World Council of Credit Unions, Inc.

April 16, 2010

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

Re: Consultative document on *Strengthening the Resilience of the Banking Sector*

Dear Chairman Wellink:

World Council of Credit Unions (WOCCU) is the leading trade association and development organization for the international credit union and financial cooperative movement, representing more than 54,000 cooperatively-owned, not-for-profit credit unions in 97 countries with assets of more than US$1.2 trillion in the retail financial services market. Globally, all types of financial cooperatives by various names (i.e. credit unions, rural credit cooperatives, cooperative banks, savings and credit cooperatives) serve an estimated 857 million people.

Throughout the global financial crisis we are unaware of <u>any</u> credit union that received government recapitalization. Credit unions that may have incurred losses related to the broad economic problems were financially supported by the other credit unions in their respective countries. This is in stark contrast to the performance of commercial banks, many of which required public sector support that was financially burdensome to governments and their citizens. With this difference in mind, please accept our comments on the consultative document on *Strengthening the Resilience of the Banking Sector*.

General comments

We are very supportive of the framework proposed by the Basel Committee for improving the capital cushions of the global banking sector. The proposal brings common sense back to capital requirement standards as many banks were extremely thinly capitalized in terms of their retained earnings and common shares. We are equally pleased that the Basel Committee for the first time explicitly recognizes the distinct nature of capital in cooperatives and other non-joint stock companies. We urge the Committee to recognize that in some markets credit unions and other non-joint stock companies have put in place delegated or non-traditional monitoring systems because of the lack of desire or capacity of supervisors to oversee large numbers of smaller financial institutions.

Specific comments

Characterization of Ownership Shares in Cooperatives

Ownership shares are capital at risk for credit unions in the event of institutional failure. There is no incentive to redeem the shares and they are subordinate to deposits, creditors and other liabilities of the organization. We believe that credit union ownership shares should be considered tier-one capital

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if one of the two following conditions are met: 1) the credit union has the irrevocable right to refuse redemption of its ownership shares at any time; and 2) the credit union's bylaws/regulations establish in advance a level of ownership shares under which capital must not fall as a result of the redemption of shares, since doing so would jeopardize the credit union's ability to meet regulatory capital requirements. In addition, if redemption of ownership shares is limited to a prolonged notification period (i.e., greater than one year), a portion of these shares also should be considered part of tier-one capital.

We believe that shares which are fully withdrawable at any time and without the above stipulations applied should be considered liabilities.

Counterparty Credit Risk

As the Committee notes, the global financial crisis exposed the fact that large, complex financial institutions are interdependent to a much greater degree than smaller community-based financial institutions. We have advocated with the Basel Committee since 2003 that this situation demands higher, not lower, capital requirements for large financial institutions, as the current calibration of Basel II suggests. We are pleased to see a proposed capital multiplier for the largest financial institutions and validation that smaller financial institutions did not have the same problems and exposure to credit default swaps.

However, in the Committee's efforts to protect against the risk of hedge funds and unregulated, highly leveraged firms, our concern is that credit unions in many markets could also inadvertently be considered along with hedge funds as "unregulated financial intermediaries." For example, credit unions in Canada operate provincially and have no federal regulatory oversight, but rather are subject to a combination of provincial government oversight and covered by private sector stabilization funds in some provinces. In most parts of Latin America, Asia and Africa, banking supervisors have explicitly avoided oversight of credit unions due to scarce supervisory resources and the presence of many credit unions located far from the supervisors office(s). In the absence of prudential financial sector supervision, many credit unions have implemented inter-system monitoring by their national association, often with powers delegated to them from the government.

Therefore, we ask the Committee to define unregulated institutions as institutions that do not have supervisory structures delegated by governments, do not serve a defined common bond of users and are not community-based financial intermediaries.

Stress Tests

It's impractical for smaller financial institutions to be required to produce monthly stress tests on all of their counterparties. Aside from this task being beyond the technical capacity of many local, community-based institutions, credit unions often manage their liquidity and investments, and obtain fidelity and bonding insurance from entities owned on a cooperative basis by the credit union industry in a country/region. These second-tier wholesale entities have been created by credit unions precisely so that they could gain access to payment services, technologies and insurance services which individual credit unions could not obtain at reasonable prices (or at all) in the private market. As such, they are able to monitor their counterparty relationship as part-owners. Periodic monitoring of counterparties by smaller institutions could be encouraged, but should not be required.

Reliance on External Credit Ratings

We are extremely pleased that the Committee recognizes the limitation of external credit ratings and is making an effort to decrease reliance on them. The proposal suggests reliance upon the International

Organization Securities Commissions (IOSCO's) code of conduct and encourages working with "credible" agencies. However, it was precisely the brand name credit rating agencies that failed miserably during the global financial crisis and we feel that the proposed changes would do little to correct the problems experienced during that crisis. For example, we still see some central banks, such as those in New Zealand, that require a rating for any non-bank deposit taker with more than US$14 million in assets. Usage of the external credit assessments can be an effective tool in assessing credit worthiness, but their findings should not have any direct impact on risk weightings and should not be used to enable firms to forego their own analysis.

The failure of the market to regulate based on information from the external credit assessments is analogous to the failure of many banks' own internal risk managements systems. For example, the consultative document indicates that back-testing was not being completed to authentic models and now new language has been proposed for how back-testing should become completed. However, the problems were not due to a lack of ideas on how banks should conduct back-testing, but rather that back-testing creates significant expense and no immediate short-term gains for the institutions. To avoid future taxpayer bailouts of the largest financial institutions, the Committee should put even less reliance on the internal ratings-based approaches and move towards better credit analysis by firms and greater, not lesser, standards for these systemically important firms relative to local community-based financial institutions.

Procyclicality

We are supportive of the Committee's desire to ensure that more robust capital buffers are built in periods of economic strength so that they can be used during times of stress. The most difficult practical application of these concepts will be the institutions' and supervisors' ability to distinguish between periods of strength and weakness in the present environment.

The concept of forward provisioning is common in many jurisdictions and we are supportive of it. The requirement to build capital buffers would likely have the largest impact of any of the ideas presented. More problematic is the proposed methodology for trying to contain excessive credit growth in a country. While we support tempering boom-and-bust cycles, this could also hinder economic growth in developing countries where growth is most needed to raise incomes and reduce poverty. It is also impractical that small, rural financial institutions would be monitoring their country's credit-to-GDP ratio and build or use capital in sync with these forecasts. Identifying credit bubbles and preparing for their collapse is something best left to supervisory discretion and monitoring by the International Monetary Fund.

Summary

The presence of community-based, not-for-profit financial institutions has been a redeeming aspect of financial sectors during the great recession and they have aided many economies in finding solutions to harsh economic problems. It is imperative that the Committee's work not only do no harm to financial cooperatives, but also actively *promote* diversity of the financial sector. With the exception of recognizing that a cooperative's ownership shares qualify as tier-one capital and a review of how the Core Principles for Effective Banking Supervision impact microfinance institutions, this proposal and the liquidity proposal do little to aid credit union development.

We strongly urge the Committee to more actively enable the development of such institutions and serve as a counter-weight to the too-big-to-fail entities by ensuring credit union access to deposit insurance systems (only 48% of credit union systems globally have access), central bank liquidity windows, payment/settlement systems (31% of credit union systems have access) and transaction card networks. In addition, we encourage prudential, but proportional supervision of the sector to ensure

the compliance burden is not so great as to "force" credit unions to merge. Together, these actions and the recalibration of the next version of the Basel accord will help ensure that local community-based financial institutions can add to the industry's overall financial stability.

Thank you for considering our comments. We encourage the Committee to include non-joint stock companies in its quantitative impact assessments and we stand prepared to assist with its work. Please feel free to contact me at +1 608 395-2087 or via email at dgrace@woccu.org if you have any questions.

Sincerely,

Dave Grace
Vice President