The International Association of Credit Portfolio Managers (IACPM) appreciates the opportunity to comment on the "Implementing the Final Basel III Reforms in the EU". IACPM members are focused on managing a bank's credit portfolio in a way that is consistent with prudential regulatory goals. In particular, credit portfolio managers utilize various product tools such as credit derivatives, credit insurance and securitisation to effectively manage portfolio concentration risk. This response letter is focused on Question 146 and specifically Net Short Credit/Equity in the Banking Book.

Previously, IACPM responded to BCBS 352 "Minimum capital requirements for market risk" (specifically page 7, paragraph 13c) and BCBS d436 "Revisions to the minimum capital requirements for market risk (specifically page 36, paragraph 13b and Footnote). As we stated in these letters, IACPM is concerned that there are unintended consequences that can arise from a certain interpretation of the wording of net short credit/equity in the banking book. In BCBS d436, paragraph 13b, the statement reads that a net short credit or equity position in the banking book must be included in the trading book. The Footnote to paragraph 13b in the same document explains that "A bank will have a net short risk position or credit risk in the banking book if the present value of the banking book increases when an equity price decreases or when a credit spread on an issuer or group of issuers of debt increases". As discussed in IACPM's previous response letters that can be found here: http://iacpm.org/wp-content/uploads/2018/06/IACPM-Basel-FRTB-Letter-2018.pdf, this language suggests that a "net short credit position" can arise in instances where credit default swaps (CDS) are used to hedge credit exposures (such as loans, commitments, or other unfunded exposure) held in the banking book.

It is important to highlight that CDS is generally subject to mark – to – market accounting (MtM) while the credit risk exposure, such as a loan, is often not subject to the same accounting standard. Therefore, if the credit spread of an issuer rises, and the present value of the CDS changes, the loan may not experience the same offset. We remain concerned that the specific paragraphs highlighted above bring into scope positions that credit portfolio managers manage within a bank. As detailed above, credit portfolio managers are concerned that net short credit positions as described in these statements that currently fall under banking book rules in the Basel 3 standards could be moved into the trading book. It is important to remember that credit portfolio managers' roles and responsibilities within a banking organization are different from a trading platform.

The hedging activity of a bank's loan portfolio could see increased capital requirements if these particular paragraphs are not clarified under the new rules in Europe. We do not believe the intention of these statements was to create unintended consequences for the credit hedging activity done by credit portfolio management desks. Therefore, we are hopeful that the language will be revised so that credit portfolio activities can continue to use CDS to hedge credit exposure risks. By clarifying the language and allowing credit portfolio managers to continue using CDS to hedge credit risk, banks will be able to extend further credit in European countries.

We thank the European Commission and welcome efforts to draft guidelines that are consistent with legislative text as well as transparent and pragmatic for the industry participants. IACPM remains willing to engage in dialogue with the European Commission around the net short credit risk topic.