



October 5, 2017

Filed electronically

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

Re: Consultative Document – *Capital treatment for simple, transparent and comparable short-term securitisations*

Dear Mr. Coen:

World Council of Credit Unions (World Council) appreciates the opportunity to comment on the Basel Committee on Banking Supervision's (Committee) Consultative Document *Capital treatment for simple, transparent and comparable short-term securitisations*.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 60,000 credit unions in 109 countries with USD 1.8 trillion in total assets serving 223 million physical person members.²

World Council supports the Committee's efforts to revise the securitization framework to assist the financial industry in the development of simple, transparent and comparable (STC) term securitization structures for short-term securitizations such as asset-backed commercial paper. We believe that the establishment of STC rules for short-term securitizations will help make asset-backed commercial paper a more stable funding source for issuers and as well as a safer and more attractive investment.

This letter is supplemental to our comment letter³ filed simultaneously on the Basel Committees and the Board of the International Organization of Securities Commission's Consultative Document *Criteria for identifying simple, transparent and comparable short term securitisations*.⁴

Issuance of or investment in asset-backed commercial paper is relatively uncommon for credit unions and other community-based financial cooperatives. Some Australian

¹ Basel Committee on Banking Supervision, *Capital treatment for simple, transparent and comparable short-term securitisations* (July 2017), available at <http://www.bis.org/bcbs/publ/d413.htm>.

² World Council of Credit Unions, *2015 Statistical Report* (2016), available at https://www.woccu.org/documents/2015_Statistical_Report_WOCCU.

³ http://www.woccu.org/advocacy/position_papers

⁴ Basel Committee on Banking Supervision & Board of the International Organization of Securities Commissions, *Criteria for identifying simple, transparent and comparable short-term securitisations* (July 2017), available at <http://www.bis.org/bcbs/publ/d414.htm>



mutual banks issue asset-backed commercial paper and, prior to the global financial crisis beginning in 2007, some Canadian credit unions and wholesale credit unions in the United States also issued asset-backed commercial paper. Canadian and US credit unions largely withdrew from issuing these investments, however, as a result of dislocations in the asset-backed commercial paper markets in those jurisdictions beginning in 2007.⁵

Credit unions and similar mutuals in a few jurisdictions—such as state-chartered credit unions in the US states of Florida, Georgia, Iowa and Maine—are allowed to invest in commercial paper subject to minimum credit quality standards and portfolio limitations,⁶ although most credit unions' portfolio shaping rules do not allow credit unions to invest in commercial paper.

Question 3: What are respondents' views regarding the requirement that the support required by Criterion B7 has to be provided by a single entity and the consequences of a subsequent replacement of this entity?

World Council supports the Committee's proposal that the sponsor of the conduit should backstop the conduit to protect investors against losses, but we do not support the proposed Criterion B7 requirement that only a single entity can provide this support. We urge the Committee to revise the final version of Criterion B7 to allow asset-backed commercial paper facilities to be sponsored and backstopped by a consortium of smaller financial institutions.

Credit unions and other community-based financial cooperatives are generally much smaller than internationally active commercial banks and do not enjoy the implicit governmental backstop that the market believes too-big-to-fail Global Systemically Important Banks and Domestic Systemically Important Banks enjoy. We are concerned that a requirement that only a single institution can provide this support would effectively prohibit community-based financial institutions from issuing asset-backed commercial paper because the market will likely perceive a backstop from a

⁵ See, e.g., Brendan O'Neill & Mike Dean, Restructuring of Canada's \$32 Billion Market in Asset-Backed Commercial Paper Completed Through a CCAA Plan of Compromise and Arrangement, *INSOL World* (Q2 2009), available at [http://www.goodmans.ca/files/file/docs/Restructuring%20of%20Canada%27s%20\\$32%20Billion%20Market.pdf](http://www.goodmans.ca/files/file/docs/Restructuring%20of%20Canada%27s%20$32%20Billion%20Market.pdf).

⁶ See Fla. Stat. § 657.04(3)(b), available at http://www.leg.state.fl.us/Statutes/index.cfm?App_mode=Display_Statute&Search_String=&URL=0600-0699/0657/Sections/0657.042.html ("INVESTMENT SUBJECT TO LIMITATION OF TWO PERCENT OF CAPITAL OF THE CREDIT UNION.— . . . Commercial paper and bonds of any corporation within the United States which have a fixed maturity, as provided in subsection (7), except that the total investment in all such paper and bonds may not exceed 10 percent of the capital of the credit union."); Ga. Code Ann. § 7-1-650(4)(E), available at <https://dbf.georgia.gov/georgia-laws-ocga-title-7>; Iowa 533.301(5)(h), available at <https://coolice.legis.iowa.gov/Cool-ICE/default.asp?category=billinfo&service=iowaCode&input=533#533.301>; Me. Rev. Stat. Ann Title 9B, § 862(C), available at <http://legislature.maine.gov/statutes/9-B/title9-Bsec862.html> ("In the case of commercial paper, the commercial paper should be rated in the 2 highest grades.").



non-systemically important institution, with a lower amount of total capital (even if the smaller institution is well-capitalized on a percentage basis) and not having the implied governmental backstop of too-big-to-fail institutions, as inferior to a backstop from a systemically important bank.

We urge the Committee to revise the final version of Criterion B7 to allow asset-backed commercial paper facilities to be sponsored and backstopped by a consortium of smaller financial institutions.

Question 4: What are respondents' views on the options being considered by the Committee for determining STC compliance?

World Council supports the Committee's proposed "dual attestation of compliance" with the proposed STC requirements attested to by both the issuer and the investor of the asset-backed commercial paper, and we do not support the proposed alternative where only the investor would be responsible for determining compliance in this area.

While we agree that investors should conduct some level of due diligence, the issuer will be the entity structuring the issuance and would presumably design the issuance to meet the STC criteria in order to meet market expectations. Including a statement in the issuance's prospectus regarding whether the issuer designed the offering to meet the STC criteria would place little, if any, additional regulatory burdens on the issuer.

Placing responsibility in this area solely on the investor, however, would create significant compliance burdens on smaller institutions seeking to invest in these products.

We also are concerned that making investors solely responsible for determining whether an investment meets the STC criteria would create an incentive for sophisticated issuers to attempt to mislead less sophisticated investors into believing that a product was STC-compliant when it is not. This is especially true if applicable disclosure requirements do not require issuers to provide highly granular data, such as the credit scores of the borrowers of the issuances' underlying loan collateral, to investors. Opacity by issuers regarding the value of underlying asset-backed collateral was a major driver of volatility during the global financial crisis, including in the asset-backed commercial paper market.

Asset-backed products are essentially financial sausages resulting from a bricolage of thousands of different loans. We believe that the sausage maker (i.e. the issuing conduit sponsor) is the entity with the best information about how the sausage was made, such as if it was intended to meet STC criteria. The issuer should be required to share this information with investors in the interest of transparency and financial stability.



World Council supports the Committee’s proposed “dual attestation of compliance” with the proposed STC requirements attested to by both the issuer and the investor of the asset-backed commercial paper.

Question 5: Do respondents have any comments or concerns over the proposed capital treatment?

A) Physical Persons Should be Excluded from the Definition of “Credit-Impaired Borrowers” to Promote Financial Inclusion

World Council urges the Committee to revise its proposed definition of “credit-impaired borrowers” in Criterion A3 to exclude physical persons from this definition in order to promote financial inclusion. As proposed, no loans made to “credit-impaired borrowers” could be transferred to the securitization and “credit-impaired borrowers” is defined to include anyone who:

- i. Has declared bankruptcy within the previous three years;
- ii. Is “recorded on a public registry of persons with an adverse credit history;”
- iii. Has a low credit score from an external credit bureau (which can be indicative of a lack of credit history); or
- iv. Whose loan is subject to a dispute between the borrower and the original lender.

World Council urges the Committee not to apply the first three of these criteria to physical persons. While we agree with the last criterion (i.e. loans that are subject to a dispute should not be transferred), we believe that applying the first three of these criteria to physical persons will have the unintended consequence of excluding many physical persons with little credit history or who have had their debt reduced or eliminated by bankruptcy from access to credit, such as auto loans.

We also believe that the proposed Criterion B7 requirement that issuers provide support to protect investors “against any losses,” if finalized, provides a significant credit enhancement that makes it unnecessary to exclude loans to individuals with low credit scores or who have declared bankruptcy from the collateral pool.

Many physical persons need a car to travel to and from work. Without a car many of these individuals would lose their jobs and be unable to earn a living, as well as be effectively cut-off from access to lenders who use commercial paper to help fund their lending activities, such as many auto lenders.



Excluding physical persons who have declared bankruptcy within the prior three years from access to credit would also not likely improve the credit quality of an asset-backed security. While these individuals would have had credit problems in the past, the bankruptcy process would have significantly reduced or eliminated their previous debt load and therefore would make them better able to afford new credit than they would have been prior to filing bankruptcy.

Further, jurisdictions like the United States often prohibit individuals who have filed for bankruptcy liquidation from refiling for a new bankruptcy liquidation proceeding for a long waiting period such as eight years.⁷ In these jurisdictions, physical persons who have recently filed for bankruptcy counterintuitively have had their creditworthiness enhanced because they cannot file for bankruptcy liquidation again for several years, unlike other borrowers.

Regarding the proposed criterion that the borrower not have “a credit score indicating a significant risk of default,” individuals with little credit history, such as many low-income individuals and younger people, have low credit scores because of a lack of prior credit history instead of a history of credit problems. Excluding these individuals from access to credit would frustrate efforts to help these individuals enter the financial system notwithstanding their lack of adverse credit history.

It is also unnecessary from a credit-risk safety and soundness standpoint to exclude loans made to these physical person borrowers from an asset-backed commercial paper issuance because of the Committee’s proposed Criterion B7 requirement that “the sponsor should provide support covering 100% of the national value of the notes issued by the conduit against any losses.”

If finalized as proposed, the requirement that a depository institution backstop the asset-backed commercial paper facility means that investors will only be exposed to the credit risk of the issuances’ underlying borrowers if the sponsoring institution fails.

We do not believe that it makes sense from a safety and soundness or financial inclusion standpoint to exclude a large percentage of the world’s physical persons from access to credit when the sponsoring institution is providing the conduit with a capital and liquidity backstop because investors would only need recourse to the underlying collateral in the remote event of the sponsoring institution’s failure.

We urge the Committee to revise its proposed criteria on “credit-impaired borrowers” in Criterion A3 not to prohibit loans made to physical persons with low credit scores, who have declared bankruptcy within the past three years, or who have been recorded on a

⁷ See 11 U.S.C. § 727(a)(8), available at <https://www.law.cornell.edu/uscode/text/11/727> (“The court shall grant the debtor a discharge, unless— . . . the debtor has been granted a discharge under this section, under section 1141 of this title, or under section 14, 371, or 476 of the Bankruptcy Act, in a case commenced within 8 years before the date of the filing of the petition . . .”).



public registry as having credit problems from being included in an asset-backed commercial paper collateral pool.

B) Depository Institutions Should be Conduit Sponsors

World Council supports the proposed requirements in Criterion C15 that conduit sponsors should be financial institutions that are licensed to take deposits from the public, and strongly supports the proposal to give national regulators discretion regarding what prudential standards and level of supervision are appropriate for domestic depository institutions such as credit unions and similar financial cooperatives.

Credit unions rarely operate on a cross-border basis and are typically subject to national-level rulebooks that may not be easily comparable to those in other jurisdictions, especially in the European Union (EU) where credit unions in most Member States are exempt from the EU's Capital Requirements Directive.⁸ Credit unions in these and other jurisdictions are subject to stringent investment portfolio shaping rules that often make it unnecessary to apply risk-based capital requirements; further, without national discretion in this area an institution may not have the flexibility to conduct the activities necessary to participate sufficiently in the market.

We urge the Committee to finalize Criterion C15 as proposed.

C) Definition of "Homogeneity"

Criterion A1's additional guidance on the proposed "homogeneity" requirement for STC asset-backed commercial paper states that "the nature of the assets should be that there would be no need to analyse and assess materially different legal and/or credit risk factors and risk profiles when carrying out risk analysis and due diligence checks for the transaction."

We urge the Committee to provide further clarification in this area regarding its expectations for asset homogeneity. For example, if the collateral pool includes auto loans, it is not clear from the proposal whether the pool could include a mix of loans for new autos and used autos, or whether the pool would have to be limited just to loans for new autos only, or for used autos only. Clearer guidance in this area, or an allowance of national discretion to fill in the gaps in the Committee's criteria, would help reduce compliance burden and provide additional certainty to institutions as to when an asset can be considered homogeneous.

⁸ See Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, Article 2(5), 2013 O.J. (L 176) 338, available at http://ec.europa.eu/internal_market/bank/regcapital/legislation-in-force/index_en.htm.



D) Asset Performance History

We urge the Committee to revise its proposed Criterion A2 on asset performance history to reduce the minimum track record period for retail and non-retail exposures to no more than two years. As proposed, the Committee's minimum track record period for an issuer would be at least seven years for non-retail exposures and at least five years for retail exposures. These performance history requirements are likely to prove to be a barrier to market entry for smaller institutions by essentially requiring a seasoned portfolio, and would therefore not be consistent with a regulatory level playing field.

We believe that a track record of two years will provide supervisors and investors with sufficient information regarding the issuer's loan underwriting standards because loans that have been seasoned by at least a year of on-time payments are significantly less likely to result in a default. In other words, material deficiencies in an institution's underwriting standards will manifest themselves in less than two years.

We do not believe that a longer seasoning period would provide meaningful information about the issuer's underwriting; rather, the additional data provided by a five-year or seven-year minimum seasoning period would be prone to volatility resulting from macroeconomic conditions that would not be attributable to the issuer's underwriting standards per se.

We believe that a five-year or seven-year seasoning period is also unnecessary if the Committee finalizes the backstop requirements of proposed Criterion B7 since Criterion B7 would require the issuer to protect investors against any losses. As such, the issuer would be required to "eat its own cooking" and would be the main institution exposed to credit losses resulting from potential problems in its underwriting standards. Supervisory concerns about a particular institution's expertise regarding loan underwriting with a shorter track record than five or seven years are better addressed on a case-by-case basis through the supervisory review process utilizing documents of resolution or similar regulatory contracts.

We urge the Committee to accord flexibility in this area by reducing the minimum track record period for retail and non-retail exposures to no more than two years, especially if the financial institution is otherwise operating in a safe and sound manner.

E) Financial Institution Policies and Procedures

We urge the Committee to clarify proposed Criterion C16's requirement that a financial institution have well-documented procedures and policies and "should be able to document expertise in providing liquidity and credit support" for asset-backed commercial paper conduits. Without clarification, the requirement of "documented expertise" would likely bar new entrants from the STC asset-backed commercial paper



market since new entrants would not be able to document such expertise simply because they were a new entrant. This would have an anti-competitive effect that would only allow market incumbents to offer STC asset-backed commercial paper, which would not be consistent with the principle of a regulatory level playing field.

We also urge the Committee to clarify that these requirements can be met through the use of a third party or independent contractor to help meet the experience requirement.

We urge the Committee to clarify its expectations for providing liquidity and credit support for asset-backed commercial paper facilities so that institutions that do not currently issue asset-backed commercial paper have the option to enter this market.

Regarding policies and procedures, as written this provision would be subject to subjective examiner review and could be revoked arbitrarily upon review by a prudential regulator. We urge the Committee to clarify the minimum standards or criteria by which a financial institution can meet the threshold, or state that national regulators have discretion to define these requirements through a public consultative process.

World Council appreciates the opportunity to comment to the Committee on the Consultative Document *Capital treatment for simple, transparent and comparable short-term securitisations*. If you have questions about our comments, please feel free to contact me at medwards@woccu.org or +1.202.508.6755.

Sincerely,

A handwritten signature in black ink that reads "Michael S. Edwards". The signature is written in a cursive, flowing style.

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