



March 13, 2009

Mr. Nout Wellink  
Chairman  
Basel Committee on Banking Supervision  
Bank for International Settlements  
Centralbahnplatz 2  
CH-4002 Basel, Switzerland

**Re: Guidelines for Computing Capital for Incremental Risk in the Trading Book**

Dear Chairman Wellink:

World Council of Credit Unions (WOCCU) is the leading trade association and development organization for the international credit union movement, representing more than 49,000 cooperatively-owned, not-for-profit credit unions in 96 countries. The global movement holds aggregate assets of more than US\$1.1 trillion in the retail financial services market. Worldwide, financial cooperatives of all types serve an estimated 857 million people.

***Comments***

Very few credit unions anywhere in the world have trading desks or are involved in derivatives and equities. Those that do have trading books generally have relatively straightforward and minor positions. However, as financial sector participants we do have significant interest in the health of banking systems. It is within this context that we are responding to the questions posed in the consultative document entitled *Guidelines for Computing Capital for Incremental Risk in the Trading Book*.

**Question 1:** If many of the losses that have led to the current crisis have occurred through financial institutions' trading books and there is evidence, or its possibility, that the lower capital requirements for the trading book led banks to place credit-risky instruments in the trading book rather than the banking book to avoid the higher capital charges, there seems to be little room for debate on this item other than to equalize the capital charges between the banking and trading books.

It is unclear whether application of a Value at Risk (VaR) model with a one-year as opposed to 10- day tail would have significantly changed the current situation. The concepts of credit risk concentration and ceilings are well established concepts in *Core Principles of Banking Supervision Methodology* and Basel II. We would encourage the Basel Committee to apply these concepts more broadly to institutions involved in retail, wholesale and investment banking – particularly the latter two.

**Question 2:** While settlement risk is real, we believe that credit risk is still the primary driver of most major market disruptions. Any approach should place greater emphasis on asset quality rather than duration of the position.



**Question 3:** The prospect of assessing values in illiquid markets is addressed in the consultative document on *Revisions to the Basel II Market Risk Framework*. Consistent with our position above, we are in favor of eliminating the prospect of regulatory arbitrage between the banking and trading books.

International Financial Reporting Standard 7 defines illiquidity as “a low volume of transactions in similar assets [for which] an entity finds it difficult to find a counterparty.” While this definition and the prospect of how a mark to model as described in the *Revisions to the Basel II Market Risk Framework* document seem reasonable, practical implementation of these concepts has proven difficult in the current global economic climate. This has occurred in part because national legislation in some jurisdictions requires usage of generally accepted accounting practices and/or adherence to International Financial Reporting Standards. The inconsistency between this legislative mandate of accounting standards and regulatory allowances continues to cause havoc for financial institutions. We support the Committee’s continued work with accounting standards boards in this regard.

***Additional Comments:***

In our May 2001 comment letter in response to the first iteration of Basel II, we noted that “our concern with the reliance on external credit assessments is related to the potential negative impact this may have on liquidity markets.” The status and quality of the credit rating agencies and the increased emphasis that Basel II has put on their work remains a concern. The reliance on them should be diminished within Basel II. To make this transition it may mean that regulator’s own evaluations of institutional strength becomes more transparent. In fact, in jurisdictions such as New Zealand, credit union regulators have abdicated portions of their supervisory responsibilities to credit rating agencies. We encourage the Committee to collaborate with the relevant national bodies in re-assessing the usage of ratings and the framework in which credit rating agencies operate.

Thank you for your kind consideration. Please feel free to contact me at (608) 395-2087 or via email at [dgrace@woccu.org](mailto:dgrace@woccu.org) if you have any questions.

Sincerely,

Dave Grace  
Vice President