IACPM

May 2, 2021

Implementation of Basel standards in the UK
Consultation CP 5/21 of the Prudential Regulation Authority (PRA)

The **IACPM** (International Association of Credit Portfolio Managers) is a global 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.

The IACPM's institutional member firms comprise the world's largest financial institutions, and as such overlap the membership of several other financial industry associations. Our perspective is different, however, in that the IACPM represents the teams within those institutions who have responsibility for managing credit portfolios, including actively controlling concentrations, adding diversification, managing the return of the portfolio relative to the risk and applying capital to new lending.

In carrying out these responsibilities successfully, credit portfolio managers contribute to maintaining the safety and soundness of their respective financial institutions. Effective credit portfolio management is critically important to our prudential supervisors and to policy makers more broadly because of its role in supporting financial institutions' ability to lend.

In addition, our members also include investors, insurers and reinsurers, which participate in credit risk transfer transactions as buyers of credit assets or credit protection sellers.

As the PRA is consulting on implementation of the Basel Standards through a new Capital Requirement Regulation (CRR), the IACPM would like to communicate the main areas of concern of its members on CRR regulations applicable up to end 2020, as well as on Basel III finalisation, specifically about the treatment of **synthetic risk transfer instruments** used for credit risk mitigation.

- The IACPM and its members are concerned that CRR regulations cannot facilitate the expected growth of **synthetic on balance-sheet securitisations** in support of safe real economy finance, for various economic, operational and technical reasons, some of them being listed below:
    - The complexity of the Significant Risk Transfer (SRT) assessment process, the challenge to comply with SRT tests (First loss/PBA/CRT tests), and the grey areas that remain to be clarified
    - The application of the STS framework for synthetic on balance-sheet securitisations, notably about definition of exposure value for synthetic excess spread, triggers for non-sequential amortisation, inclusion of fees on retention rate, etc
    - The need to simplify the reporting templates and to challenge their appropriateness for private securitisations

- The application of the output floor based on Standardised RWA contemplated by the finalisation of Basel III, which has a double - and probably unintended - negative effect on synthetic securitisation. A number of solutions could be considered, such as
  - Exclude securitisations from the scope of Basel III output floor, because the calibration of the formulas already incorporates a margin of conservatism
  - Apply the SEC-IRBA based on RWA calculated under the Standardised approach
  - Recalibrate the SEC-SA only for the purpose of the output floor calculation.
- Other pending points which still remain to be proposed, such as
  - The simplification and recalibration of the risk weights per securitisation tranche
  - The eligibility in LCR of transactions which qualify under the STS framework
  - The framework for sustainable or green securitisations.

- The IACPM and its members are also concerned that CRR regulations do not facilitate **prudentially regulated private credit insurers**' ability to offer credit protection to banks. The product allows banks to further increase their lending capacity to the real economy.

1. Credit insurance protection eligible as financial guarantee under CRR is a well-established and relied upon tool for banks wishing to distribute the credit risk associated with lending businesses including but not limited to trade credit. Through the use of **non-payment credit insurance** in corporate lending, SME lending, asset backed lending, mortgage lending, project and infrastructure financing as well as trade flows, banks are able to undertake further lending while prudently managing their exposures, risk limits and regulatory capital.
   - However, amendments contemplated by the finalisation of Basel III are likely to negatively affect the use of credit insurance by regulated financial institutions. Despite their privileged, or 'super senior' position as policyholders under law (The Insurers (Reorganisation and Winding Up Regulations) 2004, Part IV, regulations 21-26) and regulation (Solvency II), that position is not recognised by a more favourable LGD under the finalisation of Basel III. The negative impact on insured exposures does not only materialise when substituting two unsecured exposures (in SME/corporate lending), but is even amplified when credit insurance protection is purchased on loans secured by another funded collateral (in asset-based finance).
   - On this specific issue, **the IACPM fully supports the initiative of the International Underwriting Association, Lloyd's Market Association, the International Credit & Surety Association and the International Trade & Forfaiting Association as expressed in their letter dated April 30, 2021, to Mr Newton and Ms Robinson-Hammond.**

2. Credit insurance has also developed as an increasingly important tool for many banks wishing to distribute the junior or mezzanine risk associated with pools of lending exposures by using **unfunded balance sheet securitizations**. The ability of well capitalized, highly rated and prudentially regulated private credit insurers to provide unfunded risk protection in respect of balance sheet securitizations has significantly

broadened the distribution options available to banks for these transactions, offering counterparty diversification and providing greater opportunities to manage credit risk and related capital, and ultimately undertake further lending.

  - However, the STS framework for balance sheet synthetic securitisations requires either funded credit protection (by way of cash collateral or 0% risk-weighted debt securities) or unfunded credit protection provided by a limited number of potential counterparties (e.g. 0% risk-weighted multilateral development banks). Therefore, unfunded credit protection provided by credit insurers does not benefit from the favourable treatment of the STS framework.
  - These STS Requirements should be amended so as not to limit the availability of a key distribution channel that is currently available to banks to support real economy lending in respect of balance sheet securitisations

The IACPM will continue to provide information and insights to the PRA on the topics here above, so that regulations can evolve safely and for the benefit of real economy transformation and growth.

Yours sincerely,

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