

NOTE FROM IACPM'S EXECUTIVE DIRECTOR

Dear Members,

2018 was a busy year as the IACPM remained actively engaged in an array of important regulatory and accounting issues. Below, we provide you with an update on the various activities and also discuss the focused research survey work we completed throughout the year. We also highlight some of the various meetings held globally that members had the opportunity to attend and provide a preview of what events might be of interest to your firm in 2019.

The IACPM remains active in a wide range of regulatory advocacy topics. As expected, the pace of consultative documents has slowed with the global regulatory landscape now transitioning to implementation. Therefore, our efforts are focused around the impact of these changes on member firms. One example is the December 2017 release of *Basel III: Finalising Post Crisis Reforms*. These final rules will affect credit portfolio managers in the coming years and IACPM remains actively involved in industry dialogue around the potential impact. We were very pleased that the language in this document around No Restructuring CDS (NoR CDS) was favorable to members granting full regulatory capital relief for these trades once implemented. This was a high profile and meaningful win for IACPM members after years of hard work on this topic. Our members are closely watching the potential changes to Volcker and Dodd-Frank as well as the global securitization market changes. Also, this year, the Basel Committee issued a second consultation around the Fundamental Review of the Trading Book (FRTB) with members drafting a response letter on net short credit risk. Securitisation continues to be an important risk mitigation tool for members and the IACPM remains in active dialogue with regulators as well as responding to consultative documents on this topic.

The IACPM 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 issues such as the evolving discipline of **Credit Portfolio Management, Standardized Credit Approaches, IFRS9 and CECL Expected Credit Loss Provisions, Fundamental Review of the Trading Book, Synthetic Securitisation and No Restructuring CDS**.

Attached is a brief summary of some of the actions taken by the IACPM and our members in 2018. 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.



Som-lok Leung, *Executive Director*

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FOR MORE INFORMATION ABOUT IACPM'S ADVOCACY

IACPM Monthly Regulatory Committee (*by conference call*)

Contact **Jennifer Bearden** at jennifer@iacpm.org to be added to the distribution list.

IACPM REGULATORY UPDATE

BASEL UPDATE

After publishing our 2017 Regulatory and Accounting Newsletter in November, Basel released *Basel III: Finalising post-crisis reforms (BCBS d424)* in December. Back In 2016, the IACPM submitted a joint response letter as well as a separate letter focused on NoR CDS to the Basel Committee. As a reminder, the original Basel document released in 2014 *Revisions to the Standardized Approach for Credit Risk (BCBS d307)* provided no capital relief for NoR CDS trades. The second Basel consultative document released in 2015 returned to the status quo, 40% mandatory haircut for NoR CDS trades. The December 2017 final Basel paper included language that suggests regulators should allow 100% regulatory capital relief for NoR CDS trades for jurisdictions which meet defined bankruptcy code requirements. In fact, much of the language included in the final paper was drafted by the IACPM. This change, once adopted, is a significant change for global member firms that employ credit default swaps as a risk mitigation tool in the United States.

FUNDAMENTAL REVIEW OF THE TRADING BOOK

In 2017, members raised concerns about the *Minimum Capital Requirements for Market Risk (BCBS d352)* and the IACPM submitted a Frequently Asked Question (FAQ) to the Basel Committee on the topic of net short credit risk. Since our members actively manage loan positions and often use CDS to manage the risk, this issue is very timely and important. The 2017 document has language that suggests “net short credit risk positions” should reside in the Trading Book. Currently, the risk of both loan and CDS hedge resides in the Banking Book and regulatory capital relief is given for managing the risk. However, under the language in the document, the potential interpretation exists for a new short credit risk position to arise when the credit spread of the underlying name or CDS hedge increases (thereby increasing the present value of the position) while the loan position remains static in accrual accounting.

The Basel Committee issued a second consultative document in March, *Revisions to the Minimum Capital Requirements for Market Risk (BCBS d436)*. The net short credit risk language was identical in both Basel papers. IACPM submitted a formal response letter solely focused on this topic. The concern is if the existing language would be approved by local jurisdictions, banks could be de-incentivized to hedge banking book exposures. The expectation is that Basel will release final guidance by the end of the year.

SECURITISATION UPDATE

Members continue to use securitization as a tool to mitigate credit risk. At the end of 2017, the European Banking Authority (EBA) released a consultative document on *Significant Risk Transfer in Securitisation*. IACPM partnered with the Association for Financial Markets in Europe (AFME) to submit a response letter which included answers to the thirty-three questions posed in the consultative document on significant risk transfer. Additionally, the IACPM submitted an updated quantitative market volume analysis to the EBA. The survey had previously been conducted in 2015 and provides a snapshot around the size of the synthetic securitization market. Member firms presented data that dated back to 2008. The data highlighted in the survey included: tranche and pool size as well as investor and geographical breakdown for synthetic deals.

This past summer, the Prudential Regulatory Authority (PRA) released a consultation paper *Securitisation: The new EU framework and Significant Risk Transfer*. This paper highlighted the PRA’s approach to the European Union’s Securitisation Regulation that will go into effect on January 1, 2019. The consultative document also included a perspective on the PRA’s expectations around significant risk transfer transactions. Once again, IACPM partnered with AFME to submit a joint response letter. As a follow up to the letter, the Associations met with the PRA to discuss topics in further detail.

CREDIT INSURANCE

The PRA released a consultation paper “Credit risk mitigation: Eligibility of guarantees as unfunded credit protection”. IACPM was involved with the International Institute of Finance (IIF), International Chamber of Commerce Banking (ICC), and the International Trade and Forfeiting Association (IFTA) to discuss topics of concern included in this consultation. The IACPM then held a London regional meeting on credit risk mitigation with representatives of the PRA where our members were able to express viewpoints directly to the regulators. Members were comfortable that the topics raised during these discussions covered the critical issues within the consultative document and therefore decided that the IACPM would not join a joint response letter.

This fall, the IACPM held a full day meeting in New York City on credit insurance including banks and insurance companies for an interactive informal discussion around the topic. There were sessions held on demystifying the product, credit insurance versus other credit portfolio management tools, regulatory issues and documentation. A key takeaway from the meeting that participants would like to see IACPM pursue is whether it may be possible to craft more standardized documentation around credit insurance. As a next step, IACPM is planning a Winter 2019 full day Credit Insurance Forum in London.

IACPM RESEARCH

ASSESSING & ADVANCING CLIMATE RISK AWARENESS

The IACPM in collaboration with Oliver Wyman conducted a global benchmarking study with focus on strategic and business implications of climate change. Facing the increasing effects of climate risk, financial institutions need to develop a more thorough understanding of the risks involved and how best to assess and measure these risks so that they can be incorporated into strategic planning, risk appetite statements, portfolio management and credit decision processes. Increasing climate risk awareness can also help build greater value for clients.

Topics explored included the progress of TCFD implementation and challenges encountered, the integration of climate considerations into credit risk management, including the scope of the integration, approaches taken, as well as governance and ownership within institutions. The results will be presented at the IACPM Fall Conference in Stamford, followed by a white paper in early spring.

COUNTERPARTY CVA & XVA

The concept of counterparty credit risk as a risk factor relevant to derivative financial instruments and the related practices of transaction pricing, valuation for financial reporting purposes, and capital requirements have continued to evolve over the past decade. As the concept evolved, CVA desk organizational structures had to continue to adapt quickly. Partnering with Fintegral, the specialist risk management consulting firm, the IACPM conducted a benchmarking survey on the topic. Contrary to other studies that focus on capital and market valuation aspects of counterparty risk, this survey explored evolving organizational structures of global CVA desks to identify possible best practices. The survey results as well as a white paper were shared with participating firms at the annual CVA roundtable meeting held every March in London.

CONCENTRATIONS & LIMITS

The IACPM also benchmarked concentration and limit frameworks at IACPM member firms, a topic we last looked at in 2011. There was strong interest in this survey from members with over half the membership participating. As a follow-up to the survey, the IACPM held two member led webinars to discuss the results of the survey and provide practitioner perspectives. Planned for 2019 are IACPM hosted practitioner forums as a forum for member firms to discuss this important topic in more detail.

RISK RATING SYSTEMS

The IACPM conducted a survey to explore Risk Rating Systems, a topic that was last explored at the IACPM in 2012. The survey assessed the structure and granularity of internal credit risk rating scales used for the wholesale/non-retail portfolio considering regulatory practices. The key subject areas, identified by a working group of IACPM member volunteers, include: internal risk rating grade equivalents, Basel IRB PD mapping, frequency of PD range review as well as risk rating model calibration. Almost two-thirds of IACPM member institutions participated in this benchmarking project.

LIQUIDITY TRANSFER PRICING

At the suggestion of one of IACPM's member firms, a targeted survey on the topic of liquidity transfer pricing practices across institutions was conducted. In particular, the benchmarking explored the allocation of liquidity premiums and liquid asset costs to loan portfolios and off-balance sheet items, as well as the application of liquidity transfer pricing rates in loan pricing models.

DFI & ECA SURVEY: CREDIT ASSESSMENT PROCESSES

The survey explores credit assessment processes at DFIs and ECAs, looking at topics such as the responsibility for proposing and approving initial credit ratings, the frequency of credit rating reviews, key performance metrics used for monitoring assets, and process governance. It has been designed with the help of a working group of IACPM DFI and ECA member volunteers and it is the first of a planned series for IACPM's DFI ECA membership.

DIGITIZATION & INNOVATIONS IN CREDIT

The IACPM and Global Risk Institute have recently released a fintech paper discussing the changing landscape of the financial services industry as digitization impacts customers and the services provided. Highlights from this paper will be presented during the Fall Conference in Stamford.

PRINCIPLES & PRACTICES

As we look to 2019, the bi-annual Principles and Practices survey will kick off in the first quarter. This survey is our most requested one as firms share insight on mission, mandate and priorities within the field of credit portfolio management.

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 2018, the IACPM met with regulatory agencies and central banks including members of the Basel Committee, EBA (Europe), ECB (Europe), MAS (Singapore), The Federal Reserve and Office of the Comptroller of the Currency (United States), Reserve Bank of India (India), Bank Negara Malaysia (Malaysia), JFSA and Bank of Japan (Japan), ECB (Germany), Ministry of Finance (France), Bank of Japan (Japan), and the PRA (United Kingdom).

In addition to these meetings, IACPM also participated in workshops with regulators. For example, IACPM members and McKinsey held meetings globally with regulators as well as the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) to discuss the results of the IFRS9/CECL survey. Additionally, the IACPM met with the Office of the Superintendent of Financial Institutions (OSFI) in Canada to highlight the evolving discipline of benefits of credit portfolio management and explain how different banks structure and implement this function. In 2019, we plan to meet with other global regulators to continue the important dialogue around credit portfolio management business models. Furthermore, the IACPM was asked to speak at the Structured Credit Investors and the Information Management Network meetings that focused on the securitization market.

The IACPM will maintain an active dialogue with global regulators on topics such as **Securitisation, No Restructuring CDS and IFRS9/CECL expected credit loss** as well as other important subjects in the coming year. In addition, the IACPM will continue to host a number of informal, regional roundtable discussions with members and regulators on topical issues in 2019 as implementation progresses on many regulatory requirements, and as new topics arise.

LINKS TO ADDITIONAL INFORMATION REFERENCED

SECURITISATION LETTERS

Consultative Document
<https://goo.gl/1wdD72>

Joint Associations Comment Letter
<https://goo.gl/13tMgE>

Consultative Document
<https://goo.gl/aTSxZ9>

Joint Associations Comment Letter
<https://goo.gl/DCEX1o>

BASEL III: FINALISING POST CRISIS REFORMS (BCBS D424)

IACPM Comment Letter
<https://goo.gl/zUBpcB>

Final Paper
<https://goo.gl/q363hG>

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.

SECURITISATION WORKING GROUP

Member firms were actively involved in the *Significant Risk Transfer in Securitisation* response letter and quantitative volume analysis that was submitted to the European Banking Authority at the end of 2017. The working group also provided important feedback to the *Securitisation: The new EU framework and Significant Risk Transfer* joint response letter that was submitted to the Prudential Regulation Authority. The working group also meets periodically and conducts short surveys on topical issues. Members interested in this topic continue to participate in a number of discussion forums at IACPM Conferences and with regulators.

FUNDAMENTAL REVIEW OF THE TRADING BOOK WORKING GROUP

The FRTB Working Group was created in 2017 to address concerns around the Net Short Credit Risk section within the *Fundamental Review of the Trading Book* final text. This working group met frequently to draft an IACPM response letter to the 2018 Basel Committee's *Revisions to the minimum capital requirements for market risk*. We continue to engage in dialogue with regulators on this issue and expect final text from Basel by the end of 2018.

ACCOUNTING WORKING GROUP

The Accounting Working Group was actively involved in helping shape the *IACPM/McKinsey Benchmarking: New Accounting Standards for Credit Loss Allowances (IFRS 9/ CECL)*. This important topic was discussed with various global regulatory agencies as well as at the IACPM's meetings and conferences. We expect that this survey will be repeated in 2019 so the working group will continue to be active.

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