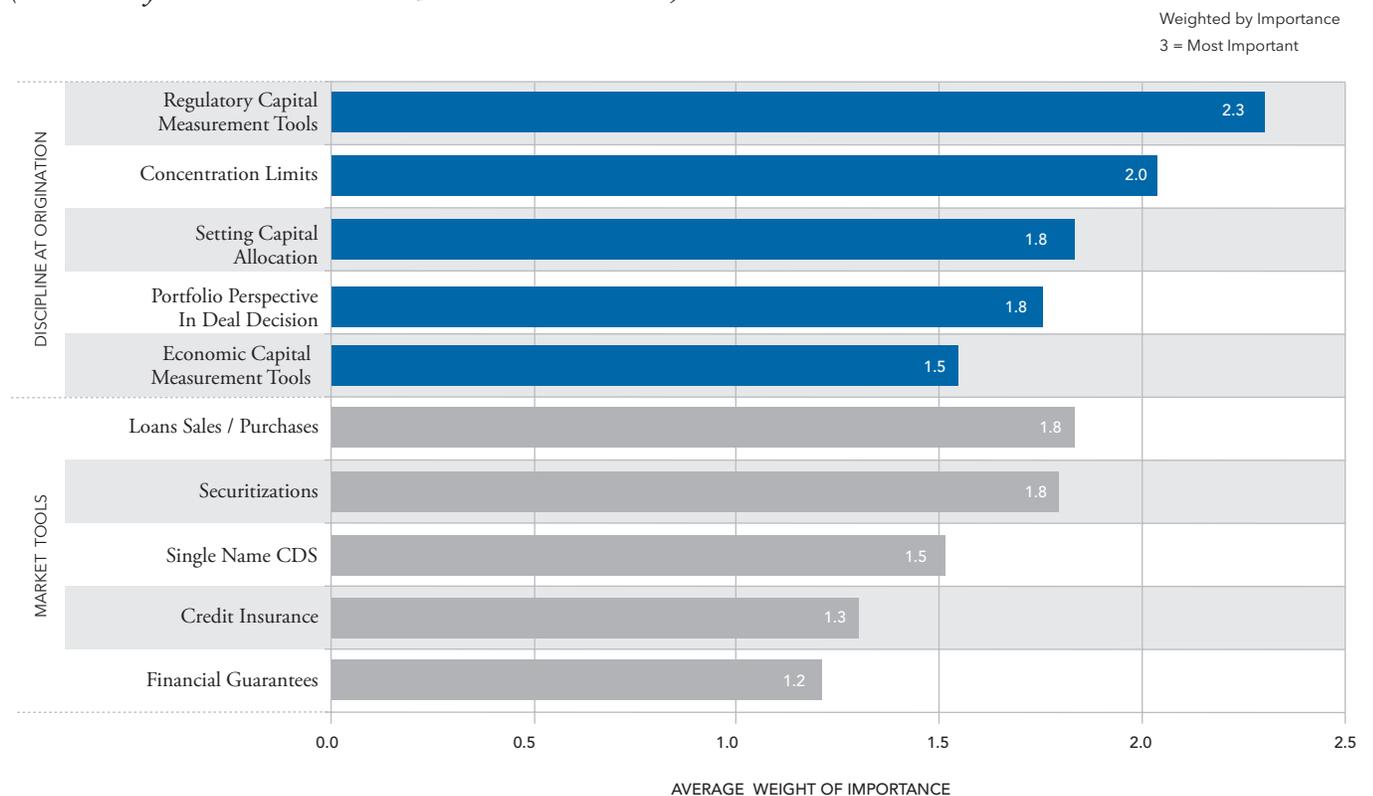
CPM units are employing a range of tools – origination-focused and market-focused, where available – to implement portfolio risk mitigation strategies. Origination focused approaches to credit portfolio management have maintained strong importance for CPM since 2009. They have assumed relatively more importance today versus market tools (CDS, securitization, loan sales) which have declined in overall prominence due to constraints on availability, liquidity and cost/expense.

### ORIGINATION TOOLS

On an “importance weighted” basis, comparing 2017 to 2009 levels, **origination tools clearly continue to rank highest** in the CPM arsenal. For the greater than USD 500 billion bank group, two origination tools – regulatory capital measurement tools and concentration limits topped the list (2.3 and 2.0 weighted importance respectively). For the less than USD 500 billion bank group, Concentration Limits far exceeded other origination tools (2.5 weighted importance vs next highest at 2.0 for Portfolio Perspective in Deal Decision).

Figure 7

Relative Importance of Selected CPM Tools for Banks / Investment Banks by Balance Sheet Asset Size  
(Banks Only – Greater than USD 500 Billion Asset Size)



## MARKET TOOLS

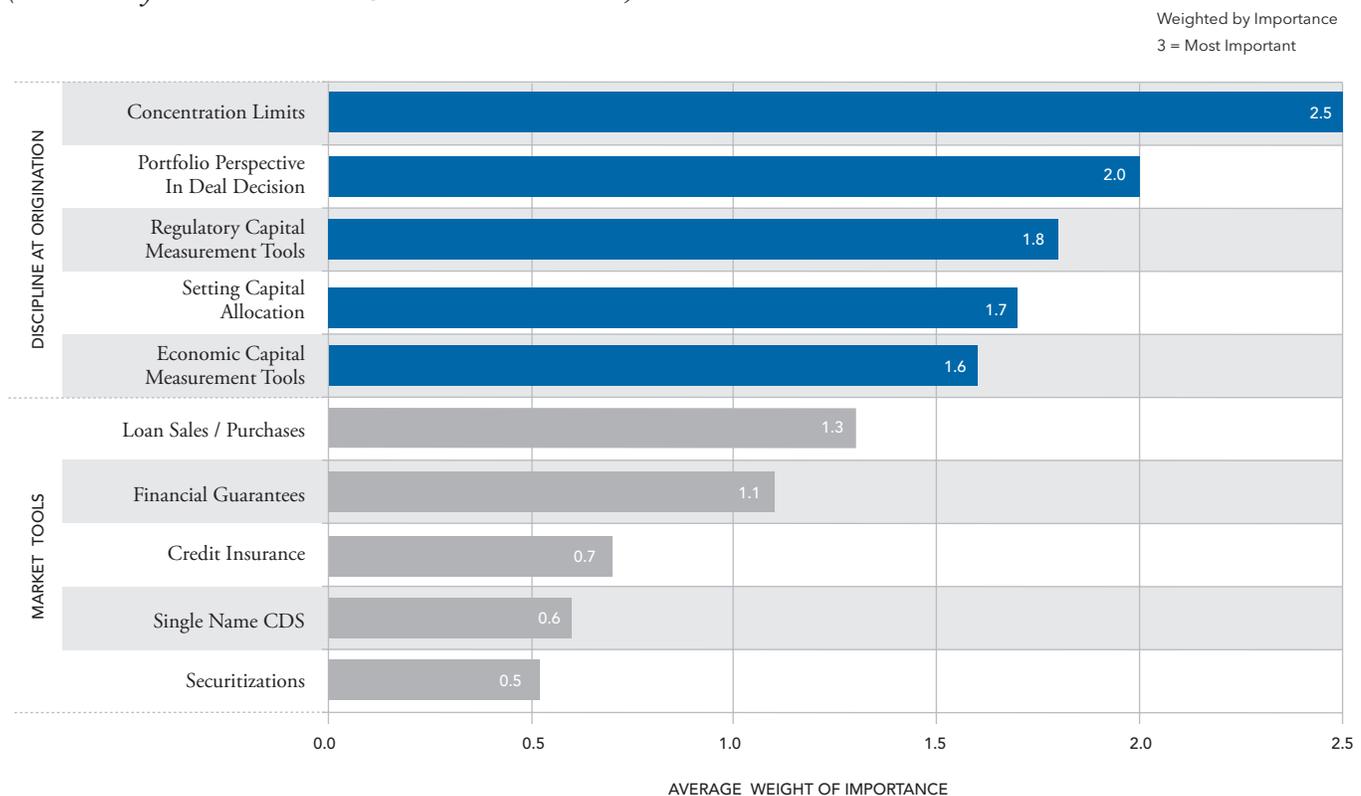
**Market tools are actively in use, though somewhat less so than in 2009.** Not surprisingly the tools ranked higher in overall importance for the greater than USD 500 billion group of bank respondents. Loan sales, securitization and CDS are all ranked closely in importance. For the Less than USD 500 billion group of banks, loan sales ranked as most important among market tools and other market tools trailed significantly in importance. For both bank groups, credit insurance and guarantees maintained small roles in the toolkit. (Figures 7 & 8)

Looking forward, respondents expect the use and importance of market tools to increase over the next 12-24 months. Loan sales, securitization and credit insurance all show an expectation for increased use and importance.

## CAPITAL MEASUREMENT

The data shows that an overwhelming majority of firms (71%) today use regulatory capital as the most important measure. Looking forward over the next two years, the expectation is that economic capital will grow slightly in importance with regulatory capital decline slightly to about 60%.

*Figure 8*  
Relative Importance of Selected CPM Tools for Banks / Investment Banks by Balance Sheet Asset Size  
(Banks Only – Less than USD 500 Billion Asset Size)



## VI. CPM In the Future: Evolution and Priorities

The IACPM 2017 *Principles and Practices in CPM Survey* shows clearly that CPM has continued to grow as a discipline, and in material ways. This growth reflects changing objectives and requirements within the firm, which in turn result from the many changes in the credit markets and regulatory environment that have been affecting financial institutions worldwide.

### ONGOING OBJECTIVES

- Portfolio Structure / Concentrations and Limits
- Portfolio Information
- Helping Guide Origination
- Optimizing Risk / Return – Quantitative and/or Qualitative
- Risk Mitigation as Appropriate
- Strategic and Governance Roles and Linkages

### EMERGING PRIORITIES

- **Risk Identification and Data**  
The ongoing need to enhance and integrate portfolio data across the enterprise and maximize use of additional sources of data (e.g., digital technologies)
- **Emerging Risk Assessments**  
Development/refinement of early warning tools and techniques on portfolio, industry and sector risks (e.g., dashboards to promote forward looking strategies)
- **Evolving Regulations and Impact**  
The implementation of IFRS 9/CECL and the impact of Basel 4 on business and strategy

### *About the IACPM*

The IACPM is an industry association established to further the practice of credit exposure management by providing an active forum for its member institutions to exchange ideas on topics of common interest. Membership of the IACPM is open to all financial institutions that manage portfolios of corporate loans, bonds or similar credit-sensitive financial instruments. The IACPM represents its members before regulatory and administrative bodies around the world, holds conferences and regional meetings, conducts research on the credit portfolio management field, and works with other organizations on issues of mutual interest relating to the measurement and management of portfolio risk. Currently there are more than 90 financial institutions worldwide that are members of the IACPM. These institutions are based in 21 countries and include many of the world's largest commercial wholesale banks, investment banks and insurance companies, as well as a number of asset managers. More information about the IACPM may be found on our website: [www.iapcm.org](http://www.iapcm.org).

## Appendix

### DEMOGRAPHICS & SURVEY PARTICIPATION

For the IACPM 2017 *Principles and Practices in CPM Survey*, globally a total of 53 member firms participated, comprised of mainly banks and investment banks. About one-fifth of all respondents are development banks, export credit agencies or re-insurers respectively. (Figure 9 & 10)

In terms of size, almost half of all respondents have approximate total balance sheet assets greater than USD 500 billion. (Figure 11)

Figure 9  
Survey Participants by Nature of Firm

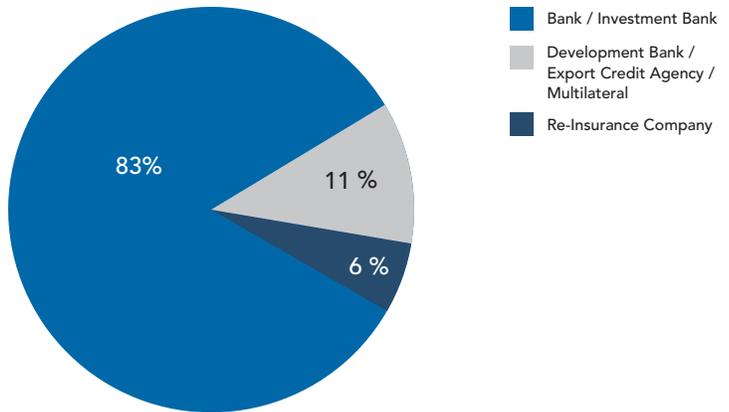


Figure 10  
Survey Participants by Region of Domicile

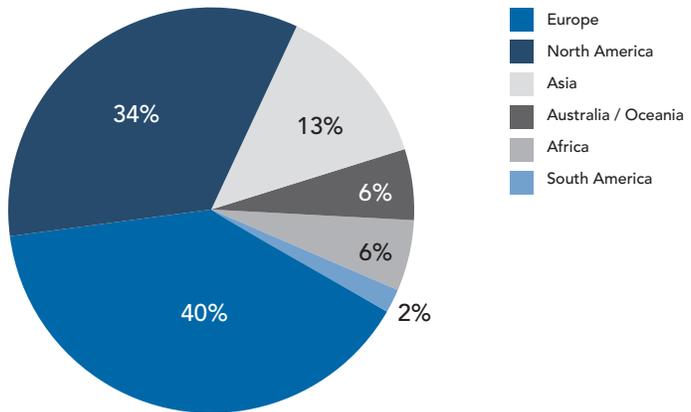
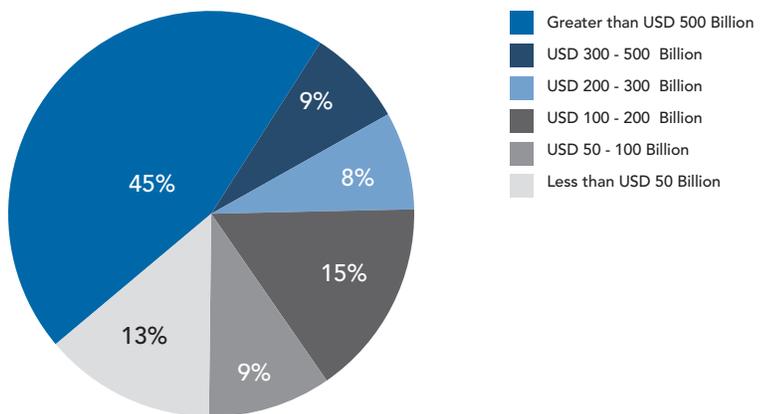


Figure 11  
Survey Participants by Approximate Total Balance Sheet Assets



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