February 12, 2016

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

Re: Consultative Document: *TLAC Holdings*

Dear Mr. Coen:

World Council of Credit Unions (World Council) appreciates the opportunity to comment on the Basel Committee on Banking Supervision's *TLAC Holdings* consultative document regarding standards for internationally active banks' "total loss absorbing capacity" (TLAC) instruments.[1] World Council is the leading trade association and development organization for the international credit union movement. Worldwide, there are 57,000 cooperatively owned credit unions in 105 countries with US$ 1.8 trillion in total assets serving 217 million natural person members.[2]

1. World Council Supports Limiting TLAC Rules to "Internationally Active Banks"

World Council supports the Basel Committee's proposal in section 2 to limit application of the *TLAC Holdings* standard to "internationally active banks." We urge the Committee to finalize this language as proposed.

World Council is generally supportive of the TLAC framework's goal of eliminating the implicit public subsidy enjoyed by global systemically important banks (G-SIBs). Applying these TLAC rules to non-G-SIBs, however—especially credit unions and other community financial institutions which are not internationally active—will not achieve that objective because they are not beneficiaries of any such implicit subsidy. Worldwide, the US$ 1.8 trillion in total credit union assets are spread across 57,000 unrelated institutions, with an average credit union asset size of approximately US$ 32 million in total assets. No credit unions qualify as G-SIBs and credit unions rarely operate on a cross-border basis.

A. Credit Unions Rarely Operate on an International Basis Because of "Common Bond" Rules

Credit unions rarely operate on an international basis in large part because only individuals who fall within a credit union's "common bond of association" can become members of the credit union and do business with it. Common bond limitations on membership are typically

[1] Basel Committee, *TLAC Holdings* (Nov. 2015), *available at* http://www.bis.org/bcbs/publ/d342.pdf.
[2] World Council of Credit Unions, *2014 Statistical Report* (2015), *available at* http://www.woccu.org/publications/statreport.

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geographic—such as all people who live or work in a particular city, rural district or province—or associational, such as all people who work for a particular company or government agency.

Credit unions' common bonds generally prevent them from operating on a cross-border basis. A very limited exception occurs in the context of credit unions serving the employees of international organizations, like the United Nations, which sometimes have non-transactional representative offices outside of their home country. Credit unions serving military personnel are also often present on overseas military bases, however, these credit unions do not operate on a cross-border basis because they remain under the jurisdiction of their home country pursuant to military law and only do business with personnel who are stationed on the base.

B. Applying TLAC to Credit Unions Would Impose Unjustified Capital Costs

Applying TLAC to credit unions and other institutions that do not operate on a cross-border basis would likely impose unjustified capital costs on these institutions. Many credit union systems do not have a regulatory framework for issuing TLAC-style instruments like contingent convertible bonds, and the markets for these instruments in the jurisdictions with the necessary legal authority to issue them are neither deep nor liquid, if they exist at all.

In many cases, the only investors in a credit union's capital instruments are its own members. This is either because only members are allowed to buy them as a legal matter or because non-member investors, when they are allowed to invest in credit union capital instruments at all, are most commonly philanthropic organizations that invest at below market yields, as low as a 0 percent coupon, in order to help the credit union expand its services (rather than seeking a commercial return on the investment). There is limited philanthropic funding available for this type of investment and these investments are not usually traded. Anecdotal evidence from the few credit unions that have explored the potential for a commercial market for such instruments suggests that commercial investors would demands much higher yields—such as coupons between 7 to 14 percent or more—that would impose excessively high, unsustainable capital costs on most credit unions.

There is no ready commercial market for credit union TLAC instruments and the potential market for such instruments is highly speculative at best. The market for these types of TLAC-compliant contingent convertible bonds issued by large European banks has also recently become dislocated: Currently, the gap in yield between these bonds and interest rate swaps insuring them is a spread of approximately 9 percent.[3] These market conditions increase our concerns that there would be little or no interest in similar instruments issued by credit unions, or that such a market would be illiquid.

World Council urges the Committee to finalize limiting application of the *TLAC Holdings* to "internationally active banks" as proposed.

[3] Christopher Whittall, "Investors Flee Risky European Bank Debt," *Wall Street Journal*, Feb. 9, 2016, *available at* http://www.wsj.com/articles/investors-flee-risky-european-bank-debt-1455055488

2. Uninsured Deposits Should Qualify as TLAC

World Council believes that uninsured term deposits with at least one-year remaining duration and similar types of credit union shares should qualify as TLAC so long as they are subject to a penalty for early withdrawal or redemption.

Most credit unions already have significant stocks of uninsured term deposits or functionally similar type of share classes such as "share certificates" which are in many ways equivalent to preferred stock in terms of legal structure.[4] These items are subordinate to insured deposits and most or all other "excluded items" as defined by the Financial Stability Board with respect to TLAC issued by G-SIBs.[5]

These items also absorb losses in a liquidation or purchase and assumption transaction as a form of gone concern capital if losses exceed retained earnings and other Common Equity Tier 1, Additional Tier 1 and Tier 2 capital items. The Basel III Net Stable Funding Ratio also assumes that all term deposits with a remaining maturity of one year or more will remain with the institution in a crisis. Uninsured credit union term deposits and similar types of share classes therefore are part of a credit union's total loss absorbing capacity de facto.

We urge the Committee to include all uninsured term deposits and similar items like share certificates with at least one-year remaining maturity within the definition of eligible external TLAC so long as these items are subject to a penalty for early withdrawal or redemption. While we agree that TLAC should not include liquid deposits, credit union term deposits' early withdrawal penalties and share certificates' early redemption penalties make these items sufficiently sticky and stable so that they would be available to help absorb losses in a failure.

3. Common Equity Tier 1 Capital Should Always Qualify as Meeting Regulatory Buffers

World Council opposes the proposal in section 6 that "Common Equity Tier 1 that is being used to meet TLAC requirement cannot be used to meet the [Basel III] regulatory capital buffers." The Committee should not finalize this aspect of the proposal.

World Council opposes this aspect of the proposal because credit unions generally rely on retained earnings to build capital. In some jurisdictions, retained earnings—a form of Common Equity Tier 1 capital—are the only type of regulatory capital available to most credit unions as a legal matter. Even when the applicable credit union rulebook permits credit unions to issue capital shares or subordinated debt instruments, the demand for these instruments is limited and they form a negligible part of most credit unions' capital.

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[4] Section 107(6) of the United States' Federal Credit Union Act authorizes federal credit unions to accept "payments, representing equity . . . on share certificates which may be issued at varying dividend rates and maturities" but which are typically accounted for as a liability. 12 U.S.C. § 1757(6)(B), *available at* https://www.ncua.gov/Legal/Documents/fcu_act.pdf.

[5] Financial Stability Board, *Principles on Loss-absorbing and Recapitalisation Capacity of G-SIBs in Resolution: TLAC Term Sheet* at 14-15 (Nov. 2015), *available at* http://www.fsb.org/wp-content/uploads/TLAC-Principles-and-Term-Sheet-for-publication-final.pdf.

If a credit union is subject to the *TLAC Holdings* standard, in most cases that credit union would need to use its retained earnings to meet its TLAC requirements unless uninsured term deposits and similar classes of credit union shares qualify as TLAC. This means that most credit unions—even if the institution is well capitalized—would find it difficult or impossible to meet the Basel III regulatory capital buffer requirements if Common Equity Tier 1 items like retained earnings cannot be used to meet the buffer requirements as well as to meet TLAC requirements.

World Council opposes the proposed language in section 6 that "Common Equity Tier 1 that is being used to meet TLAC requirement cannot be used to meet the [Basel III] regulatory capital buffers" and urges the Committee <u>not</u> to finalize this aspect of the proposal.

World Council appreciates the opportunity to comment on the Basel Committee's *TLAC Holdings* consultative document. 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