World Council of Credit Unions

July 15, 2016

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

Re: Consultative Document: *Prudential Treatment of problems assets – definitions of non-performing exposures and forbearance* (April 2016)

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 *Prudential Treatment of problems assets – definitions of non-performing exposures and forbearance*.[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 57,000 credit unions in 105 countries with USD 1.8 trillion in total assets serving 217 million natural person members.[2]

1. Uniform Definition for "Non-Performing Exposures"

World Council supports the Committee's proposal to set a uniform definition of "non-performing exposures" that applies to all institutions subject to the Basel III framework. As proposed, "non-performing exposures" would be defined as any loan that is more than 90 days past due (DPD) whether the institution is subject to the standardized approach or the Internal Ratings-Based (IRB) approach.

The proposed definition of "non-performing exposures" of 90 DPD is the same period of arrearage as the Basel II definition of "default" applicable to institutions following the standardized approach.[3] In the context of the IFRS 9 *Financial Instruments* standard, we view the 90 DPD threshold as an appropriate period of arrearage after which institutions should in general transfer an impaired asset from Bucket/Stage 2 (i.e. having experienced a significant increase in credit risk, a rebuttable presumption of which occurs when a loan is 30 DPD) to Bucket/Stage 3 (i.e. significant credit impairment, at which point an institution must analyze a loan and its collateral individually), unless circumstances indicate that an earlier reclassification is appropriate.

[1] Basel Committee on Banking Supervision, *Prudential Treatment of problems assets – definitions of non-performing exposures and forbearance* – Consultative Document (2016), *available at* http://www.bis.org/bcbs/publ/d365.pdf.
[2] World Council of Credit Unions, *2014 Statistical Report* (2015), *available at* http://www.woccu.org/publications/statreport.
[3] *See* Basel Committee on Banking Supervision, *International Convergence of Capital Measurement and Capital Standards* ¶¶ 75, 452 (2006), *available at* http://www.bis.org/publ/bcbs128.pdf.

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2. The Committee Should Redefine "Default" to Eliminate the Less Stringent Treatment Currently Accorded to IRB Institutions

We also urge the Committee to revise its definition of "default" to eliminate the more lenient treatment extended under that definition to large banks following the IRB approach. Currently, the world's largest banks are allowed to treat a retail or public sector exposure as non-defaulted until it is 180 DPD, whereas institutions subject to the standardized approach must treat an exposure as defaulted when it is only 90 DPD. The Committee should create a single definition of "default" applicable both to institutions subject to the IRB approach as well as to institutions subject to the standardized approach.

There is no reasonable policy reason to allow large banks to treat an exposure as non-defaulted for up to three months longer—or twice as long in terms of the number of days that the loan is in arrears—than a standardized approach institution's defaulted exposures. To the contrary: According less stringent default treatment to too-big-to-fail banks is inconsistent with the Committee's principle of proportionality and also allows institutions with implicit state backing to delay regulatory interventions, such as prompt corrective action measures, that permits institutional credit problems to fester and grow worse. In many situations, allowing large banks to delay recognition of loan losses in this manner will ultimately result in these banks causing greater losses to taxpayers than would otherwise occur.

3. Retail Exposures Should Be Analyzed on a Transaction by Transaction Basis

World Council strongly supports the Committee's proposed statement in paragraph 27 that "in case of retail exposures as defined in the Basel II standard, exposures can be recognised as non-performing on a transaction by transaction basis" (as opposed to all loans to one borrower being treated as non-performing when only one of that borrower's loans is in arrears). We urge the Committee to finalize this sentence as proposed.

Credit unions lend primarily to consumers, who are also the credit union's owners. In many cases consumers choose to pay most of their loans even if they decide to cease making payments on others. For example, a consumer who relies on his or her automobile to go to work will typically pay their auto loan even when they are unable to pay other loans, since losing their vehicle could result in loss of employment.

Similarly, some consumers choose to pay their mortgages before other loans, since the consumer lives in the home secured by the mortgage. In other cases, some consumers choose to pay their credit cards first—even though these loans are typically unsecured—because they rely on these revolving credit products for working capital and to make purchases online or with vendors, such as hotels, that require credit cards for surety purposes.

Which loans a consumer chooses to pay first can vary, but even consumers who have overextended their use of credit typically have income sufficient to pay the loans that are the most important to their lives or livelihoods. The Committee's proposed approach of treating consumer loans "on a transaction by transaction basis" should be finalized as proposed.

4. Criteria for Exit from the Forborne Exposures Category

World Council believes that a loan that has been subject to forbearance measures, such as a workout or a troubled debt restructuring (TDR), should be able to exit the forborne exposures category in a shorter period of time than the 1 year proposed in paragraph 41 of the consultative document.

The purpose of forbearance measures is typically to realign a borrower's credit costs with his or her means. Even a few months of on-time payments for a restructured loan should be indicative of improved credit quality since the lending institution has effectively given the borrower a fresh start that takes into account the borrower's ability to repay, typically after the borrower has suffered from reduced means such as a job loss.

We believe that the Committee should treat these forborne exposures as performing after on-time payments have been made for at least 90 days. This would align the Committee's definition of "non-performing" loans with its timeframe for loans exiting the forborne exposures category.

World Council appreciates the opportunity to comment on the Basel Committee's consultative document on the *Prudential Treatment of problems assets – definitions of non-performing exposures and forbearance*. 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