World Council

January 16, 2019

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

Re: Consultative Document: *Leverage ratio treatment of client cleared derivatives* (October 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 *Leverage ratio treatment of client cleared derivatives*.[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 89,000 credit unions in 117 countries with USD 2.1 trillion in total assets serving 260 million physical person members.[2]

Question 2: To what extent would the two potential revisions discussed in this consultative document adequately meet the G20 Leaders' policy objectives of strengthening the resilience of the banking system by preventing excessive leverage and promoting central clearing of standardised derivative contracts?

World Council believes that the Committee's two proposed revisions to the leverage ratio are fully consistent with the G20 Leaders' policy objectives of strengthening the resilience of the banking system by preventing excessive leverage and promoting central clearing of standardised derivatives contracts. We believe that the G20 Leaders' objective of promoting central clearing of standardised derivatives contracts cannot be achieved without reform to the leverage ratio treatment of these exposures.

We urge the Committee to finalize the proposed Option 3 revision to the leverage ratio in order to help preserve community-based financial institutions' access to interest-rate derivatives in order to hedge interest rate risk. Under Option 3, the

[1] Basel Committee on Banking Supervision, *Leverage ratio treatment of client cleared derivatives* – 9Consultative Document (Oct. 2018), *available at* https://www.bis.org/bcbs/publ/d451.htm.
[2] World Council, *Statistical Report* (2017), *available at* https://www.woccu.org/impact/global_reach/statreport.

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standardised approach to counterparty credit risk (SA-CCR) would be used for banks' leverage ratio capital requirements with respect to client cleared derivatives.

We are concerned that smaller users of interest rate swaps and caps may in the future no longer be able to access interest rate derivatives at fair rates (or at all) unless revisions such as the proposed Option 3 are made to the leverage ratio's treatment of client cleared derivatives.

Credit unions and other community-based depository institutions that use interest rate derivatives typically have relatively small hedged positions that are usually less than EUR 1 billion and which are usually structured to hedge against interest rate risk (with positions that are typically "all one way").

Continued access for credit unions and other community based-depository institutions to fair and affordable interest rate swaps and caps promotes safety and soundness by helping community-based institutions hedge interest rate risks related to fixed-rate mortgage loans held in portfolio and similar fixed-rate investments.

In central clearing, risk is often mitigated through robust initial margin levels. It is therefore a sound approach that is consistent with the G20 Leaders' policy objectives to consider both cash and non-cash margin pursuant to SA-CCR when determining banks' leverage ratio requirements with respect to client clearing activities, as well as allow variation margin received from a client to offset the replacement cost and potential future exposure amounts of client cleared derivatives, as Option 3 would do.

While we do remain concerned that SA-CCR may itself have capital requirements for banks involved in client clearing of derivatives that are too high for credit unions and other community-based financial institutions to be able to maintain access to interest rate derivatives at fair rates, both Option 2 and Option 3 appear to be improvements compared to the status quo.

Option 3, however, appears to be the best of the proposed alternatives in our view because it takes into account variation margin received from a client to offset the replacement cost and potential future exposure amounts of client cleared derivatives.

We do not, however, believe that segregation requirements should be necessary for a bank to utilize the revised treatment.

We urge the Committee to finalize the proposed Option 3 revision to the leverage ratio in order to help preserve community-based financial institutions' access to interest-rate derivatives to hedge against interest rate risk.

Question 3: What are the potential forward-looking behavioural dynamics of the client clearing industry that could occur as a result of possible changes to the leverage ratio treatment of client cleared derivatives?

World Council urges the Committee to reduce Basel III's capital requirements for client cleared interest-rate swaps and caps to help better ensure continued access to interest rate derivatives for smaller uses, such as credit unions and other community-based depository institutions. We believe that the Committee finalizing its proposed Option 3 revision to the leverage ratio will help credit unions and other community-based depository institutions maintain access to interest rate swaps and caps at fair rates.

Reducing leverage ratio-related capital requirements—especially for banks that are derivatives clearers or issuers—would help ensure that community-based depository institutions continue to have access to interest rate swaps and caps at affordable rates. Without changes to the leverage ratio, we are concerned that many banks that are interest rate derivative clearers and issuers may drop clients that have portfolios below several billion Euro because of the leverage ratio's high cost of capital.

We urge the Committee to finalize its proposed Option 3 to reduce the leverage ratio's capital requirements for client cleared derivatives in order to help better ensure continued access to interest rate derivatives for smaller clients such as credit unions and other community-based depository institutions.

World Council appreciates the opportunity to comment on the Basel Committee's consultative document *Leverage ratio treatment of client cleared derivatives*. If you have questions about our comments, please feel free to contact me at medwards@woccu.org or +1-202-843-0702.

Sincerely,

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