

## NOTE FROM IACPM'S EXECUTIVE DIRECTOR

Dear Members,

So far, 2012 has been a year of many challenges for Credit Portfolio Management due to the spate of new regulations and the difficult market environment. The IACPM has been making its voice heard on a number of proposed regulatory and accounting changes, and we are pleased to report that we have had success on issues such as liberalizing requirements for fair value treatment of loans hedged by CDS.

Because of the steadily expanding range of important issues with which we are dealing on behalf of our members, we decided that it is important to provide you with a regular overview of our activities. This Regulatory and Accounting News overview is the first of periodic updates we will publish on the key topics the Association is addressing. We hope you will find them helpful and informative. We welcome your comments and suggestions.

Regards,



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**FOLLOWING IS A BRIEF SUMMARY OF THE KEY ISSUES WE HAVE BEEN ADDRESSING RECENTLY:****Hedge Accounting (IFRS 9)**

**ISSUE** Credit portfolio managers have long had to confront the accounting mismatch between CDS hedges (usually mark-to-market) and loans in the banking book (usually accrual). Ability to get hedge treatment for CDS hedging loans under the accounting standards is difficult; the other approach--the election of fair value for loans hedged with CDS--has also proven hard due to accounting requirements of: fair value election at time of origination only; no proportional or partial election for a loan facility; and inability to move the loan back to the banking book if the hedge is no longer needed.

**STATUS:**  
**Successful**  
**Resolution**  
**for CPM**

The IASB began its review of these issues several years ago and, in December 2010, provided an exposure draft of IFRS 9 – accounting for hedging activities.

**IACPM ACTIONS** IACPM's Accounting Committee immediately identified issues with the proposal which remained very restrictive on hedge accounting and fair value requirements. In response to the proposal, IACPM and Accounting Committee members opened a dialogue with the IASB who were very receptive to gaining a further understanding of the issues facing credit portfolio managers using CDS to hedge loans. IACPM provided a number of [comment letters](#) to the IASB on these issues. The IASB indicated that they were not prepared to change hedge accounting requirements in any material way but would work to make fair value election requirements more reflective of business realities for CPM.

In September 2012, IASB released the final draft of the General Hedge Accounting Requirements which will be added to IFRS 9 Financial Instruments. It incorporates the bulk of the changes that IACPM had been seeking and provides for: 1) election of fair value at times other than origination; 2) proportional or partial election of fair value; and 3) taking a loan out of fair value if the hedge is terminated. Losses on the mark must be taken at the time of election. The draft will remain on the [IASB website](#) until December 2012 (no comments being sought), after which the IASB will move to finalize the document in 2013.

## Basel III and Liquidity Coverage Ratio (LCR) Definitions

**ISSUE** IACPM’s Regulatory Committee discussed the parameters of the Basel Liquidity Coverage Ratio and noted that some are ambiguous and leave room for differing interpretations, especially in regard to treatment of commercial paper backup and other liquidity facilities.

**STATUS:** Ongoing

**IACPM ACTIONS** IACPM conducted a member survey on Basel III Liquidity Facility LCR Definitions, asking how firms are approaching key parameters of the ratio such as the definition of “liquidity facility”, “financial institution”, as well as other documentation issues related to the designation of liquidity facilities. Survey responses showed a range of interpretations regarding the definitions and documentation approaches. At the request of IACPM’s Regulatory Committee--and given the lack of clarity of some of the definitions as evidenced by the range of responses from the survey--IACPM is currently discussing these issues and selected survey results with Basel regulators.

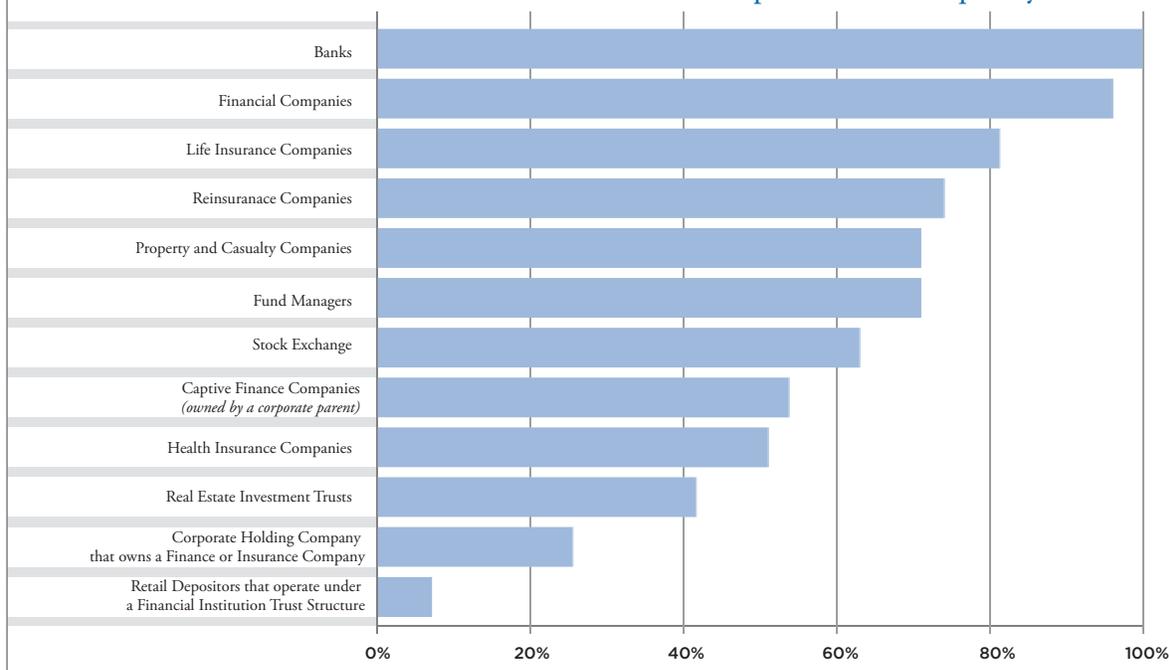
### How banks determine what constitutes a “liquidity facility” for the purposes of Basel III.

*Multiple selections possible.*

**% OF TOTAL RESPONDENTS**

If the credit agreement language on facility purpose says for general corporate purposes “including commercial paper backup”, we must consider the facility to be a liquidity facility.	37 %
If the credit agreement language on facility purpose says for general corporate purposes, but does not say “including commercial paper backup”, we will not consider the facility to be a liquidity facility.	37 %
We review to see if the borrower has a CP program in place to determine “liquidity facility” status.	19 %
Does not apply. We do not have any CP backup facilities.	30 %
Other	22 %

### Borrowers Considered “Financial Institutions for the Purpose of Basel Liquidity



## BCBS RWA Benchmarking

**ISSUE** To assess RWA measurements in practice and the consistency of capital standards across the globe, BCBS commenced work on an RWA benchmarking effort (Hypothetical Portfolio Exercise (HPE)) with a number of banks late in 2011. The BCBS planned to identify a portfolio of real and hypothetical loans in an array of industries and sectors for the global benchmarking. Following discussions with BCBS staff, IACPM members indicated that the planned RWA benchmarking was similar in scope to IACPM's recently completed Economic Capital Benchmarking Project.

**STATUS:**  
Moderate  
Success

**IACPM ACTIONS** IACPM believed it would be useful to promote a dialogue with BCBS on these issues and contacted BCBS SIG Banking Book subgroup leads, Mark Levonian of the US Office of the Comptroller of the Currency and Nai Seng Wong of the Monetary Authority of Singapore. We provided information about our experience on the Economic Capital Project and "lessons learned" in the data collection and analysis process for use as they constructed the RWA survey and identified the portfolio to be analyzed. IACPM Regulatory Committee members participated in a phone call with BSBC SIG Banking Book subgroup members and provided insights on important parameters and format for the survey. The BCBS RWA benchmarking is currently being completed by members and, while some of our comments were incorporated in the final template, there were still some issues with the data and format requirements as members prepared their submissions.

IACPM and Regulatory Committee members believe it was valuable to open the dialogue with the BSBS staff members on these issues and we will continue to monitor the project to see if any aspects will be made publicly available when it is complete.

## Conflicts of Interest in Securitizations

**ISSUE** The U.S. Securities and Exchange Commission (SEC) proposed Rule 127B to implement the prohibition on material conflicts of interest in connection with securitizations under Section 621 of the Dodd-Frank Act. The rule is intended to address transactions such as Abacus where the issuer established the vehicle to take a risk view that was not known to the investors. Although this is a proposed U.S. regulation, it would, if enacted, have a global effect in that any synthetic structure with U.S. investors would potentially be covered. In addition, regulations in one jurisdiction may ultimately be harmonized globally as with the risk retention rules initially established in Europe.

**STATUS:**  
Awaiting  
resolution/  
ruling from  
SEC

**IACPM ACTIONS** IACPM's Regulatory Committee cited two major concerns with the rule as proposed: 1) Banks would be prohibited from hedging balance sheet risk on non-retail assets through synthetic securitizations if the bank is the underwriter sponsor of the securitization vehicle; and 2) The inference that hedging transactions, and actions undertaken by banks in connection with the servicing of commercial loans that reference assets for synthetic securitizations, create conflicts with synthetic asset-backed securities investors and would therefore be prohibited.

IACPM has submitted a [comment letter to the SEC](#) in February 2012. Our letter was supported by several letters from investors who also support these synthetic balance sheet transactions ([BlueCrest](#); [Orchard Global Asset Management](#); [PGGM](#)). The IACPM met with the SEC and had multiple follow-up conversations with SEC staff. In response to their requests, IACPM has provided additional comment letters ([June 28, 2012](#) / [September 7, 2012](#)) further defining: 1) the nature of the transactions implemented by CPM units as part of prudent risk management practices; and 2) on the estimated size of the market based on a survey of Synthetic Securitization Volume IACPM conducted among our members.

SEC staff have expressed support and are providing materials to the SEC Commissioners for their decision. The timing for the decision on this issue is not clear, but will likely be in 2013.

## Capital requirements for bank exposures to central counterparties (CCPs)

**ISSUE** The Basel Committee released in July the interim rules for the [capitalization of bank exposures to central counterparties](#). The rules provide for trade exposures with eligible CCPs to apply a 2% risk weight plus add-on capital for default fund contributions. The July release is silent on ability to use the 2% risk weight for banking book exposures hedged in accordance with Basel II IRB rules. We believe this is an oversight, but as a result, the release is ambiguous on whether IRB exposures hedged with eligible CCPs may be assigned the 2% risk weight, or must still meet the Basel II Section 481 requirement that, in all cases, both the borrower and all recognised guarantors must be assigned a borrower rating at the outset and on an ongoing basis using PD substitution or double default.

**STATUS:**  
**Awaiting**  
**response/**  
**decision**  
**from BCBS**

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

## LINKS TO ADDITIONAL INFORMATION

### Hedge Accounting (IFRS 9)

Final Draft of the IASB General Hedge Accounting Requirements <http://bit.ly/QlauCb>

IACPM Advocacy Promotes Changes Favorable to Credit Portfolio Managers <http://bit.ly/ZxrFav>

### Conflicts of Interest in Securitizations

IACPM Comment Letter, February 2012 <http://1.usa.gov/UyVhVC>

#### *Letters of Support:*

BlueCrest <http://1.usa.gov/SR6OKQ>

Orchard Global Asset Management <http://1.usa.gov/PQauyZ>

PGGM <http://1.usa.gov/ZxsbFp>

#### *Additional IACPM Comment Letters:*

June 28, 2012 <http://1.usa.gov/TwrLMc>

September 7, 2012 <http://1.usa.gov/UDDsPQ>

### Capital requirements for bank exposures to central counterparties (CCPs)

Basel Committee rules for capitalization of bank exposures to CCPs <http://bit.ly/Q1Z1rp>

IACPM Comment Letter <http://bit.ly/ZxsUq9>

## 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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