IACPM

March 21, 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 Fraud, Manipulation, or Deception in Connection with Security-Based Swaps; Prohibition Against Undue Influence over Chief Compliance Officers; Position Reporting of Large Security-Based Swap Positions (File No. S7-32-10)

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 security-based swap ("**SBS**") position reporting requirements set forth in proposed Rule 10B-1 under the Securities Exchange Act of 1934 (the "**Exchange Act**") and proposed Schedule 10B, as reflected in the above-captioned proposed rulemaking (the "**Proposed Rule 10B-1**") and on the anti-fraud provisions set out in proposed Rule 9j-1 under the Exchange Act (the "**Proposed Rule 9j-1**", together with Proposed Rule 10B-1, the "**Proposed Rules**").[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 the membership of several other financial industry associations. Our perspective is different, however, in that the IACPM represents the teams within those institutions who have responsibility for the prudential management of credit portfolios, including actively controlling concentrations, adding diversification, managing the return of the portfolio relative to the risk, and applying capital to new lending. In addition, our members also include investors, insurers, and reinsurers, which participate in credit risk transfer transactions as buyers of credit assets or credit protection sellers.

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[1] SEC Release No. 34-93784 (December 15, 2021), 87 Fed. Reg. 6652 (February 4, 2022).

IACPM strongly supports efforts to enhance transparency in the spirit of improving competition and decreasing fraud, manipulation, and deception in the market. We understand those are the principles underlying the Proposed Rules. However, we believe further consideration of the Proposed Rules is necessary to more appropriately tailor the requirements and allow the Commission to achieve its goals while avoiding unintended adverse consequences on mainstream banking business in both the United States and internationally.

Effective credit portfolio management is critically important to the banking system. Banks' ability to lend to corporate and retail borrowers depends on their ability to transfer the risks associated with their banking books efficiently and promptly. Prudential supervisors and policy makers scrutinize regulated financial institutions' ability to lend and mitigate risk through the lens of systemic risk to the financial system and to the economy as a whole. At all times, the ability and willingness of banks to provide financing to corporate borrowers is an extremely important avenue for those borrowers to secure capital. Banks' ability and willingness to extend credit depends on the ability to mitigate risk on their exposure through a variety of instruments, including by means of executing SBS transactions.

As described below, **the IACPM would like to draw the SEC's attention to two negative consequences of the broad application of the Proposed Rules to CPM risk-mitigating transactions**:

- On the lending side, the negative impact of such disclosure on banks' mainstream lending activity thereby, impairing the flow of credit to the real economy.

- On the market side, the potential confusion or misuse of the hedging data by market participants, who could misinterpret the disclosure as short positions taken by banks, rather than hedging long positions from their lending book.

<u>Background</u>

Credit portfolio management ("**CPM**") risk mitigating transactions are an essential tool for banks' prudential risk and capital management. CPM transactions are widely used by banks to transfer risk efficiently and cost-effectively to ensure that they can continuously accept new credit exposure to their clients while maintaining compliance with their risk appetite and capital requirements. As such, this is a highly regulated activity. The capital rules, whether under Regulation Q or other local law implementation of the Basel rules, are both extremely detailed and granular, and also scrutinized in detail by the banks' examiners and auditors on a real-time basis.

CPM transactions can take a number of forms in addition to SBS, including insurance, financial guarantees and credit-linked notes. SBS transactions executed for CPM purposes can also range from simple single-name credit default swaps to bespoke transactions involving managed portfolios of diverse reference obligations drawn from across a bank's network. In all cases, banks as protection buyers and investors as protection sellers must comply—often on a cross-border basis—with derivative, insurance and securities laws, the Volcker Rule, and prudential capital requirements.

Further, by definition, CPM transactions hedge positions that are held in a bank's banking book and reflect exposures associated with the operation of its banking business, including, in particular, mainstream lending activity. CPM transactions are not executed for speculative purposes. There is, therefore, neither any investor protection benefit nor any market protection benefit to be obtained from application of Proposed Rule 10B-1 to CPM transactions.

Discussion and Requests

In that context, Proposed Rule 10B-1 presents material risks to banks' risk mitigation activities, and therefore, their capacity to engage in mainstream lending, in the following ways:

- There are **confidentiality concerns** surrounding the information required to be disclosed under Proposed Rule 10B-1. Many credit risk management transactions involve portfolios of loans to borrowers throughout the bank's branch network. Some jurisdictions impose extensive restrictions on banks from disclosing information about their clients and their client relationships. Additionally, credit agreements and other client documentation often explicitly restrict a bank's ability to disclose information about the client or details relating to any transactions or loans without the client's prior written consent, even where disclosure is mandatory or associated with hedging activity. There are also non-contractual constraints to consider, given that much of the wholesale loan market is not public and, therefore, borrowers expect creditors not to disclose. For instance, at the more bespoke end of the lending market are borrowers that are, for example, family farms, sole proprietorships or small businesses, which have a general expectation that their lending activities remain private, and which have no expectation of being named in public documentation or the public domain. Banks subject to such mandatory disclosure will therefore find themselves in breach of law or contract with their clients, or unable to hedge exposures where either the jurisdiction or the loan agreement prohibit the bank from disclosing its lending position, or where, while not constrained by law or contract, the bank is unwilling to disclose over concerns for client relationships where clients expect the bank to treat such information as confidential.

- Proposed Rule 10B-1 risks either **increasing the costs, or decreasing the appetite, of risk mitigation** by hedging through credit default swaps. Banks that are party to large loans or other credit exposure routinely hedge those transactions in the SBS market. If the exposure is large, the bank may phase the execution of its hedge transactions over a number of days to diversify its investor base and counterparty risk, and to optimize pricing and liquidity. If the bank were required to publicly disclose its hedges in real time, there is a risk that this information would alert market participants to the bank's hedging activity, incorrectly indicate that the bank is taking short positions, and therefore affect the bank's lending portfolio risk mitigation strategy. This could lead to market participants taking positions that increase the bank's cost of hedging or create greater concentration on the bank's balance sheets through the inability to economically hedge, undermining prudent management and inherent risk stability of the bank. As the pricing effect becomes known, it will likely be passed to borrowers, thereby raising costs to main street businesses.

- There are substantial **operational issues and costs** associated with implementation of systems and compliance programs required under Proposed Rule 10B-1 particularly for CPM desks of firms that do not have dealer desks. Proposed Rule 10B-1 requires reports to be made within 1 business day of a position exceeding one of the relevant thresholds.[2] In addition, a reporting party must take into account positions of all of its group's trading entities.[3] In the context of CPM transactions, it may be difficult to compile all of the required information within that timeframe both on the basis of the number of reference obligations, but also because the transaction may involve hedges where the borrower is not the same entity as a CDS reference entity, or the transaction is undertaken on a group-hedging basis. Compliance with these requirements will require the capability of a real-time system, which tracks all SBS positions across several entities, and which contains all of the information required to be provided on Form 10B, or which can be found and compiled within the

[2] Proposed Rule 240.10B-1(a).

[3] Proposed Rule 240.10B-1(a)(1).

1 business day timeframe. This information includes related securities and derivatives (also on a group-wide basis). Meeting these requirements would likely require a substantial operational build for market participants. While banks already have sophisticated IT systems that track their CPM transactions and exposure, in many cases on a group-wide basis, integration of the disclosure requirements under Proposed Rule 10B-1 would require a significant amount of additional investment and potentially require verification of matters to which the banking entity that engages in CPM transactions may not have access, because of the disclosure regulations to which its branches and/or affiliates are subject. The expected costs of implementation and ongoing compliance that the Commission provides in the Proposed Rules release[4] are far lower than those actually expected by market participants. Banks expect the costs for initial adaptation to exceed multiple millions of dollars with ongoing costs in the hundreds of thousands, per year.

- By failing to **differentiate between market-making activities and *bona fide* risk mitigation hedging** transactions undertaken by originating banks as principals against their banking book exposures, Proposed Rule 10B-1 would discriminate against non-market-making banks, which engage in SBS activity for the purpose of hedging commercial risks associated with their lending business. Where market-making banks' disclosures under Proposed Rule 10B-1 would not necessarily permit market participants to distinguish between the bank's market making and banking book hedging activity, in the case of a non-market-making bank, it would be clearer that the activity is associated with loan hedging. That in turn would mean that the bank's loan book would be much more readily transparent to other banks and market participants, which could materially affect the bank's ability to compete in its core businesses.

With respect to Proposed Rule 9j-1, IACPM members note that their transactions have been subject to material non-public information ("**MNPI**") and information barrier requirements for many years, and that they already expend considerable resources on compliance policies and procedures to address those requirements. In addition, given the broad drafting of Proposed Rule 9j-1, we have concerns that a bank's routine business decisions, such as the decision of whether to refinance a distressed name could give rise to allegations of fraud and manipulation, where such decision impacts a bank's business unrelated to trading SBS and that is separated from such business by existing information barriers. Any action to act regarding a distressed name would be subject to an onerous determination process to ensure it does not trigger such allegations. Proposed Rule 9j-1 would entail further significant costs and challenges to reconcile the scope of the new regulation with existing practices, without conferring corresponding benefits to market safety or regulatory efficiency.

In light of the above, IACPM urges the Commission to take the following actions:

- Exclude a market participant's SBS transactions executed in connection with its CPM banking book activity from the reporting obligations of Proposed Rule 10B-1.

- Clarify that Proposed Rule 9j-1 does not prevent lenders from exercising their rights and remedies to modify, forebear and waive provisions under credit agreements where it holds an SBS position on the same reference entity or from engaging in risk mitigation activities with respect to reference obligations under CPM transactions.

We appreciate the opportunity to share our comments on the Proposed Rules. While we support the Commission's ongoing effort to combat fraudulent activity and decrease incentives to engage in manufactured or other opportunistic SBS strategies, we believe the application of the Proposed Rules to banks' CPM and risk management transactions will have **negative consequences on both market**

[4] SEC Release No. 34-93784 (December 15, 2021), 87 Fed. Reg. 6652, 6688-6690 (February 4, 2022).

effectiveness and lending growth to the detriment of both 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