



March 13, 2009

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

**Re: Revisions to the Basel II Market Risk Framework**

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. Please accept our comments on the consultative document entitled *Revisions to the Basel II Market Risk Framework*.

***General Comments***

Cooperative financial institutions play a vital role in the provision of retail financial services to local communities for more than 857 million working class, low- and middle-income individuals worldwide. To date, we are unaware of any credit unions globally that have received tax-payer recapitalization or assistance as a result of the global financial crisis. This current experience regarding credit union stability is supported by empirical research conducted by the International Monetary Fund in 2007 (see Hesse and Cihak, WP/07/02, 2007), which concludes that cooperative financial institutions are more stable than commercial banks.

We are concerned that Basel II provides more favorable treatment for larger, complex financial institutions compared to smaller, more stable financial cooperatives. The bias is evident to us in rules governing capital charges for re-securitization exposures. While we understand the Committee's interest in advancing risk modeling, the current crisis indicates that existing models were not well developed to begin with, causing many banking sectors to suffer high levels of concentration risk among few institutions. As such, it seems counterintuitive that large institutions presenting the greatest systemic have *lower* capital charges, freeing up comparatively more capital under Basel II. This situation is borne out in the Committee's past quantitative impact studies and, we believe, unfairly penalizes smaller financial institutions inherently better able to individually spread banking sector risk.



*We strongly urge the Basel Committee to reassess and balance this fundamental inconsistency between Basel II and its stated intention of “strengthening the soundness and stability of the international banking system.”<sup>1</sup>*

### ***Specific Comments***

#### **Page 4**

The capital charges identified for the standardized and internal ratings based (IRB) approaches contain too much variance between them and with unsubstantiated preference towards the IRB approach. This will have the affect of a relative increase in capital for smaller, less complex, often more stable financial institutions.

#### **Page 7**

We believe an additional qualitative standard should be added, one that requires a financial institution’s senior management to monitor and understand the risks to which market activities expose his/her institution.

#### **Page 10 paragraph (d)**

This section and its overall framework lack concentration limits on risk assets. We believe that overall financial sector stability would increase if such concentration levels were introduced, especially for institutions that collect public deposits.

#### **Page 13 paragraph (ii)**

More definitive guidance regarding stress testing should be given as opposed to stating what “could” be tested.

#### **Page 19 paragraph (c) & page 20 paragraph 18**

The consultative documents identify and recognize that many new products (i.e., collateralized debt obligations) and methodologies (i.e., originate-to-distribute loans) were introduced in recent years without bank management, markets and risk models fully understanding and managing product risks. It appears that the revised framework is being modified to bring these new products under the purview of Basel II, but the larger issue of how to assess capital charges and manage risks of future financial innovations is not dealt with.

To be sure, we believe that product innovation and experimentation is necessary and can benefit financial systems. However, we would prefer to see a framework in which concentration ceilings and initial capital charges are in place for a number of years for all new products of significance. We believe this framework could help stem the creation of products with the sole intent of regulatory arbitrage. The creation of an initial ceiling and timelines for review will still allow for market innovation, but also give regulators and counterparties a period of time to understand and test new product innovations in a safer environment.

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<sup>1</sup> International Convergence of Capital Measurement and Capital Standards. Basel Committee on Banking Supervision. July 1988. page 1.



### **Page 23 Marking to Model**

It is unclear what supervisory approvals are necessary, under what conditions and how long a time may elapse before an institution opts for marking assets to model, as opposed to marking to market. This area could benefit from greater elaboration.

We would once again strongly urge the Basel Committee to reassess and balance inconsistencies within the Basel II framework. 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,

A handwritten signature in purple ink that reads 'Dave Grace'.

Dave Grace  
Vice President