World Council of Credit Unions

April 30, 2015

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

Re: Consultative Document: *Guidance on accounting for expected credit losses* (Feb. 2015)

Dear Mr. Coen:

World Council of Credit Unions (World Council) appreciates the opportunity to comment on the Basel Committee's *Guidance on accounting for expected credit losses* consultative document.[1] Credit unions are cooperative depository institutions that operate to promote thrift and financial inclusion, 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 103 countries with USD 1.7 trillion in total assets serving 208 million natural person members.[2]

Summary of World Council's Comments

1. **Proportionality:** World Council strongly supports the concept of proportionally expressed in paragraph 12 of this proposal. Credit unions are generally much smaller than internationally active banks; globally the average size of a credit union is roughly USD 30 million in total assets.[3] Many credit unions would find it prohibitively expensive to implement aspects of this proposal intended for internationally active banks. In some cases we believe that small credit unions retaining an incurred loss methodology would be appropriate because of the regulatory burdens associated with the expected credit loss approach and credit unions' strong performance during the recent financial crisis under incurred loss methodologies. We urge the Committee to finalize paragraph 12 as proposed.

2. **Supervisory Guidance versus RAPs:** While supervisory guidance can be useful for interpreting generally accepted accounting rules in the financial institution context (such as by clarifying timing requirements and so forth), we do not support the ability of supervisors to impose pro forma Regulatory Accounting Principles (RAPs) for loan loss provisioning that are more stringent that the generally accepted accounting rules that would otherwise apply to the credit union. RAPs for loan loss provisioning that are more stringent than the generally accepted accounting rules often result in credit unions which are over-reserved, have artificially low regulatory capital levels as a result of being over-reserved, and are at a

[1] Basel Committee on Banking Supervision, *Guidance on accounting for expected credit losses -- consultative document* (2015), *available at* http://www.bis.org/bcbs/publ/d311.htm.
[2] World Council of Credit Unions, *2013 Statistical Report* (2014), *available at* http://www.woccu.org/publications/statreport.
[3] *See id.*

World Council of Credit Unions, Inc.
601 Pennsylvania Avenue NW, South Building, Suite 600, Washington, DC 20004 • Phone: +1-202-638-0205 • Fax: +1-202-638-3410 • www.woccu.org

competitive disadvantage compared to similar financial institutions following generally accepted accounting principles.

3. **IFRS 9 "Practical Expedients" and Credit Unions:** We do not support the prohibition contained in paragraphs A46-A48 of the Appendix on "internationally active banks and those banks more sophisticated in the business of lending" using the "practical expedients" of IFRS 9 to the extent that these paragraphs apply to credit unions. Credit unions are rarely internationally active and we believes that the proportionality concept in paragraph 12 should allow less complex financial institutions, including most credit unions, to use the practical expedients of IFRS 9 and similar less burdensome accounting methods.

World Council's Detailed Comments

1. Proportionality

World Council strongly supports the concept of proportionality expressed in paragraph 12 of the proposed guidance:

> "For less complex banks, consistent with the Basel Core Principles, the Committee recognises that supervisors may adopt a proportionate approach with regard to the standards that supervisors impose on banks and the conduct of supervisors in the discharge of their own responsibilities. This allows less complex banks to adopt approaches commensurate with the size, nature and complexity of their lending exposures."

We urge the Committee to finalize paragraph 12 as proposed. Without the proportionality concept, many less complex financial institutions, including most credit unions, would likely find it difficult to comply with all of the aspects of this guidance.

For example, many credit unions would likely find it prohibitively expensive to develop expected credit loss (ECL) computer modeling of the complexity envisioned by the guidance for internationally active banks set forth in Principle 5 and paragraphs 56-58. These credit unions have strong track records of safe and sound loan underwriting in their local communities, and should be able to implement ECL models that are commensurate with their limited complexity. Further, in terms of "independent" validation of this model, we believe that the credit union's Supervisory Committee[4]—a committee elected by the credit union's members that is independent from the credit union's board of directors and is responsible for its internal audit function—would be the appropriate independent entity to validate the institution's ECL model.

Credit unions also performed well in general during the recent financial crisis under the IAS 39 incurred loss model and similar incurred loss standards pursuant to national generally accepted

---

[4] *See, e.g.*, Section 115 of the US Federal Credit Union Act, 12 U.S.C. § 1761d ("Supervisory committee; powers and duties; suspension of members; passbook"), *available at* https://www.law.cornell.edu/uscode/text/12/1761d ("The supervisory committee shall make or cause to be made an annual audit and shall submit a report of that audit to the board of directors and a summary of the report to the members at the next annual meeting of the credit union; shall make or cause to be made such supplementary audits as it deems necessary or as may be ordered by the Board, and submit reports of the supplementary audits to the board of directors; may by a unanimous vote suspend any officer of the credit union or any member of the credit committee or of the board of directors, until the next members' meeting . . .").

accounting principles, especially compared to the systemically important banking institutions that were unprepared for the losses they experienced during the global financial crisis and ensuing recession. We believe that smaller and less complex credit unions should be able to retain an incurred loss methodology when permitted to do so under applicable accounting rules.

We also believe that paragraph 12 should allow a long transitional period for phase-in of this guidance and new ECL accounting standards so that credit unions have sufficient time to build up additional loan loss reserves and adjust their back office systems in anticipation of the new rules.

2. Supervisory Guidance versus RAPs

We support the Committee's proposed approach of giving a credit union's or bank's management the primary role in determining the institution's credit risk management strategy and policies in a manner consistent with applicable accounting rules, as expressed in proposed Principles 1 and 2.

While we also agree that supervisors should periodically evaluate the effectiveness of the institutions as set forth in Principle 9, and be satisfied with the institution's methods to determine allowances pursuant to Principles 10 and 11, we do not believe that the supervisor's role in this area should be prescriptive. Although supervisory guidance can be useful with respect to clarifying generally applicable accounting standards' gray areas concerning timing and so forth, we do not support the ability of supervisors to impose RAPs for credit loss allowance provisioning that are more stringent than the applicable generally accepted accounting rules.

Supervisory RAPs can be useful in jurisdictions that do not have consistently applied generally accepted accounting rules and/or do not have strong professional accounting and auditing standards—which is primarily an issue in the developing world—and RAPs can also make sense in the context of small credit unions in order to reduce regulatory burdens. RAPs which are more stringent that the generally accepted accounting principles developed by the relevant accounting authorities, however, create unjustified regulatory burdens and often result in credit unions that are over-reserved and at a competitive disadvantage compared to competing institutions following generally accepted accounting principles.

The issue of collective analysis of loans for allowance determination purposes as proposed in Principle 3 is also relevant to the issue of RAPs because some credit union supervisor-created RAPs do not permit credit unions to do an individual loan analysis that takes into account the value of the loan's collateral, etc. Rather, in some recent cases, credit unions supervisors have used RAPs to require credit unions to establish loan loss reserves based on a collective "roll rate" methodology promulgated by the supervisory agency that is more stringent than the generally accepted accounting rules established by the jurisdiction's accounting authorities, does not permit individual analyses of loans, and determines expected loan losses based solely on the number of days that a loan is in arrears.

In many cases credit unions subject to these more stringent RAPs have become over-reserved relative to their competitors following generally accepted accounting principles and, because the allowance for loan losses is provisioned from a credit union's retained earnings (which are its main source of capital), these institutions are also often also subject to regulatory capital "Prompt

Corrective Action" remedial measures[5] that would not apply but for the over-provisioning of the allowance for loan losses.

We support the ability of institutions to do a collective analysis of loans of a similar type in order to reduce regulatory burden—especially in the case of a large numbers of unsecured loans or loans that have similar collateral—but we think that credit unions should be able to do an individual analysis of any loan in arrears if the institution believes that an individual analysis of the loan would be more probative.

In the context of IFRS 9, for example, this would mean that a credit union could place any loan in arrears in the co-called "Bucket 3" for individual analysis and bypass the collective-allowance "Bucket 2". We believe that this approach is consistent with both this proposed guidance and the IFRS 9 standard, as well as with other ECL accounting standards.

3. IFRS 9 "Practical Expedients" and Credit Unions

We do not support the prohibition contained in paragraphs A46-A48 of the Appendix on "internationally active banks and those banks more sophisticated in the business of lending" using the "practical expedients" of IFRS 9 to the extent that these paragraphs apply to credit unions.

Most credit unions are smaller financial institutions with less complex financial assets than those held by commercial banks and, globally, the vast majority of credit unions have less than USD 10 million in assets and the global average assets size of credit unions is only USD 30 million. Even in the United States of America—which is the world's largest credit union system by assets (the more than 6,300 US credit unions collectively have USD 1.1 trillion in total assets)—the *median* asset size of a US credit union is only USD 24.5 million.[6]

High compliance costs create artificial economies of scale which benefit the largest financial institutions, reduce diversity in the financial sector, and make it more difficult for credit unions to promote financial inclusion because they are less able to afford regulatory compliance costs compared to large banks. Credit unions are consumer-owned cooperatives which operate to serve their members by providing financial services on a not-for-profit basis, meaning that the credit union's compliance expenses reduce the institution's ability to fulfill its mission of providing its members with financial products at fair rates. Many of the compliance expenses which make sense for complex international banks operating myriad lines of business are not justified in the context of regulating a small credit union engaged in traditional community banking on a local scale.

For these reasons accounting authorities such as the United Kingdom's Financial Reporting Council (FRC) have determined that credit unions should apply less stringent accounting standards, such as the FRS 102 standard derived from *IFRS for SMEs* in the case of British and Irish credit

[5] *See, e.g.*, 12 C.F.R. part 702 ("Prompt Corrective Action"), *available at* https://www.law.cornell.edu/cfr/text/12/part-702.

[6] Credit Union National Association of the USA, *US Credit Union Profile: Year-End 2014* at 2 (2015), *available at* http://cuna.org/Research-And-Strategy/DownLoads/uscu_profile_4q14/.

unions starting in 2016.[7] Similarly, credit unions in the United States of America with less than USD 10 million in assets have a long history of following a set of RAPs adopted in the National Credit Union Administration's (NCUA) *Accounting Manual* instead of US Generally Accepted Accounting Principles (US GAAP).[8]

We believe that the proportionality concept expressed in paragraph 12 of this guidance should provide prudential regulators and national accounting authorities with flexibility regarding less complex financial institutions' expected credit loss accounting, whether under IFRS 9 or another ECL accounting standard, such as:

- Not requiring the discounting of expected future cash flows at the credit-adjusted effective interest rate, in order to reduce the standard's compliance burden on smaller institutions.

- Permitting a long transitional period for phase-in of the new IFRS 9 standard and other expected credit loss standards so that credit unions have sufficient time to build up additional loan loss reserves and adjust their back office systems in anticipation of the new rules.

- Allowing flexibility to adopt less stringent accounting standards, whether they are generally applicable standards (such as those for small and medium-enterprises) or RAPs, in order to reduce regulatory burden on small financial institutions. Examples include FRS 102 in the case of British and Irish credit unions, and the NCUA *Accounting Manual* in the case of US credit unions with less than USD 10 million in total assets.

World Council appreciates the opportunity to comment on the Basel Committee's proposed *Guidance on accounting for expected credit losses*. 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

---

[7] *See, e.g.*, Financial Reporting Council, *Accounting and Reporting Policy FRS 102: Staff Education Note 14 – Credit unions – Illustrative financial statements* (2015), *available at* https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/SEN-14-Illustrative-Credit-Union-Financial-Stateme.pdf

[8] National Credit Union Administration, *Accounting Manual* (2002), *available at* http://www.ncua.gov/Legal/GuidesEtc/Pages/Accounting-Manual.aspx.