March 27, 2022

Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: Notice of Proposed Rulemaking on the Prohibition Against Conflicts of Interest in Certain Securitizations (File No. S7-01-23)

Dear Ms. Countryman:

The International Association of Credit Portfolio Managers ("**IACPM**") appreciates the opportunity to provide comments to the Securities and Exchange Commission (the "**Commission**" or "**SEC**") on the proposed rulemaking on conflicts of interest in securitizations (the "**Proposed Rule**") implementing Section 27B of the Securities Act of 1933, as amended (the "**Securities Act**").[1]

IACPM 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 with the membership of several other financial industry associations. Our perspective is unique, however, in that the IACPM represents the teams within those financial institutions who have responsibility for the prudential management of such institutions' credit portfolios, including actively controlling concentrations, adding diversification, managing the return of the portfolio's components relative to their risk, and allocating capital to new credit exposures. In addition, our members also include investors, insurers, and reinsurers, which participate in credit risk transfer transactions as buyers of traditional and synthetic securitization transactions and sellers of credit protection.

We want to highlight that our comments to the Proposed Rule are *solely* focused on transactions executed by banks for the purpose of risk mitigation and capital release of commercial assets in the banking book, excluding any arbitrage and trading book activities.

[1] SEC Release No. 33-11151 (January 25, 2023), 88 Fed. Reg. 9678 (February 14, 2023).

We have also attached herein an overview of the types of risk mitigation tools used by banks for various risk or capital management purposes, so as to properly position synthetic on-balance-sheet securitizations within the broader toolkit of credit portfolio managers. As you will see, these tools are all unfunded as they aim to transfer the credit risk of loans, borrowers or loan pools to third parties. These tools consist of credit derivatives, credit insurance and synthetic on-balance-sheet securitizations. As these risk-sharing transactions transfer genuine credit risk to professional investors or insurers, they are mostly private and structured in partnership between the bank and the investor(s) or insurer(s). They should not be compared to capital markets transactions like true sale securitizations, traditional asset-backed securitizations, residential mortgage-backed securities, commercial mortgage-backed securities or collateralized loan obligations.

For synthetic on-balance-sheet securitizations specifically, we are also attaching the high-level results of our last annual survey on synthetic securitizations, with details on volumes and types of transactions executed by banks globally through year-end 2021 for risk and capital management on their own commercial assets. Our 2022 annual survey is ongoing and we are happy to share the results with the SEC in the course of April 2023.

IACPM strongly endorses the principles of market integrity that lie behind the Proposed Rule. IACPM is also particularly appreciative of the consideration that the Commission has given to IACPM's previous responses to the 2011 proposed rule and our related meetings with the staff. However, we believe that the Proposed Rule continues to present many of the same risks as the 2011 proposed rule to mainstream banking business in both the United States and internationally.

As described below, the IACPM considers that the Proposed Rule would functionally prevent banks from entering into synthetic securitization transactions, including issuing synthetic asset-backed securities ("**ABS**"), for the purposes of portfolio risk mitigation because:

- The scope of a "conflicted transaction" is so broad that it would be impossible for a bank to comply with the Proposed Rule unless it is amended to acknowledge and accommodate (a) activities undertaken within a banking group behind existing information barriers and (b) normal servicing, enforcement and loss determinations with respect to assets within a synthetic reference portfolio;

- The scope of the risk-mitigating hedging activities exception is limited to hedging activity arising out of the sponsor's securitization activities. In the context of credit portfolio management ("**CPM**") activities within a bank, that exception is unworkably narrow and does not address the situation where the bank has multiple strategies to manage risk associated with a single asset pool; and

- The definition of a "securitization participant" is so broad that it could encompass investors and intermediaries whose activities are essential to achieving an orderly and efficient market in synthetic risk transfer instruments.

In this letter, we focus on issues that are specific to CPM activities within banks. We have had the opportunity to review the comment letters prepared by other trade associations, including the Securities Industry and Financial Markets Association, the Structured Finance Association, the Loan Syndications and Trading Association, the American Investment Council and the Association for Financial Markets in Europe and we share their concern about the broader disruption that the Proposed Rule threatens to bring to financial markets that are crucial to mainstream banking and risk transfer activities.

Background – the purpose and forms of Credit Portfolio Management transactions

Effective CPM is a critically important risk management function to the health of banks and the banking system more generally. Banks' capacity to lend to corporate and retail borrowers depends on their ability to manage the risks associated with their banking books efficiently and promptly, including by hedging and transferring such risks where necessary. Risk-mitigating CPM transactions, in particular, are an essential component of a banks' risk management framework and allow such institutions to deploy their resources in a risk-adjusted manner. CPM transactions, which include traditional as well as synthetic securitization transactions, allow banks to transfer risk efficiently and cost-effectively so that they can continuously pursue their core lending objectives while maintaining compliance with their regulatory liquidity and capital requirements.

As highlighted in our comment letter to the 2011 proposed rule[2], banking regulators both in the United States and abroad have long recognized synthetic securitizations, including synthetic ABS transactions, as an effective risk transfer tool. Importantly, properly structured synthetic securitizations that are recognized as risk mitigants for regulatory capital purposes "free up" financial institutions' regulatory capital, enabling them to make more credit available to their customers.

Recent events have shown that the safety and soundness of banks depends on their ability to maintain a diversified, balanced portfolio of assets on their balance sheets. Effective CPM entails detailed consideration of the exposures that a bank should retain and those it should transfer out in the interest of managing credit, liquidity and duration risk.

CPM transactions are a critical means for effectuating such transfers of risk. CPM transactions can take various forms, including insurance, derivatives and guarantees, bank-issued credit-linked loans and credit-linked notes[3] and issuances of synthetic ABS. The economic substance of the transactions is substantially the same in all structures: a protection seller sells the bank protection against losses arising from specified events (typically, but not exclusively, credit losses) on a portfolio of assets. Those assets are generally held in the bank's banking book and arise from the operation of its banking business, including, in particular, mainstream corporate and consumer lending activity.

There are a wide variety of CPM transaction forms through which banks achieve the same essential function of transferring credit risk to investors, with the market having matured to allow for the broadest range of banks to access the broadest range of investors. Choosing the optimal form of CPM transaction turns on a number of factors, including:

- regulatory restrictions limiting the availability of credit insurance in some jurisdictions;
- under some jurisdiction's capital rules, unfunded credit default swaps and financial guarantees are only recognized as risk mitigants if they are provided by certain types of eligible counterparties;
- some protection sellers are constrained in their ability to act as lenders or parties to derivative contracts, while others are constrained in their ability to purchase securities;
- tax and regulatory restrictions prevent banks in some jurisdictions from issuing credit-linked notes directly, and so must issue synthetic ABS as an alternative;

[2] IACPM's response to the 2011 proposed rule is available here: https://www.sec.gov/comments/s7-38-11/s73811-18.pdf.

[3] As corporate debt securities, credit-linked notes do not constitute asset-backed securities as defined in the Proposed Rule.

- conversely, some jurisdictions regulate bankruptcy-remote special purpose issuers ("**SPV Issuers**") to an extent that precludes their use in CPM transactions;

- some investors want to buy synthetic ABS rather than directly-issued liabilities of a bank so as to avoid assuming incremental credit exposure to the bank, as the principal would be held by an SPV Issuer; and

- the liabilities of an SPV Issuer may be capable of achieving a higher rating than a credit-linked note or credit-linked loan issued by the bank directly.

Each form of CPM transaction exists for a reason, and blocking access by banks to any single form of CPM transaction could materially impair their ability to access essential markets for portfolio risk mitigation, and thereby reduce lending by banks to borrowers in the real economy.

IACPM is concerned that, as drafted, the Proposed Rule will effectively shut down the ability of banks to engage in synthetic ABS CPM transactions in the United States.

Impact of the Proposed Rule on CPM Transactions

The Proposed Rule affects synthetic ABS CPM transactions in three primary ways:

Prong (iii) of the definition of "conflicted transaction" is incompatible with full-service banking and fails to recognize the importance of information barriers

- Prong (iii) of the definition of "conflicted transaction" is so broadly drafted that it would capture any transaction executed anywhere within a bank's group of affiliates and subsidiaries that takes a position that would benefit from the actual, anticipated or potential adverse performance of the asset pool supporting or referenced by the synthetic ABS.

  Without recognition of the information barriers in place with a bank, that is an impossible standard for all but the smallest of banks to satisfy. At any time, contrary positions may be taken by personnel within the bank or an affiliate who, because of the effective information barriers under which banking groups already operate to comply with existing securities rules and other regulatory and risk management obligations, are deliberately unaware of the existence of not only of the synthetic ABS but even of the exposure that the bank is hedging by issuing the synthetic ABS. For example, within an affiliated swap dealer, traders may be taking contrary positions on assets within the reference portfolio underlying the synthetic ABS, or may be shorting an index that is closely correlated to assets in the reference portfolio.

  Prong (iii) also includes transactions in which a sponsor of a synthetic ABS might benefit from "a loss of principal, monetary default or an early amortization event" on the synthetic ABS. This situation could arise in a number of foreseeable and innocent circumstances relating to a CPM transaction. For example, the sponsor of a synthetic ABS transaction referencing a severely delinquent commercial real estate loan might agree, after a long work-out period, to accept a deed in lieu of the property underlying the loan, thereby triggering a credit event and a loss of principal. That is exactly what the synthetic ABS is intended to achieve, but it would nonetheless apparently constitute a conflicted transaction.

The breadth of prong (iii) and the lack of recognition of information barriers, therefore, make CPM transactions in the form of synthetic ABS functionally untenable and would prevent all but the smallest of banks from engaging in synthetic ABS transactions.

The Risk Mitigating Hedging Activities Exception is too narrow to facilitate effective CPM activities

- While the Proposed Rule includes an exception intended to facilitate risk-mitigating hedging activities, the exception is unnecessarily narrow and does not address the real conditions under which synthetic ABS is issued.

  In particular, the risk mitigating hedging exception excludes "activities of a securitization participant … in connection with and related to individual or aggregated positions, contracts or other holdings of the securitization participant arising out of its securitization activities…." Strictly limiting a financial institution's risk-mitigating hedging activities to those that "[arise] out of its securitization activities" would place an unnecessary constraint on such institution's ability to effectively hedge and manage risk, particularly in the context of CPM transactions that are designed to address portfolio credit and other risks not related to such institution's securitization exposures.

  Additionally, the broad definition of "conflicted transaction" as described above means such hedging activity may be prohibited to the extent it has an incidental negative effect on the market value of an ABS or synthetic ABS in which the financial institution may have acted as securitization participant. For example, a bank may be prevented from entering into a CPM transaction (including issuing an ordinary ABS for funding purposes or engaging in a whole-loan sale) simply because such transaction constitutes a "conflicted transaction" in relation to another synthetic ABS sponsored or originated by the same bank. Restricting a bank's ability to effectively hedge its risks in such a manner could not have been intended by Section 27B of the Securities Act.

  Additionally, the risk-mitigating hedging activities exception is only available to the extent the hedging activity complies with certain specified conditions set out in the Proposed Rule, including that such activity is subject to "ongoing recalibration … to ensure that the hedging activity satisfies the requirements" set out in Section (b)(1) of the Proposed Rule and "does not facilitate or create an opportunity to benefit from a conflicted transaction other than through risk-reduction."

  This condition flows from the same premise above that a financial institution's risk-mitigating hedging activities should be narrowly tailored to the risks *arising out* of its securitization activities, and implies that an institution should be reducing its hedges as its securitization exposures decline or mature. That simply does not accurately reflect the way credit portfolio managers manage risk in the context of CPM transactions, which can be used to hedge risks wholly unrelated to the institution's securitization exposures.

  The SEC acknowledges in the Proposed Rule that the conditions for relying on the risk-mitigating hedging activities exception are modeled off the equivalent exception in the Volcker Rule restrictions on proprietary trading.[4] The conditions in the Volcker Rule exception are arguably justifiable on the basis that a covered banking entity may be incentivized to use the exception as a cover to engage in risky proprietary trading activities. However, we see no reason why the same condition should be applied to prohibit CPM transactions, which rarely are directly calibrated to the risks of specific securitization activities.

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[4] *See* Proposed Rule at 9703; *see also* 17 C.F.R. 255(b)(1)(ii)(D)(3) (Requiring ongoing recalibration of the hedging activity by a banking entity to ensure that the hedging activity satisfies the applicable requirements and is not prohibited proprietary trading).

As drafted, the scope of the risk mitigating hedging exception is significantly too narrow to allow banks to engage in the ordinary range of CPM transactions they have engaged in to date. This risk is obliquely recognized in the Economic Analysis section of the Proposed Rule at Section III.D.2 which notes that "[d]espite the inclusion of the risk mitigating hedging activities exception, restrictions under the re-proposed rule could limit risk mitigation and revenue enhancing investment options available to affected securitization participants. For example, by restricting the type and extent of hedging allowed to those activities excepted from the re-proposed rule, securitization participants may not be able to actively hedge portfolio exposure." This significantly understates the risk, however, by focusing on the possibility that securitization participants may lose revenue generating opportunities or increase their fees to compensate. That is not the true cost of the Proposed Rule: if banks are unable to engage in effective hedging their portfolio, they may simply reduce the activity that gives rise to the risk by reducing lending activities altogether and thereby constraining access to credit or other financial transactions with corporate or consumer borrowers.

The term "securitization participant" is drafted so broadly as to include investors themselves and other parties engaged in providing services essential to the availability of CPM markets

- Finally, the definition of "securitization participant" is too broad and could capture investors and providers of essential transactions related to CPM activities. For example, CPM transactions are often conducted on an intermediated basis: a financial institution will sell credit protection in one transaction and then sell all or part of the credit risk in a simultaneous transaction to third parties. That intermediation often does not fall within the scope of bona fide market-making: the intermediary is not simply distributing synthetic ABS acquired from the original protection buyer. To the extent that either the initial transaction in which the intermediary acquires the credit risk from the originator or, more commonly, the onward sale of the credit risk takes the form of a synthetic ABS, the intermediary would be engaged in a conflicted transaction.

  In the context of CPM transactions, the definition of "securitization participant" is so broad that if could include the very investors that the Proposed Rule is intended to protect. CPM transactions generally attract highly sophisticated investors who specialize in the evaluation and underwriting of CPM transactions to ensure that they assume only the targeted risks that they intend to cover. The investors are frequently integral participants in the structuring of the CPM transaction and directly underwrite and approve the selection of underlying assets in the reference portfolio. Under the current drafting of the Proposed Rule, that activity of "direct[ing] or caus[ing] the direction of the structure, design or assembly of the [synthetic ABS] or the composition of the pool of assets underlying the [synthetic ABS]" would make the investor a sponsor of the very transaction in which they are investing in. That would prevent the investor from, for example, itself obtaining credit protection on its investment or using the synthetic ABS as collateral in a financing transaction.

  Conversely, even where the investor is not so involved as to be a sponsor, many CPM transactions involve the provision of financing to investors to induce them to acquire the risk transfer instrument. That financing is often provided by the banks that underwrite or arrange the CPM transaction. In the context of synthetic ABS, the underwriter or arranger would therefore be a securitization participant. It is a relatively common feature of such financing transactions that the investor is required to cover an adverse change in the market value of the synthetic ABS by posting margin, and if it does not, the financing party may foreclose on the synthetic ABS at a very low valuation. Notwithstanding that it would likely be executed at the request of the investor, with full understanding of the risks that it presented, that financing transaction would be a conflicted transaction under the Proposed Rule as drafted.

<u>Request for Amendment</u>

IACPM believes that, in the context of CPM transactions, all of these issues can be simply addressed, in a manner that is wholly consistent with the text of Section 27B of the Securities Act, by amending paragraph (b)(1)(ii) of the Proposed Rule by adding after the word "if" and before the colon the words "(x) the activity relates to an asset-backed security, or any asset or assets supporting or referenced by an asset-backed security, issued under an established and documented risk mitigation program established by the original sponsor of such asset-backed security, or (y)".

This language is intended to widen the scope of the risk-mitigating hedging exception to cover all activity relating to a bank's CPM transactions, including activity undertaken by an investor to facilitate its investment. It is consistent with the statutory exclusion of risk-mitigating hedging transactions, and it is not susceptible to abuse because the assets underlying the CPM transaction remain on the bank's books and are subject to comprehensive regulation and supervision by the bank's examiners. The language is also intentionally wide enough to allow sponsors and investors on the opposite side of a bank's CPM transactions to accommodate any changes to the way in which CPM transactions are structured and executed as the U.S. capital rules are amended over the coming years.

We appreciate the opportunity to share our comments on the Proposed Rule. While we support the Commission's ongoing effort to enhance market integrity, we believe the application of the Proposed Rule to banks' CPM and risk management transactions will have negative consequences on both market efficiencies and credit availability to the detriment of market participants and mainstream borrowers in the real economy. If you have any questions or would like additional information, please contact the undersigned.

Yours sincerely,

Som-lok Leung
Executive Director
International Association of Credit Portfolio Managers

<u>Attachments</u>

- IACPM White paper – Risk mitigation tools
- IACPM Annual Synthetic Securitization Survey 2021

International Association of Credit Portfolio Managers

IACPM overview of

Risk mitigation techniques in credit portfolio management

Risk sharing with credit investors is an integral part of portfolios' sustainable growth strategies

January 2022

IACPM

Introduction

Today credit market conditions, as well as prudential and sustainability regulations, are reshaping the financial services industry. In all industry sectors, the discipline of **credit portfolio management** is expanding coverage across all asset classes, and evolving to assist:

- The "**front-end**" function of credit origination into the portfolio, in policies related to risk appetite and concentration limits framework, in risk and risk/return assessment and pricing, in loan documentation, and in promotion of sustainable finance,
- The "**back-end**" function of loan portfolio management, aiming at facilitating lending growth by creating more lending capacity, mitigating concentrations and reducing capital requirements, using risk transfer solutions like loan sales, private credit insurance, credit default swaps, funded and unfunded securitisations.

The IACPM recognizes the unique and evolving role of credit portfolio managers in today's financial environment and in the transition towards a more sustainable and resilient economy. With its members active in banking, investment and insurance, the Association seeks to foster sound practices in the active management of credit exposures originated by banks and is recognized as a trusted advisor by global regulators.

The purpose of this paper is to provide an overview of the various risk mitigation and risk sharing techniques used in the "back-end" function of loan portfolio management through the whole credit cycle, describe their purpose and impact, as well as inform about IACPM initiatives to support and advance the effective and prudent usage of these tools by loan portfolio managers.

Overview of the risk mitigation techniques

Rationale

When executing risk mitigating transactions, credit portfolio managers aim to:

- **Mitigate portfolio risk**, by reducing exposure to large jump-to-defaults events or to systemic concentrations per asset class, per sector or per geography, and/or
- **Support lending growth**, by releasing capital to increase capital velocity, or reducing exposure to release limits at individual customer level.

To effect these goals, portfolio managers engage in a number of considerations related to 'front-end' risk mitigation (ie, compliance with risk appetite and concentration limits, assessment of risk adjusted return, etc) and can also consider the use of risk mitigation tools ('back-end').

Key risk mitigation tools include:

- **Loan sales**
- **Financial guarantees** and **loan-by-loan private credit risk insurance (PCRI)**, to release limits and capital on mostly illiquid borrowers
- **Single name credit derivatives (CDS)** to release limits and capital on liquid borrowers
- **Synthetic securitisations with first and/or mezzanine risk mitigation (SRT)**, to release capital on portfolios of loans

Risk mitigation tools are essential to prudent risk management and to increase lending capacity. Along the whole credit cycle, Credit Portfolio Managers will select the appropriate solution depending on their objective of risk mitigation, but also on financial, accounting, regulatory and market considerations (*).

IACPM, and its membership, have a crucial role in assuring that these tools are effective in risk mitigation so that capital flows appropriately between the full range of participants in credit markets, as these tools support real economy lending.

(*) See IACPM Principles and Practices at: http://iacpm.org/research/principles-and-practices-in-cpm/

Overview of risk mitigation techniques

Level of risk transfer

To achieve these goals, risk can be transferred at different levels:

- At **single position** level, i.e. per loan, or per legal borrower
  - By reducing exposure at borrower level, a firm releases credit limits and the capital absorbed by the transferred exposure.
- At **portfolio level**, the portfolio being sliced either vertically or horizontally (via securitisations)
  - Vertical slicing releases genuine credit default risk at position level, similar to single loan or single name credit protection,
  - Horizontal slicing ("securitisation") releases the portfolio risk and the capital attached to tranches of the distribution of losses.

Instruments used for risk transfer

Whatever the level of risk transfer as described above, the instruments used for risk transfer are:

- either **funded** ("true sale"), via loan sales or syndication, or loan sales to a true sale/cash securitisation vehicle,
- or **unfunded**, via financial guarantees, credit derivatives or private credit risk insurance (PCRI), transferring risk to sellers of credit protection. Such a risk transfer can be structured with prior horizontal slicing by synthetic securitisation, and this synthetic securitisation can be funded by credit linked notes, using eventually a separate securitisation vehicle.

The combination of level of risk transfers and instruments used is summarized in the table below.

<table>
<tr><th rowspan="3">Instruments</th><th colspan="5">Level of risk transfer</th></tr>
<tr><th rowspan="2">Single loan</th><th rowspan="2">Single Borrower</th><th colspan="3">Portfolio of loans, sliced</th></tr>
<tr><th>Vertically</th><th colspan="2">Horizontally ("securitisations")</th></tr>
<tr><td>True sale</td><td>Loan sales, syndication</td><td></td><td>Loan sales</td><td>Loan sales</td><td>Cash securitisation</td></tr>
<tr><td rowspan="3">Unfunded credit protection</td><td>Private credit risk insurance</td><td rowspan="3">Credit derivative</td><td>Private credit risk insurance</td><td>Private credit risk insurance</td><td rowspan="3">Synthetic securitisation (funded or not)</td></tr>
<tr><td rowspan="2">Financial guarantee</td><td>Financial guarantee</td><td>Financial guarantee</td></tr>
<tr><td>Credit derivative</td><td>Credit derivative</td></tr>
</table>

Impact of the risk transfer: risk mitigation and risk transformation

Depending on transaction structure, risk mitigation can reduce

- either exposure at single name level, or
- cumulative expected losses ("first loss"), which are increasing with the intensity of default and severity risks in the underlying loans (PD, LGD), or
- uncertainty of losses, i.e. capital absorbed ("mezzanine"), which is increasing with
  - the exposure to jump-to-default events, in non-granular assets pools, and/or
  - the stress correlation between the loans of the pool, which can be inflated when correlation exist also between the credit standing of the borrowers and the value of collateral assets (e.g., residential and commercial mortgages).

Below is a summary of the credit risk mitigation objectives that can be achieved or cannot be achieved by transferring different levels of risk:

Increasing lending capacity by reducing…			Exposure to a borrower	Provisions for loan losses	Stressed losses/capital
Single loan level					
Single borrower level					
Portfolio level	Vertical slicing				
	Horizontal slicing	First loss			
		Mezzanine			
		Senior			

Can be achieved   Cannot be achieved

However, depending on the instrument used for credit risk mitigation, the risk transformation introduces new financial and non-financial risks, which can be complex to estimate and mitigate, like

- counterparty risk for unfunded risk protection
- flow-back risk in the retained senior tranche, generally called model risk
- mismatches in default and recovery in credit derivatives that do not reference the exact same borrower and loan
- mismatches in accounting between the underlying assets and the risk mitigating instruments

New risks			True sale	PCRI	Financial guarantee	Credit derivative
Single loan level				Counterparty (CP) risk		Counterparty risk; Mismatches or basis risk (PD, LGD, accounting)
Single borrower level						
Portfolio level	Vertical slicing					
	Horizontal slicing	First loss	Model risk	Model risk Counterparty risk		
		Mezzanine				
		Senior				

This transformation of risk must be understood and managed by credit portfolio managers, and is one of the main shared concerns not only of financial institutions but also of regulators, who are adding layers of conservatism by buffers in capital, transparency requirements, processes of significant risk transfer assessment, etc.

IACPM initiatives to support and advance effective usage of risk mitigation techniques

For the most widely used and for emerging techniques of risk mitigation, the IACPM is providing support to its members in the form of ongoing and ad-hoc working groups, data collection / targeted research and advocacy vis-à-vis the main regulatory bodies across the world.

In particular, in this specific domain of Credit Portfolio Management, the Association prioritizes its research and advocacy efforts on the documentation, risk assessment, regulatory treatment and transparency of critical tools which are the foundations of the above transformation in banks' credit portfolio management, i.e,

- Private credit risk insurance (PCRI),
- Credit default swaps (CDS),
- Synthetic securitisations with first and/or mezzanine risk mitigation (SRT).

Data collection / Research

Annual Synthetic Securitisation Volume & Performance survey (banks only)
Collecting transaction-level data on volumes, structuring features, pricing, investor profiles and underlying portfolio performance on public and private synthetic securitisations executed by member firms

Biennial IACPM/ITFA survey on Private Credit Insurance (banks only)
Collecting data on volumes, protected assets, pricing and claims on non-payment insurance transactions executed by banks and eligible as financial guarantees

Annual SRT survey (credit insurers only)
Collecting data on volumes, underlying assets and protected tranches of synthetic securitisations executed by credit insurers

Biennial Principles and Practices survey (all members)
Updating on developments in the credit portfolio management function, including usage of risk mitigation tools

Ad-hoc surveys
Performed to better understand practices in specific domains (e.g. Reporting and transparency practices)

Working groups

Monthly Regulatory Update Call
Covers global regulatory developments

Securitisation Working Group
Focuses on synthetic on balance-sheet securitizations, including significant risk transfer assessment, frameworks for Simple, Transparent and Standard and for green/sustainable securitizations, treatment in the various prudential capital regulations, disclosure requirements, etc

Credit Insurance Working Group
Engages with regulators for a fair treatment of non-payment insurance as credit risk mitigant

Accounting and Market Working Groups
Meet as needed on issues related to IFRS 9/ CECL (accounting) and market developments such as NoR CDS (Market) and machine learning for loan sale documentation

Climate Risk Focus Group
Meets quarterly to discuss evolving risk assessments, metrics and portfolio approaches

Effectiveness of regulatory capital release – IACPM advocacy priorities

The current credit and market environment continues to evolve rapidly amid the stresses of the credit crisis and the requirements to support growth while balancing risk and return. Credit portfolio managers are being called upon to assess and mitigate the new risks emerging from the pandemic, as well as contribute to design the transition path of their credit portfolio to deliver the sustainability objectives of their firms.

Accordingly, there are a number of transformative considerations for the financial industry looking forward that will require public – private partnership to assess and mitigate risks and establish or adjust the appropriate risk management and regulatory frameworks. Among these challenges, which have an effect on capital allocation priorities, are:

- Improvement of profitability, requiring allocation of capital not only to balance-sheet growth, but also to digital investments
- Increase of market-based funding of the economy, notably by long-term institutional investors like pension funds
- Growing role of insurers in supporting economic growth, both on the assets (investments) side and the liability (credit insurance) side of their balance-sheet
- Transition to sustainable finance, and growing investors demand for investments that promote climate transition

Therefore, the IACPM wants to promote the best practices that assure the effective and prudent use of risk transfer techniques in lending books, and their alignment with the related treatment in prudential regulations.

Appendix

For 2022, IACPM advocacy priorities can be summarized as follows for each of the instruments:

	Research	Advocacy
PCRI	• Biennial PCRI Survey with ITFA	• Recognition of the super senior level of insurance protections • Standardisation of PCRI insurance policies • Impact of Basel III finalisation
CDS		• IFRS accounting of CDS hedges (completed) • Eligibility of CDS without restructuring clause • Impact of Basel III finalisation
SRT	• Yearly survey with banks on synthetic securitisation • Yearly survey with credit insurers on SRT transactions • Ad-hoc survey on ESMA reporting adequacy	• Participating to or incentivising for comprehensive review of securitisation regulations • Simplification of the significant risk assessment process • Reduction of the non-neutrality effect for on synthetic B/S transactions • Impact of Basel III finalisation • Simplification of the disclosure templates for private securitisations • (EU) Eligibility of credit insurers as providers of credit protection in STS transactions • Framework for sustainable securitisation supporting the ESG transition

IACPM

Further Information

To discuss this report or for more information on the IACPM, please contact:

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About the IACPM

The Association represents its members before regulators around the world, holds bi-annual 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.

There are more than 125 financial institutions worldwide that are members of the IACPM. These institutions are based in 26 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.

Today credit market conditions, and new regulations, are shaping the financial services industry. The discipline of credit portfolio management is evolving within firms to include the measurement and management of credit risk at the enterprise level, in addition to execution of risk mitigation strategies in credit markets.

CPM has increasing linkages with: front-end credit originators; the setting of risk appetite and limit structures; funding and liquidity for the firm; and management of counterparty risk. CPM is also expanding coverage of credit assets beyond investment grade and leveraged to include middle market and retail, as well as in some cases bonds and other credit-sensitive instruments.

The IACPM recognizes the unique and evolving role of credit portfolio managers in today's financial environment, and offers an excellent forum through which these issues can be identified, understood and addressed.

Synthetic Securitization Market Volume

May 2022 – Select Survey Results

www.iacpm.org

What we Did

- As in prior years, this survey provides the IACPM community with the information needed to monitor the market of synthetic on balance-sheet securitizations. The collected data covers all public and private transactions, funded or unfunded, regardless of the instrument used for synthetic risk transfer, as long as these transactions are executed for banks' own balance-sheet management.
- With the support of the IACPM securitization working group, we utilized the feedback received after last year's collection - provided by regulators as well as the IACPM community - to update the data collection and to provide even greater aggregate transparency to survey participants and to support regulatory discussions.
- The European Banking Authority (EBA) continues to utilize the collected data to inform ongoing regulatory work on synthetic securitizations, to monitor the effectiveness of this regulatory framework, and to simplify where appropriate.
- The aggregate data included in this deck represents new production from 24 banks, 2016 through 2021.
- The data was collected per year and per trade based on inception date, with a yearly total of the new production.

Main messages – Markets dynamics and market players

Volumes	▪ Since 2016, the 24 contributing banks issued **302** synthetic securitisations, mitigating risk on **€553 bn of assets**, by protecting **€44bn** of First Loss and Mezzanine tranches with average attachment and detachment points at 0.0% and 8.0% respectively.
Dynamics	▪ For the large banks which participated in the survey, volumes of synthetic securitization issuance in 2021 returned close to the pre-pandemic level. ▪ Smaller local banks, mostly not captured in this survey, also started using CRT in 2021. ▪ Due to amortization, trades are mostly effective for risk/capital release in the first three years, after which the underlying pools drop by almost 50% compared to inception.
Originating Banks	▪ While dominating 5 years ago, the share of EU loans continues to drop in the underlying assets.
Securitized Assets	▪ Corporate loans, represent almost two-third of the assets, with SMEs at 17% and a growing share of income-producing real estate (IPRE) lending, mortgages, auto loans, trade and asset-based finance.
Investors	▪ **Investment funds** are dominant sellers of credit protection with just a slight dip in 2020 at the height of the COVID crisis. **Pension funds** (investors in first loss tranches) and **credit insurers** (investors in mezzanine tranches) have gained some ground over the past three years. ▪ Despite depletion in the tranches distributed in 2020, and the after-COVID context, credit investors – mostly private – continued in 2021 to have an appetite in first loss tranches, with **average attachment point of 0.0% and average coupons paid at their lowest levels since 2016** (8.4%).

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Main messages – Structuring features

Protected Tranches and Risk Transfer Instruments	▪ Senior tranches continue to represent +/-85% of the underlying nominal, but synthetic securitization is not used for long term funding as senior tranches are retained in 99% of the deals. ▪ The share of deals issued without SPV increases year after year and represents now some 50% of the reported trades and 74% of the nominal of protected tranches. ▪ Financial guarantee (unfunded, collateralized or embedded in CLNs) is the main instrument used for risk transfer to SPVs (73% of the 48% protected tranche volume transferred to SPVs). ▪ First Loss tranches attach on average at 0% and detach at 6.3%. The main instrument used for First Loss risk transfer is credit linked note with financial guarantee. ▪ Mezzanine tranches attach on average at 2.2% and detach at 8%. Collateralized and unfunded financial guarantees are the most popular, with an increasing share of credit risk insurance. ▪ The share of unfunded mezzanine tranches is increasing but is not (yet) the most important.
Sustainability	▪ At this point, less than 3% of all trades are sustainability linked. For those deals that are sustainable linked, most are linked through underlying assets.

Synthetic Securitization Market Volume 2022

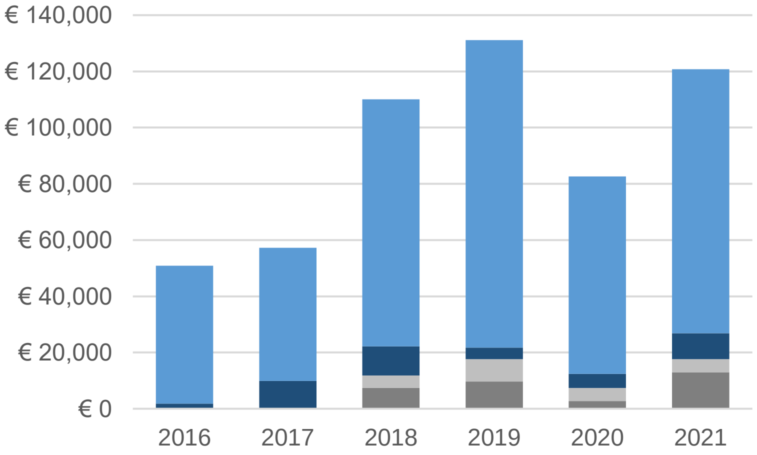
BALANCE SHEET SYNTHETIC SECURITIZATIONS

Submissions from 24 Banks are included

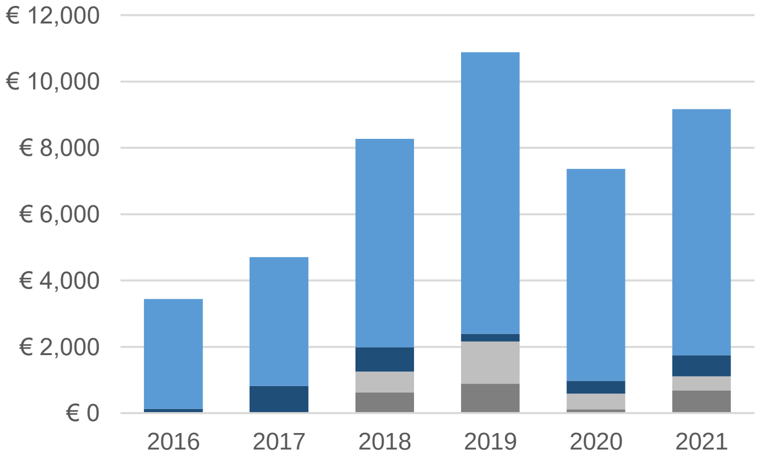
Synthetic Securitization Volume (in mln Euro)

Over 80% of synthetic securitizations support commercial lending to SMEs and mid-Corps. By risk sharing with investors/insurers, synthetic securitizations sourced in the last six years more than €35 bn of capital for new lending to this asset class.

Underlying Pool Size at Inception In mln Euro, By Underlying Asset Class



Protected Tranches at Inception In mln Euro, By Underlying Asset Class



Business/ Real Economy Finance (1) | Asset Based Finance (2) | Retail Finance (3) | Other

(1) Corporate, SMEs, Trade Finance, Mixed | (2) Project Finance, Commercial Mortgages, Income-producing Real Estate (IPRE) Lending | (3) Residential Mortgage Loans, All Other Retail Exposures

Source: IACPM 2022 Synthetic Securitization Market Volume Survey

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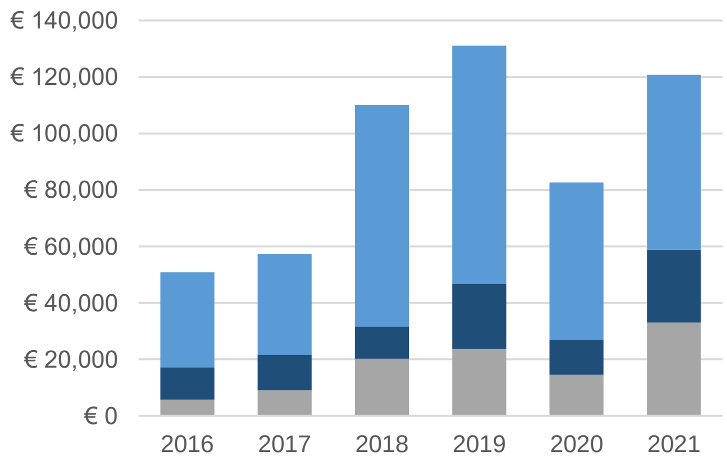
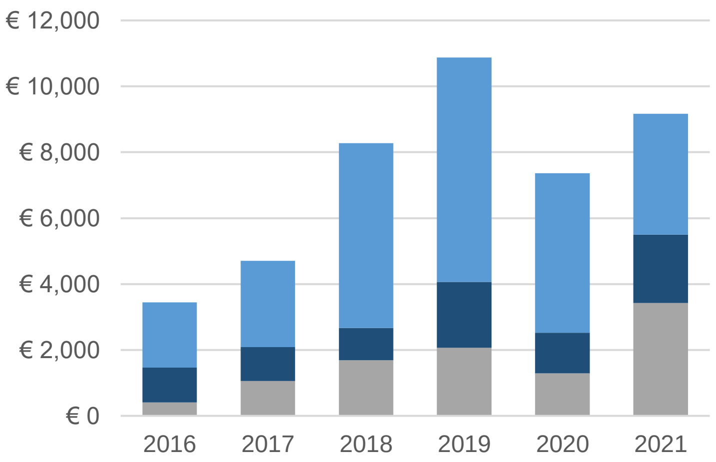
Synthetic Securitization Volume (in mln Euro)

While dominated by European banks in the past with over 80% of the assets, the market is now opening to banks domiciled in the US and in other regions.

Underlying Pool Size at Inception In mln Euro, By Issuer Region



Protected Tranches at Inception In mln Euro, By Issuer Region



Source: IACPM 2022 Synthetic Securitization Market Volume Survey

(1) Other regions include Switzerland, United States, Canada, and Asia.

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Synthetic Securitization Trade Flow: Underlying Pool
Grand Total

Year of New Production	# of Trades	RWA approach underlying loans			STS (2) qualification		Underlying pool size (notional) Sum (in mln Euro)		Underlying Pool Size at Inception By Region (in mln Euro)					Protected Tranches (in mln Euro)		% Placed with public trades (3)
		# of Trades			# of Trades											
		Advanced IRB	Foundation IRB	Standardized	*Yes*	*No*	at inception	at reporting date	*Multi Region*	*European Union (EU) excl. UK*	*UK*	*North America*	*Other Regions (1)*	*At Inception*	*At Reporting Date*	*Weighted Average %*
2016	27	23	2	1	0	25	€ 50,841	€ 5,741	€ 13,125	Not enough data				€ 3,445	€ 1,287	0.0%
2017	39	30	6	1	1	34	€ 57,270	€ 13,449	€ 16,000	€ 20,585	€ 5,495	Not enough data		€ 4,702	€ 1,754	0.0%
2018	53	46	4	3	1	51	€ 110,114	€ 56,574	€ 54,762	€ 31,725	€ 1,879	€ 7,598	€ 14,149	€ 8,275	€ 5,523	2.8%
2019	68	53	7	7	0	65	€ 131,103	€ 99,505	€ 50,565	€ 40,305	€ 13,921	€ 8,312	€ 18,001	€ 10,881	€ 8,855	0.9%
2020	50	44	2	4	4	43	€ 82,638	€ 66,314	€ 28,321	€ 29,459	€ 3,758	Not enough data		€ 7,366	€ 6,271	0.0%
2021	65	53	3	9	11	51	€ 120,754	€ 114,528	€ 54,851	€ 21,152	€ 7,643	€ 13,547	€ 23,559	€ 9,169	€ 9,169	1.5%
2016 - 2021	**302**	**249**	**24**	**25**	**17**	**269**	**€ 552,720**	**€ 356,112**	**€ 217,625**	**€ 163,996**	**€ 41,428**	**€ 42,990**	**€ 86,682**	**€ 43,838**	**€ 32,858**	**1.1%**
	100%	**82.5%**	**7.9%**	**8.3%**	**6%**	**94%**	**100%**	**64%**	**39.4%**	**29.7%**	**7.5%**	**7.8%**	**15.7%**	**7.9%**	**9.2%**	

% of Underlying Pool Size

Source: IACPM 2022 Synthetic Securitization Market Volume Survey

(1) Western Europe outside the EU, Central & Eastern Europe, South/Latin America, Asia, Multi-country (same region), Unknown
(2) EU designation. Prior to April 2021, trades qualified as STS under prior Article 270 regime.
(3)) "Public trades" is referring to tranches that are distributed and quoted on public markets, i.e., non private transactions.

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Synthetic Securitization Market Volume 2022

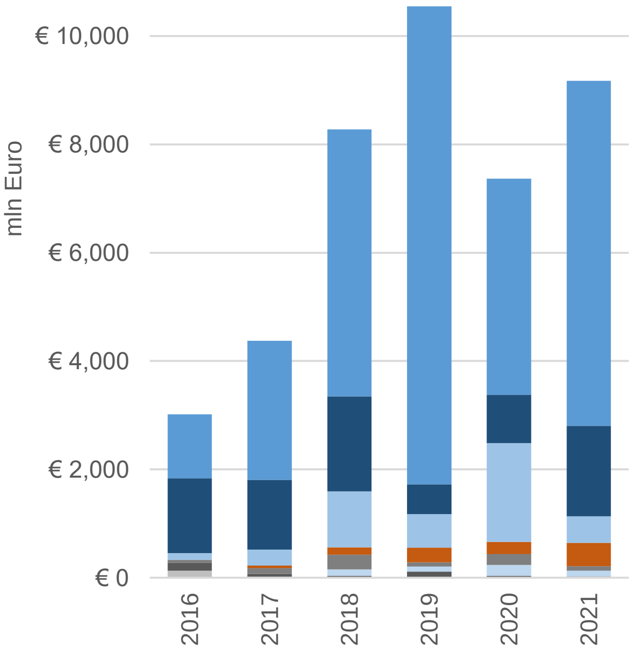
INVESTOR BASE

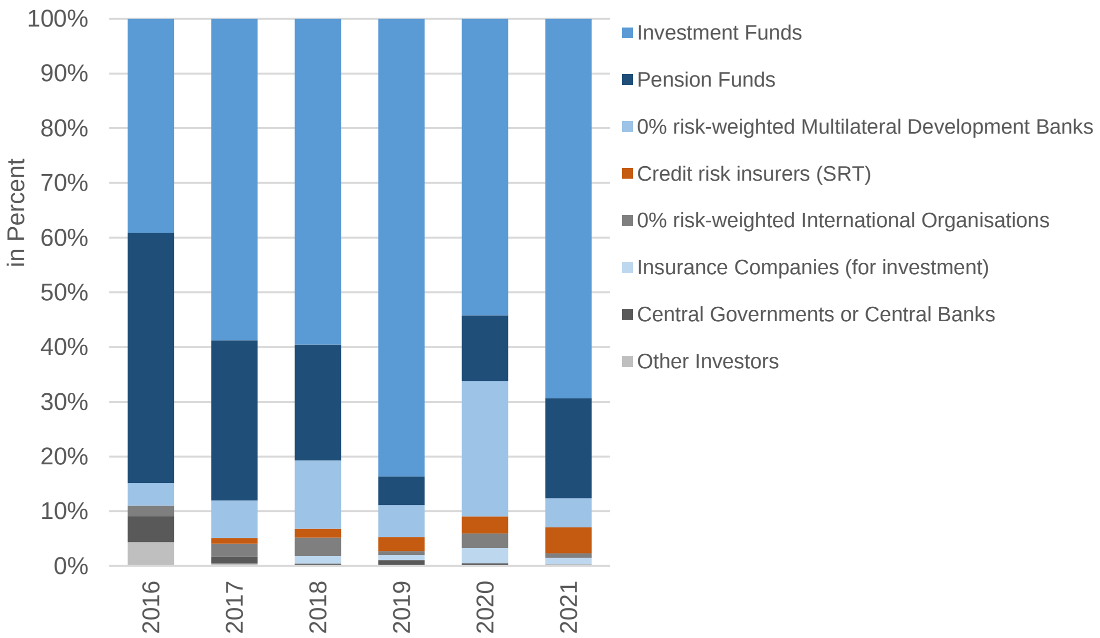
Submissions from 24 Banks are included

Synthetic Securitization Trade Flow:

Protected Tranche Volume at Inception, By Investor Type over Time

Investment funds, dominant sellers of credit protection up to 2019, are now losing some market share at the benefit of pension funds (investors in junior tranches) and credit insurers (investors in mezzanine tranches).





Source: IACPM 2022 Synthetic Securitization Market Volume Survey

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