

21 March 2014

Secretariat of the Basel Committee on Banking Supervision  
 Bank of International Settlements  
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 baselcommittee@bis.org

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**RE: BCBS 269 – Revisions to the Securitisation Framework**

Dear Sirs,

The International Association of Credit Portfolio Managers (IACPM)<sup>j</sup> is pleased to have the opportunity to comment on the Basel Committee's consultative document, "Revisions to the Securitisation Framework". We have joined a group of associations (including CREFC, GFMA, AFME, ASIFMA, SIFMA, IIF, ISDA, SFJ and SFIG) to provide the majority of our comments to the Basel Committee (the "joint association letter"). The purpose of this brief letter is to highlight the importance of these joint comments as they relate to bank balance sheet securitisations, a risk management tool that is very important to the members of IACPM.

The IACPM's institutional member firms comprise the world's largest financial institutions, and as such overlap the membership of the other financial industry associations providing you joint comments. Our perspective is different, however, in that the IACPM represents the teams within those institutions who have responsibility for managing credit portfolios. IACPM members are the groups responsible for managing the bank's loan portfolio, including actively controlling concentrations, adding diversification and managing the return of the portfolio relative to the risk, and managing counterparty risk related to derivatives exposure. In carrying out these responsibilities successfully, credit portfolio managers contribute to maintaining the safety and soundness of their respective financial institutions.

Bank balance sheet securitisations (both cash and synthetic) are an important part of the tool kit that portfolio managers use to manage credit risk. The framework proposed in BCBS269 will create disincentives for using bank balance sheet securitisations, and we fear that if many of the recommendations in the joint association letter are not adopted to revise the framework, we will see a reduction or an elimination of this important tool. Specifically, bank balance sheet securitisations would best be supported by a recalibration of the risk weight floor, and a recalibration of the Internal Ratings-Based Approach (IRBA), as suggested in the joint association letter.

There are compelling reasons for maintaining a regulatory environment that allows for bank balance sheet securitisations:

- Bank balance sheet securitisations facilitate concentration management by allowing risk transfer of illiquid assets that usually cannot be actively managed or transferred in other ways. Often, these illiquid assets represent natural concentrations that arise from the franchise or "footprint" of a bank (e.g., German middle market assets for a large German bank), and bank

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balance sheet securitisations provide one of the few ways to reduce and diversify these concentrations, short of a cessation of lending to these areas.

- Bank balance sheet securitisations free capacity, allowing banks to continue lending. By reducing concentrations, banks can free up capital and risk capacity. This recycling of capital helps banks to continue lending in circumstance when it would otherwise be constrained from doing so.
- Bank balance sheet securitisations help reduce systemic risk. By transferring unwanted risk from banks to investors that desire it, bank balance sheet securitisations help to stabilize the financial system, making banks more resilient. Importantly, when structured well and in partnership with sophisticated investors who are well positioned to take on these risks, these transactions avoid many of the conflicts of interest that arose during the financial crisis that regulators are now proposing regulation to avoid. As an appendix to this letter, we have attached letters from three investors in bank balance sheet securitisations that were used in our discussions with the U.S. SEC as they explored the subject of bank balance sheet securitisations. These letters add insightful perspective on how effectively these transactions work.

Bank balance sheet securitisations are examples of securitizations working at their best, providing mutual benefit for both buyers and sellers. Banks can use these tools to transfer risk, manage concentrations, and free lending capacity. In addition, investors can gain exposure to asset classes otherwise unavailable to them.. We hope that the Basel Committee will consider the above points as you evaluate the recommendations of the joint association letter.

Sincerely,



Som-lok Leung  
Executive Director  
International Association of Credit Portfolio Managers

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<sup>i</sup> The IACPM is an industry association established in 2001 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 in 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 90 financial institutions worldwide that are members of the IACPM. These institutions are based in 17 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.iacpm.org](http://www.iacpm.org).

## Appendix



June 20<sup>th</sup>, 2012

*Via email: rule-comments@sec.gov*

Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549  
Attn: Elisabeth M. Murphy, Secretary

RE: Proposed Rule 127B and its effect on synthetic balance sheet securitisations

Ladies and Gentlemen,

We are a leading pension administrator in The Netherlands, named PGGM, and currently manage €121 billion (April 30, 2012) of pension assets for a number of Dutch pension funds, including € 116 billion (April 30, 2012) for the pension fund for the care and healthcare sector ("PFZW").

We write to you regarding the proposed SEC Rule 127B implementing the prohibition under Section 621 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 on material conflicts of interest in connection with certain securitisations ("**Rule 127B**"). We understand that Rule 127B will prohibit synthetic balance sheet securitisations in which we have been successfully investing in for our client PFZW since late 2006. All of these investments have been structured using the credit-linked notes format which we would like to continue to use for future investments.

The type of transactions we are referring to are so called risk sharing transactions with banks where we structure investments through which we take over part of the credit risk a bank holds on its balance sheet. The way in which we approach and set up such transactions is described below. We hope you will see we have been concerned about the same elements as you and which you want to address in your proposed Rule 127B. We would like to share with you how we have been addressing these points.

The number of risk sharing transactions we have entered into exceeds ten and the aggregate invested notional amount is more than € 2 billion, illustrating that the investments are of substantial size.

We focus on credit risk that is forthcoming from a successful core activity of a bank, and only (directly) invest in portfolios of banks that are a worldwide "top 5" player in such field of activity. The reason to have this focus is that it is relevant to us that the activity is strongly imbedded in the bank's DNA, gets a lot of attention from senior management and the means to ensure it is properly (risk) managed in the firm.

We insist there is a strong alignment of interest between parties, resulting in the bank holding at least 25% up to 33% of every credit exposure on their books unhedged. When a credit event

results in a loss for the bank, an independent verification agent is used to verify a credit claim, if any, was validly made before any payments are done.

This alignment of interest requirement is of such a size that potential losses are not easily covered by upfront underwriting fees and a few periodic coupon payments. The undesired effects of the "originate to sell" model are significantly reduced by insisting the underwriter holds a significant portion of the exposure.

We pay significant attention to the bank's processes regarding the (lending) activity we intend to share the credit risk of. We invest a lot of time in extensive and intensive due diligence to fully understand all relevant processes within the bank, such as origination, monitoring, work-out , risk management, fit within overall strategy, et cetera. In effect, we "subscribe" to these processes by entering into a risk sharing transaction with the respective bank.

As such, we do not need to know the individual names of the underlying entities in the risk sharing portfolio, however, we need to know all the risk characteristics of each line item, such as internal credit rating, industry sector, country, tenor, senior/subordinated, et cetera.

Understanding the underlying type of credit risk is another key element of our approach and due diligence. If we do not understand the underlying risk, we will not invest.

In addition to the above, we also want to benefit from the bank's work-out process and always strive to settle final loss at the same level as the bank reports on their profit & loss account. Full alignment of interest all the way and the bank's significant and relevant share in the loss contributes to this.

We strongly prefer to work directly with the bank in question. For another party to be involved there needs to be a very good reason and we would be questioning the potential conflicts of interest created by such a third party or the lack of them having 'skin in the game' (such as receiving an upfront advisory fee without being held to long term performance of their work).

When structuring a transaction, we always start with a reference portfolio that is a good reflection of the bank's total portfolio and will then work to reduce concentration risks in terms of various risk characteristics. The resulting risk sharing portfolio is very granular and the majority of the positions are illiquid names. Single obligor group limits, sector limits, rating bucket limits, geographical limits, combination of sector and geographical concentrations are all examples of criteria the reference portfolio has to adhere to.

We also require rating affirmation of each position that enters the reference portfolio to ensure adverse selection is reduced as much as possible. Another tool used to avoid adverse selection is to insist on an automated program used to select new additions to the risk sharing portfolio (instead of manual selection by individuals).

In terms of pricing these investments, we use market credit spreads and correlation, and do not look at the price of the loans the banks use themselves. We also take into account the cost of capital of the bank. In a typical structure of the investment the bank enters into a CDS (credit default swap) with an SPE (also known as an SPV, special purpose vehicle) and the SPE issues notes (credit-linked notes) to the investor in order to ensure sufficient funds are available to pay for valid claims under the CDS.



The credit losses covered by the CDS refer typically to the first loss tranche (sometimes also a second loss tranche), meaning it covers losses in the reference portfolio up to a maximum amount (expressed as a percentage of the initial reference portfolio notional amount).

Our experience has been that the risk sharing transactions we have entered into are mutually beneficial for both our client and the banks. The banks receive a perfect hedge on the names in the risk sharing portfolio (majority of exposures is typically not publicly traded) and often capital relief as well. Our client gets a unique tailor-made investment with an attractive risk-return profile. We structure what we call robust transactions that need to provide a better risk-return profile than equities, also in adverse economic circumstances. The credit losses in the risk sharing transactions have so far been less than expected at the inception of the transactions.

As an active, experienced and one of the world's largest investors in this niche, we are very open to have a further dialogue with you if you find that helpful.

Sincerely,

A handwritten signature in blue ink, appearing to read "Ruulke Bagijn".

Ruulke Bagijn  
CIO Private Markets  
PGGM Investments

Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549  
Attn: Elizabeth M. Murphy, Secretary  
Re: Release No. 34-65355; File Number S7-38-11

May 21, 2012

Ladies and Gentlemen,

Our firm, BlueCrest Capital Management (UK) LLP ("BlueCrest") manages BlueCrest Mercantile Master Fund Limited ("BlueCrest Mercantile Fund"), an alternative investment fund that is an active investor in bank balance sheet securitization transactions, including the category of deal that the SEC proposes to prohibit under Rule 127B, Example 3B (synthetic bank balance sheet securitizations).

As a fund manager, we support the SEC's efforts to reduce conflicts of interest in securitizations. However, we strongly believe that synthetic balance sheet securitizations should not be prohibited, and we support the arguments made by the International Association of Credit Portfolio Managers (IACPM), in their letter to you dated February 6, 2012.

The following is a summary of our key considerations in relation to these securitizations:

- *Core business.* Many bank balance sheet securitizations are conducted as hedging transactions in connection with the servicing of commercial and trade finance credits that constitute core business of the financial institution. These transactions tend to be managed as an ongoing longer term program and are not designed to be opportunistic, one-off or arbitrage by nature.
- *Key portfolio management tool.* Balance sheet synthetic securitizations have been used by most internationally active banks for more than two decades. They are a valuable tool for loan portfolio managers seeking to prudently manage risk concentrations in their core portfolios. Corporate and trade finance loans are generally difficult to transfer due to a lack of efficient trading infrastructure, complex documentation, issues surrounding borrower consent and relationship considerations. These practical concerns are particularly relevant for portfolios of a large number of loans (specifically, in trade finance).
- *Perfect no-basis hedge.* Most balance sheet securitizations are structured to replicate loss performance of particular loans originated and retained by the bank on its balance sheet. This represents a perfect no-basis hedge for a loan portfolio, which is not otherwise available in the standard credit markets. Standard credit default swaps reference only a limited number of

(typically larger) borrowers and tend to be most liquid in five year maturity only. This significantly constrains the hedging options available to loan portfolio managers who, as a result, may be required to take on imperfect hedges with some residual basis, prepayment or maturity mismatch risk.

- *Risk Retention.* One of the critical features of bank balance sheet securitization is the significant risk retention by the originating bank of the exposures referenced in the portfolio. The bank explicitly undertakes to keep these exposures unhedged throughout the tenure of the deal. The retention portion tends to vary between 10-20%. The typical structure also precludes an originating bank from being outright short an exposure referenced in the securitized portfolio. In our view these features are critical to ensure a better alignment of interest with investors.
- *Significant Risk Transfer.* Bank balance sheet securitizations are designed to provide a significant risk transfer from bank to investor. Hence by construction, investing in these transactions can be risky and requires significant analysis. Such risks emanate from the underlying credit performance of the portfolio, as well as from soundness of bank origination practices and its credit processes. Synthetic securitizations are marketed to sophisticated investors that are capable of evaluating specific credit risks and potential conflicts of interest. Investors are typically given access to the bank's credit and portfolio management to conduct their initial due diligence as well as on a periodic basis afterwards. All transactions are also accompanied by full disclosure of the key risks and potential conflicts of interest.

Yours faithfully,

A handwritten signature in black ink, appearing to read "John Smith".

BlueCrest Capital Management (UK) LLP



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THURSDAY, JUNE 28, 2012

Ladies and Gentlemen,

Our firm, Orchard Global Asset Management, is an investor in the types of deals that the SEC proposes to prohibit under Rule 127B, Example 3B (synthetic bank balance sheet securitizations). We believe these deals should NOT be prohibited, and support the arguments made by the International Association of Credit Portfolio Managers (IACPM), in their letter to you dated February 6, 2012.

As investors, we certainly support the SEC's efforts to reduce conflicts of interest in securitizations. However, we do not believe that synthetic bank balance sheet securitizations suffer from conflicts that would harm investors. We freely participate in these deals as knowledgeable investors, and these deals have performed well for us to date.

We use various methods to ensure interests are aligned between the originating institution and ourselves and are active in ensuring that these meet our standards and are enforced for the life of the transactions. These transactions form an important part of the investing strategy for ourselves and our investors, and we believe we are able to meaningfully contribute to bank recapitalization through these trying times.

Sincerely,

Gary Wee  
Chief Investment Officer