

June 21, 2013

Secretariat
Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland
Via email to baselcommittee@bis.org

Re: BCBS245 – Recognising the cost of credit protection purchased

To the Members of the Basel Committee:

The International Association of Credit Portfolio Managersⁱ (the “IACPM”) appreciates the opportunity to comment on the Basel Committee’s consultative document, “Recognising the cost of credit protection purchased” (the “Document”).

The IACPM appreciates regulators’ concerns that certain forms of credit protection used in the past may not have resulted in Significant Risk Transfer (“SRT”) between banks and investors. In such instances, regulators are justifiably concerned about regulatory capital arbitrage where the capital benefits of a transaction greatly overstate the level of risk transfer involved.

We also understand that the current proposals aim, in part, to ensure that banks quickly recognise losses associated with material deterioration in credit quality – regulators do not want such losses to be effectively amortised over time in the form of high annual credit protection costs.

However, we feel that the proposals outlined in the Document would have consequences which would extend far beyond these aims. The proposed requirements would almost completely undermine any regulatory recognition of the risk mitigation benefits of prudent hedging. By so doing, it would undermine the economic incentives to legitimately transfer credit risk to outside investors.

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Recommendations

Our key recommendations regarding the Document are as follows:

1. We propose that the Document either be withdrawn completely or restructured substantially as outlined below.
2. We believe that virtually all of the regulatory concerns related to SRT can be addressed through enhanced Pillar 2 guidance on this subject. A better definition of SRT requirements and a more consistent international application of these definitions should allow regulators to ensure that regulatory capital benefits are limited to those instances where risk is truly transferred to outside investors.

We've outlined below some of the key criteria which we believe could strengthen a Pillar 2 approach to SRT.

3. The Document's proposal to deduct the present value of credit protection costs should be limited to transactions which fail to demonstrate SRT. The proposed 150% risk weight is, in our view, an arbitrary and inappropriate threshold. It would act as a disincentive to hedge the most risk sensitive tranches in securitisations and would also have the unwelcome side effect of discouraging banks from hedging single name credits just when credit deterioration appears most evident.
4. Single name credit protection transactions should be excluded from the scope of this proposal except in very unusual circumstances. In general, single name credit protection reflects the following criteria:
 - a. Credit protection is purchased from an outside investor and there should be no issue demonstrating SRT. This presumes that the transaction meets current regulatory requirements such as irrevocability, credit event definitions and an appropriate alignment of maturity, obligor names and exposure seniority.
 - b. Banks are accounting for credit protection on a Mark-to-Market basis and not using credit protection to directly offset provisions for impaired credits. In this case, there should be no issue of income smoothing.

We believe that single name credit protection should be outside the scope of this proposal except in the rare cases where these two conditions are not met.

Some of the regulators we've spoken with have expressed concerns that banks were using single name hedging to mask or offset impairment provisions during the recent market stress related to European sovereign risk. As we note below, we do not understand this concern – current accounting practise is that CDS hedges **do not** offset provisions for impaired credit. Proposed changes to accounting rules related to provisions for impaired credit would, if implemented, clarify this further.ⁱⁱ

5. We believe it is important that the Committee look at the overall impact of regulatory changes affecting capital relief for hedging transactions. We have provided an example below of the impact of the December 2012 proposals regarding the Basel Securitisation Framework. Given the capital impact of those proposals, we do not believe the additional capital requirements of this proposal are generally necessary.
6. We recommend that the committee clarify that the current proposals are not intended to apply to trading book exposures and/or to exposures accounted for on a mark-to-market basis through net income.
7. We recommend that the committee clarify that hedged exposure should not have more capital than unhedged exposure. The recent proposed modifications of the Basel Securitisation Framework would apply this principle to securitised hedges. We recommend that the same principle be clearly applied to single name hedges.
8. Finally, to the extent that banks are required to deduct the present value of credit protection costs in certain circumstances, it is important that the rules reflect the reality of the way that loan commitments to corporate and SME borrowers are structured, managed and priced. Loan commitments are largely unutilized and generate relatively low direct revenue. Banks provide a variety of products to their customers and we recommend that the guidelines allow some flexibility to recognise the applicable revenues. We've provided some detailed comments on this below.

Background and Business Challenges

Many of our members face contradictory business challenges. Their shareholders, clients and, in many cases their regulators, strongly believe that banks create the most value to themselves and to the broader economy by supporting their key client base. Usually this means providing strong credit support to their domestic market or markets. In general, this is where an individual bank is most competitive and where its knowledge and understanding of business and credit risk is most advanced.

From a portfolio management standpoint, however, a bank's business franchise may be heavily concentrated – by geography, by industry or by product type. Once again, shareholders, clients and regulators look to banks to be active in managing such potential concentrations. IACPM members manage the risks of their loan portfolios by actively controlling exposure concentrations. In some cases, this can be done via a disciplined approach to new lending decisions. In other cases, banks can more readily accommodate their client's credit requirements and optimize the capital available for new business by distributing credit risk to third party investors. Single name CDS hedging and portfolio securitization hedges are essential tools to manage and distribute this risk. Banking regulators have long recognized the value of these risk mitigation techniques.

In our view, the proposed rules on high cost credit protection are extremely punitive and seem aimed primarily at the relatively few transactions that have been executed over the past 3-4 years which have attempted to arbitrage Basel capital rules by claiming capital benefits without any significant transfer of risk. We agree that these features have been used in earlier

transactions to reduce or eliminate risk transfer and, ultimately, to lower the hedge cost. We also understand and support the Basel committee's desire to restrict features such as upfront payments, guaranteed coupons and rebates which may inhibit SRT. However, it is crucial that the Document's proposals not penalise legitimate risk transfer transactions.

Applying capital penalties to hedges that achieve SRT would create inappropriate and significant disincentives to effective risk mitigation techniques. It would also create material and unfortunate divergences between regulatory and economic capital.

In addition, it would appear that this proposal has been developed without direct reference to the December 2012 consultative document "Revisions to the Basel Securitisation Framework" in which proposals are made for higher capital requirements for tranches retained by banks. As our examples below demonstrate, this proposal would materially lower the capital benefit of any securitized risk transfer transaction. This change in capital methodology may already address regulatory concerns related to that capital relief be better aligned with risk transfer.

Accounting Requirements and Risk-Based Capital

We have concerns about the mix of risk-based capital approaches with accounting methodology. To begin with, the concern that banks undertake high cost hedging as a way of avoiding provision seems misguided. Both IASB and FASB accounting rules require that credit derivatives be accounted for as Mark-to-Market instruments. Loans and other credit exposures are accounted for as accrual assets. If a bank has purchased credit protection on a loan which subsequently migrates towards default, the accounting impact will be (1) a large positive gain on the CDS hedge position when credit spreads on the CDS widen in reaction to the deterioration and (2) a loss is realized when the bank takes a provision to recognize the impairment of the credit quality of the underlying loan. There are two points worth emphasizing here. First, a provision for an impaired loan must be recognized regardless of whether the credit protection is in place. Current accounting practise for most of our members is that provisions are not adjusted to reflect potential credit hedging offsets. Secondly, the timing of the gains on the CDS hedge and the loss on the loan provision may be quite different and often occur in different accounting periods. In particular, a new purchase of CDS credit protection does not have any Day 1 P&L impact if purchased at prevailing market prices. If the CDS spread subsequently rises or falls, the CDS will then generate P&L gains or losses. However, the CDS impact and the provision adjustments are on different line entries in a bank's P&L statement. So, unless there are instances of banks not following these well accepted accounting rules, we fail to understand the regulatory concern that CDS hedging may be used as a way to mask or smooth losses due to provisioning of impaired credits.

A second accounting related concern is that both the IASB and FASB have proposed new rules on credit impairment and provisioning. While these proposals are still in a discussion and consultation phase, there is a clear trend towards requiring banks to recognize some form of "expected loss" provisioning against performing assets. Both sets of proposals would require that the provision be risk sensitive – as internal ratings of credit quality are downgraded, expected loss provisions would increase. The FASB proposal specifically prohibits the recognition of the existence of CDS credit protection covering these assets in the calculation of the provision and IFRS 9 could be interpreted to require the same treatment.ⁱⁱⁱ

We also observe that these proposals would treat capital-based transactions asymmetrically. When a bank issues equity or subordinated debt to boost its capital resources, there is no proposal to require a deduction of the present value of future interest or dividend payments on these instruments. Securitised credit hedges of performing loan pools are often used to manage the capital requirement of those loans. Where an external investor is providing cash to absorb potential losses, we believe it would be inappropriate to require that premiums for this form of capital be treated differently.

In short, we believe that attempts to mix accounting requirements with risk-based capital regulations are fraught with many difficulties. Both accounting and capital standards are evolving as accounting bodies and bank regulators react to the changing banking environment. It is unwise, in our view, to mix these two approaches without a thorough understanding of the objectives of each group.

Defining Significant Risk Transfer

We believe that the BIS December 2011 document (“High Cost Credit Protection, Basel Committee newsletter No. 16”) outlined many of the criteria that should be used to determine whether hedging transactions meet suitable standards of Significant Risk Transfer. We believe that this guidance should be largely sufficient to address regulatory concerns about capital arbitrage. However, we support a more transparent and internationally consistent definition of significant risk transfer.

As a result, we encourage the committee to develop enhanced guidelines for Significant Risk Transfer along the following lines:

1. **Pricing structure** exposes the investor to risk of loss of principal
 - a. **Premiums are “risky”** and premium income will reduce as credit losses erode the portfolio and the tranche.
 - b. **Market pricing** – pricing should be defensible in comparison to market benchmarks for similar transactions bearing in mind the liquidity and risk profile of the underlying credit exposures.
 - c. **Rebates or upfront payments** – these should not be contingent upon the credit quality or payment performance of the transaction or otherwise used to reduce an investor’s loss in the event of material credit losses.
 - i. We note, however, that standardized pricing for CDS transactions now include fixed annual spreads of 100 or 500 bp. Differences between the prevailing market pricing for an individual credit and the fixed rate are reflected on an upfront basis. This may result in an upfront payment either to the investor or to the hedger. This form of upfront payment should be permissible – based on the upfront payment being pre-determined and insensitive to subsequent performance of the transaction.

2. **Separate pool of capital** – the bank which buys protection should not own or sponsor the end risk taker and should not finance the investor’s risk position either directly or indirectly. There should be no indirect support in the form of side letters or other agreements.
3. **Bank Internal Approval Process** – how is the transaction being vetted and approved within the bank? Has the transaction been reviewed by a team independent from the group which is structuring and executing the transaction? Is this done at a sufficiently senior level?
4. **Risk Mitigation & Economic Capital** – does the bank internally assess risk in a manner that is broadly consistent with degree of capital relief? Do its internal economic capital models provide support for this degree of risk transfer? Does the bank grant comparable internal relief for the hedged credits or portfolios?

Typical Portfolio-Based Hedging Example

Many IACPM members use securitised hedging as a tool to manage the risk exposure and capital requirements of loan or trade finance portfolios. We note that the examples cited in the text of the Document generally make assumptions that seem inconsistent with the types of transactions our members generally undertake.

As a general rule, our members are usually using portfolio based hedging to manage the core, performing portfolio of their business. Underlying exposures can range from investment grade (BBB/BBB- equivalent) corporate loans to derivative counterparty risk exposure to near investment grade (BB/BB+ equivalent) SME or trade finance exposures. This is not a technique that is generally used to manage non-core portfolios or to manage distressed or watch list exposures. As a result, in almost all cases, the risk weights of the underlying exposures are well below 100% -- in contrast to the 200% portfolio risk weight assumed in the Document’s examples of Transaction C and D.

In many cases, as well, the underlying exposures are predominantly undrawn loan commitments. These commitments generally earn a reasonable credit spread to the extent that they are drawn as loans by the borrower. However, actual utilization of the commitments is generally very low – below 20% in most normal market circumstances. The undrawn commitment generally earns a very meagre spread of, say, 10-20 bp/year for most investment grade exposures. Despite this pricing structure, most syndicated loan commitments are oversubscribed. Both banks and borrowers view them as cornerstone transactions. Banks generally look at the low revenues generated by these exposures in the context of their overall relationship with the borrower. Being a core liquidity provider to the borrower may provide enhanced opportunities for other non-lending business.

Examples of the Impact of the Proposed Methodology Changes

The example below highlights the cumulative impact of the proposed Revisions to the Basel Securitization Framework (Dec 2012 Proposals) and the proposed changes in the Document.

We’ve assumed that the transactions all relate to a 5-year hedge of a portfolio of loan commitments with an average internal obligor rating of BBB-. The loan commitments are

assumed to be 10% utilized, 90% undrawn and earn approximately 0.235% per annum in credit spread and fee income. We've evaluated the cost and capital impact of a hedge of this portfolio under four scenarios: ^{iv v}

1. **Current Rules** – we've assumed a 0-7% first loss hedge of the portfolio and apply our estimate of prevailing market pricing and current Supervisory Formula (SFA) capital methodology. Broadly speaking, this is a representative transaction structure that many IACPM members would have considered prior to the current rule changes and contemplates a loss protection that is comfortably above the required level of regulatory capital and above any reasonable estimate of unexpected losses.
2. **Dec. 2012 Proposals (tranche unchanged)** – this scenario shows the impact of the Modified Supervisory Formula Approach (MSFA) outlined Dec 2012 Proposals assuming the same tranche and pricing as in Scenario 1. The capital benefit of the transaction drops materially (a reduction of 68% vs. 90% under the SFA) and the pre-tax cost / capital saved rises from to over 20% which is already an extremely high cost transaction from a purely cost of capital point of view.
3. **Dec. 2012 Proposals (wider tranche)** – this scenario also shows the impact of the MSFA methodology but assumes that the bank seeks to gain greater capital savings by adding a 7-16% second loss hedge. With this structure, capital savings are just above 80% of the original, unhedged capital and the cost/capital saved is just below 30%.
4. **Dec 2012 & March 2013 Proposals (wider tranche)** – this scenario uses the same tranching as in Scenario 3 but adds both the MSFA capital methodology and the High Cost Credit Protection requirements to deduct the present value of the premium. In this scenario, the capital savings drop to under 25% and the cost/capital saved is exceeds 80% annually.

Impact of Proposed changes to regulatory capital methodology

Scenario	1B Portfolio with BBB-Avg. Internal Rating		Net Capital		Capital Savings		Annual Cost / Capital Saved
	Tranche(s) Hedged	Capital Methodology	(€)	% of portfolio	(€)	% of unhedged	
1. Current Rules	0%-7%	SFA	5,208,000	0.5%	56,692,247	91.6%	16.7%
2. Dec 2012 Proposals (tranche unchanged)	0%-7%	MSFA	35,370,071	3.5%	26,530,176	42.9%	35.6%
3. Dec 2012 Proposals (wider tranche)	0%-16%	MSFA	13,440,000	1.3%	48,460,247	78.3%	26.0%
4. Dec 2012 and March 2013 Proposals (wider tranche)	0%-16%	MSFA & HCCP	47,001,420	4.7%	14,898,827	24.1%	84.6%
Unhedged Portfolio			61,900,247	6.2%	-	-	

We note that in all of these scenarios, the hedging is assumed to occur via a Credit-Linked Note. This is a typical structure used by our members. It means that the investor provides cash collateral equal to the full amount of the hedge (either 7% or 16% of the portfolio depending on the scenario). We believe that this is comparable to the BIS requirement to hold Core Tier 1 capital as the cash pledged via the CLN structure is unconditionally available to fund losses

in the portfolio up to the amount specified.

In Scenario 4, the cash collateral posted by the protection provider is more than 3X higher than the capital that would be required to support the portfolio if the bank were to hold the portfolio unhedged. Despite this substantial and very effective form of credit risk mitigation, the net capital requirement for the hedged portfolio is only marginally below the unhedged portfolio capital requirement.

In our view, this is a realistic example that demonstrates how the combination of various regulatory proposals creates extremely strong disincentives to a legitimate form of risk transfer. It would deprive our members of one of the few possibilities for hedging illiquid commitments.

Although we have argued in other submissions that the Dec. 2012 proposals are conservatively biased and should be modified, we accept the basic premise that more capital should be allocated to retained senior securitization tranches. With appropriate modifications, we believe that these proposals better align regulatory capital reductions with SRT and can still allow room for our members to consider using these transactions to transfer credit exposures to investors who are better able to absorb such risks.

Measurement of Loan Revenue

As noted in our examples above, CDS and securitised hedging is often undertaken against large corporate exposures. The current proposal considers whether the cost of credit protection should be offset against loan revenue. Unfortunately, in many cases, calculation of loan revenue is not a straightforward issue.

Frequently, the underlying exposure is an undrawn loan commitment. Market pricing for loan commitments typically involves the following elements:

1. An upfront fee. This can range from 0% to 0.75% for commitments to investment grade borrowers. Much higher upfront fees are typically available from non-investment grade borrowers.
2. An annual commitment or facility fee of 0.10% to 0.50% for commitments to investment grade borrowers. Higher commitment fees will be charged on non-investment grade borrowers. In both cases, however, the commitment fee is substantially below the drawn spread on the loan. Commitment fees are charged against the **undrawn** portion of the commitment. Facility fees are charged against the entire commitment – whether drawn or undrawn. Loan commitments are typically structured with either a commitment fee or a facility fee but not both.
3. A drawn spread charged on any of the utilized or drawn portion of the commitment. This spread may be close to market CDS levels at origination – however CDS market pricing is much more volatile than loan market pricing. Consequently, there may be prolonged periods during which CDS hedges (either single name or portfolio based) cost more than the revenue produced even if the commitment were fully drawn.

4. Various optional pricing elements. For example pricing may change based on the borrower's external credit rating or reported financial performance, if utilization of the commitment exceeds a specified level or if a commitment is not cancelled by the borrower before a specified date.
5. In practice, loan commitments are almost never fully drawn. Average draw rates for most of our members would be below 20% for investment grade borrowers and only slightly higher for non-investment grade borrowers. A key role of loan commitments is to provide back-up liquidity. Most corporations, both large and small, seek to have ample liquidity available to them – but have no intention of ever fully using such lending commitments on a frequent basis. Nevertheless, banks must consider the unexpected outcome of high draw rates for risk and capital purposes.

This means that revenue generated directly from lending commitments is almost always likely to be well below the cost of hedging such commitments, whatever the form of the hedge. Banks are prepared to provide loan commitments because they usually form the basis of a much broader banking relationship. Liquidity providing banks are normally able to offer a range of other services to their lending customers (e.g. cash management, foreign exchange, derivative hedging, M&A advice, bond & equity issuance, etc.). Revenues from these other products can justify the implicit subsidy created by the provision of the loan commitment.

This pricing structure complicates the Document's discussion of whether to include revenue as an offset to high cost credit protection (section 1.2 of the technical guidance). We strongly support the principle that if costs are to be considered in assessing the effectiveness of any hedging transaction, it should be the net cost of such hedging, after taking relevant revenue streams into account. This aligns with basic economic and accounting principles.

However, we note that the following considerations would make it difficult to apply the revenue test on a true economic basis:

1. One option would be to measure revenue on a "relationship basis" for each hedged exposure. This would capture the non-lending revenue generated from clients to whom a bank has extended mainly undrawn loan commitments.

While many of our members have systems which aim to measure relationship revenue, these systems are suitable as management tools but are unlikely to meet regulatory standards of verification. In most cases, the calculation of relationship income involves a judgment about or forecast of future non-lending business opportunities and can only be verified well after the initial decision to extend a commitment and /or to hedge it.

Consequently, this theoretically appealing alternative is unlikely to be workable from a regulatory standpoint.

2. A second option would be to calculate loan revenues as if the loan were fully drawn. Mathematically, this is a more defensible calculation as it can be verified by reference to the underlying loan documents. It may still contain a degree of uncertainty in cases

where drawn loan pricing is structured on a grid with different spreads applying in the event of changes in the borrower's credit quality.

Many, but not all, of our members would have systems which would permit them to readily calculate this concept and to defend this calculation.

3. A slight variation of the second option would be to calculate revenue assuming that the loan is drawn at its Exposure at Default level. EAD is a ratio that's been developed to measure risk and capital. Using this approach would result in a more conservative estimate of future revenue.
4. Any calculation of loan revenue should also capture upfront fees. For accounting purposes, such fees are often amortized over the life of the loan and we would suggest that the annual amortized fee amount be included in the revenue calculation.

None of these approaches truly captures the economic value of a loan commitment to a bank. An approach which completely ignores this broader value is misguided and approaches which capture it in an incomplete manner are only marginally preferable.

We firmly believe that loan commitments are a core banking product and are essential to the efficient functioning of a modern economy. A bank's business footprint and franchise often lead it to support key customers in its home market with large loan commitments and this can generate concentrations of exposure to that core client base. As a result, our members generally attempt to actively mitigate these concentrations and use portfolio-based and single name hedging as one of their key tools. Accounting and capital rules which heavily penalise a bank's risk and concentration management practices are unwelcome. We believe the proposed rules will incent our members to restrict the provision of low-priced liquidity facilities to their key clients.

Operational Complexity

Many of the recommendations we've made above could impose operational requirements that some IACPM members have difficulty meeting. Most IACPM members have systems which match individual hedges with the underlying loan or credit exposures. However, in many cases, these systems are built mainly for risk management purposes. As a result, they do not necessarily capture all of the loan revenue information which we described above. The revenue information is generally captured in an accounting system which may not be well integrated with the risk management system.

If the regulatory requirement to measure revenue requires extremely precise revenue information, it may be very difficult for some members to pull the right revenue information from their accounting system and marry it to the commitment amount, the prevailing utilization level and then scale it to the hedge size (in the typical case where the commitment is only partially hedged).

We note, as well, that some securitisations will have replenishment features that allow the buyer of protection to replace matured or amortised exposures. In some cases, very short-

dated portfolios such as working capital loans or trade finance facilities may have an average exposure life of only 90 days. The securitisation hedge may have a tenor of 3-5 years. One would expect, in these cases, that the portfolio would be completely replaced 12-20 times over the life of the securitisation. Such a structure would require the protection buyer to project the revenue of loans and trade facilities that will be replenished in the future and would necessarily require a number of assumptions. If the regulations require precise and highly accurate projections, it may be almost impossible to meet this requirement.

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The IACPM appreciates your attention to our thoughts and concerns. The IACPM's Board of Directors and I would welcome the opportunity to discuss these issues with the Basel Committee. If you have any comments or questions on the issues raised in this letter please do not hesitate to contact me.

Sincerely,



Som-lok Leung
Executive Director
IACPM

Appendix 1: Assumptions & Detailed Calculations of Methodology Impact

Example for High Cost of Credit Protection Letter

	Current Methodology (SFA)	December 2012 Proposals (MSFA) -- No Tranche Changes	December 2012 Proposals (MSFA) -- With Wider Tranche	March 2013 Proposals (High Cost Deduction)
Portfolio & Regulatory Capital Parameters				
Portfolio Notional Amount	1,000,000,000	1,000,000,000	1,000,000,000	1,000,000,000
Average Rating	BBB-	BBB-	BBB-	BBB-
Average PD	0.30%	0.30%	0.30%	0.30%
Hedge Maturity (Y)	5.0	5.0	5.0	5.0
Loan Maturity (Y)	3.5	3.5	3.5	3.5
Exposure at Default	100%	100%	100%	100%
Loss Given Default	45%	45%	45%	45%
Obligors	150	150	150	150
Tranche Structure & Cost				
Junior Attachment Point	0%	0%	0%	0%
Junior Detachment Point	7%	7%	7%	7%
Mezz Attachment Point			7%	7%
Mezz Detachment Point			16%	16%
Libor	1.00%	1.00%	1.00%	1.00%
Junior Tranche Premium (% of tranche)	13.50%	13.50%	13.50%	13.50%
Mezz Tranche Premium (% of tranche)		3.50%	3.50%	3.50%
Premium Cost / Portfolio	1.02%	1.02%	1.42%	1.42%
Capital Before Hedging				
Risk Weight	68.8%	68.8%	68.8%	68.8%
Kirb	5.50%	5.50%	5.50%	5.50%
Unhedged Risk Weighted Assets	687,780,523	687,780,523	687,780,523	687,780,523
Minimum Capital Required	9.00%	9.00%	9.00%	9.00%
Unhedged Capital Requirement	61,900,247	61,900,247	61,900,247	61,900,247
Capital After Hedging				
Counterparty Risk Rating	Cash	Cash	Cash	Cash
Counterparty Risk Weight	0.00%	0.00%	0.00%	0.00%
Junior Tranche Notional Amount	70,000,000	70,000,000	70,000,000	70,000,000
Junior Tranche Counterparty Capital	-	-	-	-
Mezz Tranche Notional Amount			90,000,000	90,000,000
Mezz Tranche Counterparty Capital			-	-
Retained Senior Tranche Notional	930,000,000	930,000,000	840,000,000	840,000,000
Retained Senior Tranche Capital Rate	0.56%	2.12%	1.60%	1.60%
Retained Senior Tranche Capital	5,208,000	19,716,000	13,440,000	13,440,000
Capital Requirement after Hedging	5,208,000	19,716,000	13,440,000	13,440,000
Net Capital Saving	56,692,247	42,184,247	48,460,247	48,460,247
-- as a % of unhedged Capital	91.6%	68.1%	78.3%	78.3%
Annual Cost / Capital Saved (no defaults)	16.7%	22.4%	26.0%	26.0%
Portfolio Income				
Loan Utilization Rate	10%	10%	10%	10%
Loan Commitment Fee	0.15%	0.15%	0.15%	0.15%
Loan Drawn Spread	1.00%	1.00%	1.00%	1.00%
Annual Portfolio Income	2,350,000	2,350,000	2,350,000	2,350,000
-- as a % of Portfolio	0.235%	0.235%	0.235%	0.235%
High Cost of Credit Protection Calculation				
Annual Credit Protection Cost -- Junior				9,450,000
Junior Tranche Capital (if held on balance sheet)				61,037,493
Junior Tranche Implied Risk Weight				1089.96%
Annual Credit Protection Cost -- Mezz				1,278,000
Mezz Tranche Capital (if held on balance sheet)				20,895,322
Mezz Tranche Implied Risk Weight				290.21%
Total Annual Credit Protection Cost				10,728,000
-- as a % of Portfolio				1.07%
Aggregate Discount Rate				7.88%
Risk Weight Threshold for PV Calculations				150%
PV of Junior Tranche Protection Cost				37,855,744
PV of Mezz Tranche Protection Cost				5,119,539
PV of Portfolio Income				(9,413,862)
PV of Net Credit Protection Cost				33,561,420
Capital Requirement after Hedging and High Cost Credit Protection Capital Impact				
Net Capital Saving				14,898,827
-- as a % of unhedged Capital				24.1%
Annual Cost / Capital Saved (no defaults)				84.6%

ⁱ 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 legislative and administrative bodies in the US and internationally, 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 86 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.

ⁱⁱ This should not be construed as the IACPM or its members expressing support for these accounting rule changes.

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^{iv} The calculations outlined below and in Appendix 1 are based on the IACPM's interpretation of current and proposed regulatory capital calculations for underlying Basel capital requirement (K_{IRB}) and for the SFA approach to securitisation capital requirements. For the MSFA calculations we have used the Excel calculator that has been provided by the U.S. Federal Reserve to some of the American IACPM members. The various parameters assumptions we've chosen (PD, LGD, EAD, etc.) are intended to be for illustration purposes only. In general, these choices have been based on historical data published by rating agencies or other publicly available sources. These parameters do not necessarily reflect the approved parameters that might be used by any of the IACPM's members.

^v The securitization calculations for both the SFA and MSFA have been made without taking into account the maximum capital provisions in section 610 June 2006 document, "International Convergence of Capital Measurement and Capital Standards".