July 6, 2016

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

Re: Consultative Document: *Revisions to the Basel III leverage ratio framework* (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 *Revisions to the Basel III leverage ratio framework*.[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. Revisions to the Treatment of Provisions

World Council supports the Basel Committee's proposal to modify its current leverage ratio calculation to reduce leverage ratio exposures that have been reserved for out of Tier 1 capital, including:

- Reducing the Basel III leverage ratio exposure measure by the amount of any general and specific provisions that have decreased Tier 1 capital;

- Reducing off-balance-sheet exposure items by the amount of any associated specific and general provisions that have decreased Tier 1 capital; and

- Reducing the Basel III leverage ratio exposure measure by the amount of prudent valuation adjustments for less liquid positions related to on-balance sheet assets that are deducted from Tier 1 capital.

It is logical and appropriate to reduce the leverage ratio exposures for items that have already been provisioned for (or deducted) by excluding them from the denominator of the leverage ratio. Institutions have already recognized those losses on an accounting basis in the form of reserve expenses and have decreased their Tier 1 capital to provision for these items. This

[1] Basel Committee on Banking Supervision, *Revisions to the Basel III leverage ratio framework* – 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.

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means that, economically, the institution has set aside Tier 1 funds to pay for any economic losses associated with these exposures on a dollar-for-dollar basis, which has already reduced the numerator of the institution's leverage ratio. Including provisioned-for (or deducted) exposures in the denominator of the leverage ratio would understate an institution's true level of capitalization by disregarding the existence of the provisions and effectively double counting the reserved-for exposures.

World Council supports the Basel Committee's proposal to modify its current leverage ratio calculation so as to allow the reduction of leverage ratio exposures that have been reserved for out of, or deducted from, Tier 1 capital.

2. Revisions to the Credit Conversion Factors for Off-Balance-Sheet Items: Undrawn Portions of Unconditionally Cancelable Open-End Lines of Credit

World Council urges the Committee <u>not</u> to include the undrawn portions of unconditionally cancelable open-end lines of credit, such as credit cards and similar revolving credit facilities, within the denominator of the leverage ratio. We urge the Committee <u>not</u> to finalize the aspects of the proposal—such as Paragraph 13 of the proposal's Annex—that would assign a credit conversion factor (CCF) greater than 0% to unconditionally cancelable lines of credit.

These unconditionally cancelable items should continue to receive a 0% CCF because they are fully cancelable at the credit union's option. This is especially true in the context of retail exposures and loans to small business borrowers.

We do not agree with the Committee's theory that such unconditionally cancelable lines of credit are not in fact unconditionally cancelable; in practice, credit unions cancel such lines of credit frequently in the consumer and small business lending contexts without experiencing reputational or other problems. Further, the most likely institutional response to a requirement to include the undrawn portions of unconditionally cancelable lines of credit within the denominator of the leverage ratio would be for institutions to exercise their legal rights to reduce or cancel the lines of credit subject to this rule.

We realize that some large banks have claimed to face challenges canceling lines of credit issued to large corporations such as oil companies. We believe that the Committee should focus its efforts on the rare lender-borrower relationships where *de jure* unconditionally cancelable lines of credit are *de facto* not cancelable, if and when such circumstances truly exist. Such a scenario would require the borrower to have an outsized economic and/or political influence over the lender to the degree that the lender's unconditional legal right to cancel a line of credit could not be exercised as a practical matter. Credit unions have not experienced these issues with their member-borrowers, who are typically consumers or small business owners.

Including the undrawn portions of unconditionally cancelable lines of credit like credit cards within the denominator of the leverage ratio—even with a 10 to 20 percent CCF, as the Committee has proposed for undrawn portions of unconditionally cancelable retail open-end lines of credit—would likely have negative economic consequences, especially for consumers and small businesses as well as the global economy.

If this aspect of the proposal is finalized, banks would likely cut unconditionally cancelable lines of credit to consumers and small businesses in response, in order to raise their institutional leverage ratios by reducing the ratios' denominators. This would likely lead to a significant decrease in the amount of credit available to consumers and small businesses.

Such a pull-back in the amount of credit available to consumers and businesses would dampen economic demand. This type of pull-back in available credit would also likely reduce the credit scores of consumers and small business owners (since credit scoring models often include an analysis of how much undrawn open-end credit the borrower has available).

This twofold blow to consumers and small businesses of losing access to open-end credit as well as experiencing lower credit scores as a result of the reduction in open-end credit would create a vicious cycle that increases the likelihood of global recession. Not only would aggregate open-end credit to consumers and small business be reduced, the decrease in borrowers' credit scores stemming from the reduction of borrowers' access to open-end credit would create a knock-on effect of reduced lending to consumers and small businesses in general (including closed-end loans) because borrowers' reduced credit scores would make them appear to be less creditworthy.

This type of credit contraction in the current economic environment would reduce economic activity and increase the risks of recession in many jurisdictions. The negative macroeconomic effects of recession would likely weaken the financial system as a whole and therefore negate any perceived safety and soundness benefit of including the undrawn portions of unconditionally cancelable lines of credit within the leverage ratio framework.

World Council urges the Committee to retain a 0% CCF under the leverage ratio for the undrawn portions of unconditionally cancelable lines of credit, especially with respect to retail and small business exposures.

3. Revisions to the Credit Conversion Factors for Off-Balance-Sheet Items: Capital Call Features in Cooperative Depository Institution Systems

World Council urges the Basel Committee to treat the possibility of capital calls made by wholesale credit unions on their member credit unions as internal to a cooperative depository institution system in a manner similar to how capital calls and cross-guarantees are treated in the context of cooperative bank federations, and assign these items a 0% CCF.

Although cooperative bank federations in jurisdictions like France, the Netherlands and Germany have capital call features and cross-guarantees which can create large notional liabilities, these cooperative bank off-balance-sheet items are typically disregarded for Basel III purposes because these claims are viewed as internal to a system of cooperative depository institutions.

Credit unions often form wholesale "central credit unions" or "corporate credit unions" to facilitate payments services, settlement and the provision of liquidity to their member credit unions in the same manner as central cooperative banks operate to serve their retail-level cooperative bank members. Central credit unions often have bylaws that allow the central credit unions to make capital calls on their member credit unions, such as if the central credit union is undercapitalized because of losses or requires additional capital to remain well-capitalized during periods of asset growth.

The Basel Committee's *Capital requirements for banks' equity investments in funds* standard can be used to address off-balance-sheet commitments related to a central credit union's future capital calls in the context of Basel III's Pillar 1 risk-based capital rules.[3]

For leverage ratio purposes, World Council urges the Committee to treat the relationship between retail-level credit unions and central credit unions as internal to a system of cooperative depository institutions—as is typically the case with respect to capital call features and cross-guarantees between central cooperative banks and their members—and accord these items a 0% CCF.

4. Treatment of Traditional Securitizations

World Council supports the proposed alternative whereby assets involved in traditional securitizations would be excluded from the scope of regulatory consolidation for leverage ratio purposes. In this alternative the securitized assets would <u>not</u> be included in the leverage ratio calculation.

In securitization transactions, a situation can arise where an originating institution securitizes assets that meet the test for a risk-transfer in the Basel framework but they either do not meet the criteria for accounting de-recognition or must be included as a special purpose vehicle within its scope of accounting consolidation. In these situations, the originating institution can exclude these securitized assets from its risk-based capital calculation.

This exclusion from risk-weighting can be done either: by simply excluding the assets from the scope of regulatory consolidation, in which case the assets are also excluded from the leverage ratio; or by assigning a 0% risk-weight to the consolidated securitized assets, in which case the assets would not be excluded from the leverage ratio calculations.

World Council supports the alternative of excluding these securitized assets from the scope of regulatory consolidation, in which case the assets would <u>not</u> be included in the leverage ratio. We do not believe that it is logical to include these securitized assets that have met the criteria for a risk-transfer within the leverage ratio while disregarding them from the risk-based capital ratios.

From a safety and soundness standpoint, it should be unnecessary to hold capital against assets—whether under the leverage ratio or under the risk-based capital framework—when

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[3] Basel Committee on Banking Supervision, *Capital requirements for banks' equity investments in funds* (Dec. 2013), *available at* http://www.bis.org/publ/bcbs266.pdf.

those assets have met the criteria for a risk-transfer since the originating institution no longer is exposed to risks associated with those assets.

World Council appreciates the opportunity to comment on the Basel Committee's consultative document on the *Revisions to the Basel III leverage ratio framework*. 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