



June 20, 2018

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William Coen
Secretary General
Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002
Basel, Switzerland

Re: Consultative Document: *Revisions to the minimum capital requirements for market risk* (March 2018)

Dear Mr. Coen:

World Council of Credit Unions (World Council) appreciates the opportunity to comment on the Basel Committee on Banking Supervision's consultative document *Revisions to the minimum capital requirements for market risk*.¹ Credit unions are cooperative depository institutions and World Council is the leading trade association and development organization for the international credit union movement. Worldwide, there are over 68,000 credit unions in 109 countries with USD 1.8 trillion in total assets serving 235 million physical person members.²

World Council Supports Most Aspects of the Committee's Proposed "Simplified Alternative" for Market Risk Reserves

World Council supports most aspects of the Committee's proposal to establish a "Simplified Alternative" to Basel III's standardised approach to market risk capital requirements, which would apply to less complex banking institutions. As proposed, the Simplified Approach would be a recalibrated version of the Basel II standardised approach with the addition of "scaling factor" multipliers.

World Council strongly supports the Committee's proposal not to include asset-size or trading-book-size limitations that would restrict an institution's eligibility to use the Simplified Alternative. We urge the Committee to finalize this aspect of the proposal as proposed, although we request clarification regarding the Committee's definition of "correlation trading positions" that institutions using the Simplified Alternative would be prohibited from holding.

We question, however, the need to add "scaling factor" multipliers to the Basel II market-risk reserve framework since we are not aware of any community-based

¹ Basel Committee on Banking Supervision, *Revisions to the minimum capital requirements for market risk* – Consultative Document (March 2018), available at <https://www.bis.org/bcbs/publ/d436.htm>.

² World Council of Credit Unions, *2016 Statistical Report* (2017), available at <http://www.woccu.org/publications/statreport>.



cooperative depository institution failures resulting primarily from insufficient market risk reserves under the Basel II standardised approach.

i. *Scaling Factors Should Be Limited to Help Moderate Regulatory Compliance Costs on Non-Complex, Community-Based Financial Cooperatives*

We support most aspects of the Committee’s proposal on the Simplified Alternative, but we are concerned that the increased capital costs associated with adding scaling factors to the Basel II rules may negate the regulatory burden reduction benefits of the Simplified Approach.

We are not aware of any community-based cooperative depository institution failures resulting primarily from insufficient market risk reserves under the Basel II framework. We believe that the existing Basel II standardised approach market risk reserves are sufficient with respect to credit unions and other community-based mutual depository institutions.

To the extent that the Committee believes that the addition of scaling factors is necessary to achieve safe and sound regulation of Simplified Approach institutions, we believe that a maximum scaling factor of 1.25—i.e. a market-risk reserve increase of 25 percent compared to Basel II market risk reserves—would be sufficiently conservative with respect to reserves for interest rate risk, foreign exchange risk, and commodities risk.

Credit unions and other community-based mutual depository institutions typically operate using a non-complex community-banking model and are often subject to investment portfolio-shaping rules that limit their investments primarily to loans to their members, government-guaranteed debt, and deposits held by banks or other credit unions. Community-based financial cooperatives also rarely operate on a cross-border basis.

Community-based financial institutions do not generally engage in significant trading activities except in the limited case of providing wealth management services to their members, although some community-based mutual depository institutions utilize non-complex derivatives such as interest-rate swaps and caps (to hedge against interest rate risk related to fixed-rate mortgages or bonds held in their portfolios) and also sometimes invest in asset-backed securities such as mortgage-backed securities. In the relatively rare case of a financial cooperative providing wealth management services to its members, the physical-person member—not the cooperative depository institution—is the party exposed to those assets’ market risks.

We urge the Committee not to include scaling factor multipliers in the final version of the “Simplified Alternative.” We believe that existing Basel II market risk reserves



have proven to be safe and sound vis-à-vis credit unions and other community-based mutual depository institutions.

If, however, scaling factors are indeed necessary to achieve safe and sound regulation of community-based financial institutions, we urge the Committee to limit the scaling factors for interest rate risk, foreign exchange risk, and commodities risk to no more than 1.25, which would be a 25 percent increase in these market risk reserve categories compared to Basel II.

A greater increase in community-based financial cooperatives' market risk reserves—which in our view have been sufficiently safe and sound under the Basel II standardised approach without any scaling factors—may impose increased capital costs that would negate the regulatory burden reduction benefits of the Simplified Approach.

ii. Clarification of the Committee's "Correlation Trading Positions" Definition

As proposed, banking institutions would in general need to meet at least three criteria to be eligible to use the Simplified Alternative, subject to supervisory discretion:³

- “The bank should not be a [Global Systemically Important Bank (G-SIB)].
- “The bank should not use the internal models approach for any of its trading desks.
- “The bank should not hold any correlation trading positions.”

World Council strongly supports the first two criteria and urges the Committee to finalize these aspects of the Simplified Alternative as proposed.

We believe that an institution's eligibility to employ the Simplified Alternative should be based on the institution's complexity, rather than asset-size or trading-book-size limitations. We strongly support the Committee's proposal to focus on the institution's complexity rather than arbitrary asset-size or trading-book-size limits.

We request clarification, however, regarding the Committee's definition of “correlation trading positions.”

We note that “correlation trading position” is typically defined as including “collateralized debt obligation (CDO) index tranches, bespoke CDO tranches, and nth-to-default credit derivatives.”⁴ World Council believes that it would be

³ Basel Committee on Banking Supervision, *Revisions to the minimum capital requirements for market risk* – Consultative Document, at 39.

⁴ Risk-Based Capital Guidelines: Market Risk, 77 Fed. Reg. 53060, 53066 (Aug. 30, 2012), available at <https://www.gpo.gov/fdsys/pkg/FR-2012-08-30/pdf/2012-16759.pdf>; see also, e.g., “correlation trading



reasonable from a safety and soundness standpoint to prohibit institutions holding these specific types of investments from using the Simplified Alternative. We support that aspect the Committee's proposal if the above-quoted definition of "correlation trading positions" is consistent with the Committee's intended definition of that term.

We request clarification regarding the "correlation trading position" definition, however, because some relatively simple and conservative derivatives products—such as interest rate swaps and caps or foreign exchange or commodities derivatives used for bona fide hedging purposes—could be viewed by some users of the standard as positions that "correlate" to an index such as an interest rate index. We also do not believe that the Committee intends to prohibit Simplified Approach institutions from investing in single-level asset-backed securities such as mortgage-backed securities (as opposed to some types of CDO tranches) even though these bonds are tied to the performance of an underlying pool of assets.

We urge the Committee to finalize the eligibility criteria for an institution to utilize the Simplified Alternative as proposed, albeit with a clarification regarding the Committee's definition of "correlation trading position" (such as in a footnote) to reduce compliance burdens and potential confusion for users of this standard.

World Council appreciates the opportunity to comment on the Basel Committee's consultative document *Revisions to the minimum capital requirements for market risk*. If you have questions about our comments, please feel free to contact me at medwards@woccu.org or +1-202-508-6755.

Sincerely,

Michael S. Edwards
VP and General Counsel
World Council of Credit Unions