

NOTE FROM IACPM'S EXECUTIVE DIRECTOR

Dear Members,

In 2013 the regulatory environment has remained challenging, with many new requirements being proposed for review and implementation. The IACPM has continued to serve as advocate on behalf of our membership with regulators and supervisory agencies to address the important issues affecting credit portfolio managers.

Below is a brief summary of some of IACPM's advocacy actions in 2013 that we hope will be of interest. Please feel free to share the summary with others at your firm as appropriate.

Monthly updates on IACPM's advocacy initiatives are provided during IACPM's Regulatory Committee conference calls. I would encourage you to join the Committee if you would like more information, and/or if you have advocacy issues or topics that IACPM should consider addressing. Please let me know and I will ensure that you are informed of future calls.

As always, we welcome your thoughts and feedback. Please contact me with any questions or suggestions.

Regards,



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FOLLOWING IS A BRIEF SUMMARY OF THE KEY ISSUES WE HAVE BEEN ADDRESSING RECENTLY:

Capital Requirements for Bank Exposures to Central Counterparties (CCPs)

ISSUE The Basel Committee released last year the interim rules for the capitalization of bank exposures to central counterparties. The rules provided for trade exposures with eligible CCPs to apply a 2% risk weight plus add-on capital for default fund contributions. The release was silent on ability to use the 2% risk weight for banking book exposures hedged in accordance with Basel II IRB rules. IACPM believed this was an oversight, but as a result, the release was ambiguous on whether IRB exposures hedged with eligible CCPs would be assigned the 2% risk weight, or would still need to meet the Basel II Section 481 requirement that, in all cases, both the borrower and all recognized guarantors must be assigned a borrower rating at the outset and on an ongoing basis using PD substitution or double default.

IACPM ACTIONS

IACPM submitted a [comment letter](#) seeking clarification and confirmation of treatment at 2%.

STATUS

Successfully resolved as of December 2012. The Basel Committee provided an update and clarification of the CCP rules in "[Basel III counterparty credit risk and exposures to central counterparties - Frequently Asked Questions.](#)"

Basel Revisions to the Securitization Framework (BCBS236)

ISSUE The Basel Committee's December 2012 proposed revisions to the securitization framework would impose increased capital charges which are overly conservative relative to past performance of these structures. While IACPM does not believe bank balance sheet securitizations are the target of the proposed framework, they will be negatively affected by them. Among other aspects, the proposed rules affect the most senior tranches and long dated tranches of securitizations and would effectively make the structures uneconomic as a risk transfer tool for credit portfolio managers.

IACPM ACTIONS IACPM submitted a [comment letter to the Basel Committee](#) to support the view that the proposed securitization framework is unnecessarily conservative in its calibration and structure. IACPM also supported the positions of the Institute of International Finance (IIF) and the Global Financial Markets Association (GFMA) in their comment letters. IACPM suggested that carving out a different capital treatment for bank balance sheet securitizations would be one way to preserve the risk management use of securitizations. The parameters defining what constitutes this type of transaction could be similar to [the definitions IACPM suggested to the U.S. SEC in relation to Rule 127B](#).

STATUS **Outstanding.** Discussions are ongoing with the Basel Committee.

Recognizing the Cost of Credit Protection Purchased (BCBS245)

ISSUE The Basel Committee's March 2013 proposed rules regarding recognition of the cost of credit protection would almost completely eliminate regulatory recognition of credit risk mitigation benefits of prudent hedging and substantially undermine economic incentives for legitimate risk management transfer of credit risk to external investors.

IACPM ACTIONS IACPM submitted a [comment letter to the Basel Committee](#) recommending that the proposal be withdrawn completely or restructured substantially.

IACPM's letter suggested:

- a) Enhanced Pillar 2 guidance could effectively address regulators' issues related to significant risk transfer.
- b) The proposal to deduct the present value of credit protection costs should be limited to transactions which fail to demonstrate SRT, as the proposed 150% risk weight is an inappropriate threshold and would be a deterrent to hedging risk specifically at times when prudent risk management efforts might entail doing so.
- c) Single name credit protection should be excluded from the scope of these rules.

The IACPM letter also provided a quantitative example of the capital impact of the BCBS236 (Revisions to the Securitization Framework) proposal, demonstrating that the additional capital requirements contemplated in this proposal are not generally necessary.

STATUS **Outstanding.** Discussions are ongoing with the Basel Committee. A recent telephone conference call with representatives of the Basel Working Group suggested that the final rules, or possibly a second consultative document (less likely), would be released by year-end 2013.

IASB Exposure Draft on Expected Credit Losses (IASB ED/2013/3)

ISSUE The IASB's exposure draft on expected credit losses requires that lifetime expected losses be recognized upfront for assets acquired at market rates, and it therefore creates the potential for significant distortion in financial results. As the proposed expected lifetime loss recognition is not coupled with revenue recognition, reported lifetime expected losses under the proposal will be overly conservative, difficult to estimate reliably, and not accurately reflective of anticipated financial performance. The requirements are also operationally too complex to implement within the time frame proposed by the IASB. Further, the differing approaches proposed by the IASB and FASB create additional complexities for global financial institutions.

IACPM ACTIONS IACPM submitted a [comment letter](#) to the IASB asking for changes and clarification of the issues noted above, and for additional time to implement the new standards once approved.

STATUS **Outstanding.** Discussions are ongoing with the IASB.

U.S. Joint Agency Credit Risk Retention for CLOs: 2013 Re-Proposal (SEC 34-70277)

ISSUE The second U.S. Joint Agency Notice of Proposed Rulemaking addressing Section 941 of the Dodd-Frank Act contains an option whereby CLOs can satisfy risk retention requirements via investing in "CLO eligible tranches" of loan facilities. (The original option, whereby risk retention can be satisfied by CLO managers retaining a portion of their deals, remains available.) This new option would effectively shift responsibility for risk retention to Lead Arrangers of syndicated loans and would require: 1) the loan arranger retain 5% of the designated CLO eligible tranche for the life of the loan, and 2) the 5% may not be sold or hedged. The prohibition on transferability of the retained portion, in (most likely) term loan B tranches, poses a significant issue for CPM.

IACPM ACTIONS IACPM [submitted a letter](#) to the Joint Agencies indicating that the requirement for a 5% hold in designated "CLO eligible" tranches would limit lead arrangers' appetite for other leveraged loan facilities such as revolving credits and, as such, could limit working capital flexibility for borrowers who rely on banks to provide revolving credit facilities. The retention requirement without ability to sell or hedge is also contrary to the ability to prudently manage risk in a bank's credit portfolio given the need to respond ongoing client requests for incremental credit over time against the constraints of individual obligor limits, industry limits and leveraged lending limits.

STATUS **Outstanding.**

LINKS TO ADDITIONAL INFORMATION

Capital Requirements for Bank Exposures to Central Counterparties

Basel Committee Rules for Capitalization of Bank Exposures to CCPs <http://bit.ly/Q1Z1rp>
IACPM Comment Letter <http://bit.ly/ZxsUq9>

Basel Revisions to the Securitization Framework (BCBS236)

Basel Revisions to the Securitization Framework <http://bit.ly/ZJ3Mz2>
IACPM Comment Letter <http://bit.ly/1agHFnm>

Recognizing the Cost of Credit Protection Purchased (BCBS245)

Recognizing the Cost of Credit Protection Purchased <http://bit.ly/Yfr2G6>
IACPM Comment Letter <http://bit.ly/1h8YAMd>

IASB Exposure Draft on Expected Credit Losses (IASB ED/2013/3)

IASB Exposure Draft on Expected Credit Losses <http://bit.ly/13IuESl>
IACPM Comment Letter <http://bit.ly/1cYa5Di>

U.S. Joint Agency Credit Risk Retention for CLOs: 2013 Re-Proposal (SEC 34-70277)

U.S. Joint Agency Credit Risk Retention Re-Proposal <http://1.usa.gov/17qO3Yj>
IACPM Comment Letter <http://bit.ly/19nXVPH>

For More Information about IACPM's Advocacy:

IACPM Monthly Regulatory Committee (*by conference call*)
Contact: Alison Christensen at IACPM to be added to the distribution list (alison@iacpm.org)
IACPM Regulatory and Accounting Update November 2012
<http://www.iacpm.org/news/detail.dot?id=46782>

CONTACT US

Please contact us with comments and suggestions, and if you or colleagues at your firm would like to participate in IACPM's advocacy efforts.

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