January 13, 2017

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

Re: Consultative Document: *Regulatory treatment of accounting provisions – interim approach and transitional arrangements* (Oct. 2016)

Dear Mr. Coen:

World Council of Credit Unions (World Council) appreciates the opportunity to comment on the Basel Committee on Banking Supervision's consultative document *Regulatory treatment of accounting provisions – interim approach and transitional arrangements*.[1] Credit unions are cooperative depository institutions and World Council is the leading trade association and development organization for the international credit union movement. Worldwide, there are over 60,000 credit unions in 109 countries with USD 1.8 trillion in total assets serving 223 million natural person members.[2]

1. World Council Supports the "Alternative 1" Capital Add-back

World Council supports the Committee's proposed "Alternative 1" transitional approach that would add-back to an institution's Common Equity Tier 1 (CET1) capital the additional loan loss reserves required by International Financial Reporting Standard 9 (IFRS 9) and the United States Generally Accepted Accounting Principles (US GAAP) Current Expected Credit Losses (CECL) standard. This add-back to CET1 capital would be amortized over a period of years.

We support Alternative 1 because it will: (a) add back initially all of the additional funds being transferred to loss reserves as a result of IFRS 9 or CECL; (b) would be based on differences in reserve requirement over the entire transitional period (rather than use an unchanging percentage as in proposed Alternative 2); and (c) would be compatible with both IFRS 9 and CECL (unlike proposed Alternative 3).

The implementation of expected credit loss standards standard under IFRS 9 and CECL are de facto capital increase for depository institutions subject to these accounting rules. Loss-absorbing CET1 capital will be transferred to the loan loss allowance and similar credit loss accounting provisions even though these funds are permanent, are available to absorb losses,

[1] Basel Committee on Banking Supervision, *Regulatory treatment of accounting provisions – interim approach and transitional arrangements* – Consultative Document (Oct. 2016), *available at* http://www.bis.org/bcbs/publ/d386.htm.
[2] World Council of Credit Unions, *2015 Statistical Report* (2016), *available at* http://www.woccu.org/publications/statreport.

World Council of Credit Unions, Inc.
601 Pennsylvania Avenue NW, Washington, DC 20004-2601 • Phone: +1-202-638-0205 • Fax: +1-202-638-3410 • www.woccu.org

have no claims against them, and are not be allocated to absorbing actual losses that have occurred as an economic matter.

Credit unions and other financial cooperative institutions are generally well capitalized under currently applicable incurred credit loss accounting rules. This table, for example, includes the most recent available capital ratio data applicable to credit unions and mutual building societies in Australia,[3] Canada, and the USA under incurred loss accounting standards:

	Leverage Ratio	CET 1 Risk-Based Capital Ratio	Total Risk-Based Tier 1 Ratio	Total Risk-Based Capital Ratio
Australian Mutual Building Societies[4]	Not published	18.1%	18.1%	18.6%
Australian Credit Unions[5]	Not published	15.4%	15.4%	16%
Canadian Credit Unions (excluding Quebec)[6]	14.0%	Not published	12.8%	14.1%
US Credit Unions[7]	10.7%	Not published	Not published	Not published

Although these cooperative financial institutions have high levels of capital on average, some institutions in these jurisdictions have capital levels that are below average and could be subject to Prompt Corrective Action measures unless the Committee adopts transitional measures such as proposed Alternative 1. The total amount of economic capital these institutions will have available to absorb losses will remain constant and in-line with the above figures after IFRS 9/CECL implementation, however, notwithstanding that some of that capital will be written off as provisioning expenses on an accounting basis under IFRS 9 and CECL.

Financial cooperatives are often subject to high regulatory capital requirements, and institutions that fall below the minimum capital requirement to be considered adequately capitalized typically face stringent Prompt Corrective Action requirements up to and including mandatory

[3] There are also "mutual banks" in Australia, which are cooperative financial institutions, in addition to credit unions and mutual building societies. The Australian Prudential Regulation Authority (APRA) does not, however, report statistics specifically concerning Australia's 10 "mutual banks." The data concerning Australia's 10 mutual banks is not included in this table because it cannot be disaggregated from APRA's data on small and medium-sized domestic joint-stock banks.

[4] APRA, *Statistics: Quarterly ADI Performance: 30 September 2016* at 30 (Nov. 2016), *available at* http://www.apra.gov.au/adi/Publications/Documents/2911-QADIPS-Sep-2016.pdf.

[5] *Id.* at 33.

[6] Canadian Credit Union Association, Year-End 2015 Data. NB: Approaches to measuring provincially chartered credit union Risk-Based Capital vary from province to province, and caution should be used in interpreting these results as calculations are based on the sum of data provided by provincial system.

[7] Credit Union National Association (of the USA), *Monthly Credit Union Estimates* (Nov. 2016), *available at* https://www.cuna.org/Research-And-Strategy/Credit-Union-Data-And-Statistics/.

merger or liquidation of the institution.[8] The Committee's adoption of proposed Alterative 1 will help reduce the number of institutions that are pushed into Prompt Correct Action measures solely as a result of the implementation of IFRS 9 and CECL. Adoption of proposed Alternative 1 will also allow the Committee more time to consider how best to incorporate IFRS 9 and CECL into the Committee's capital requirements framework without significantly increasing institutions' overall capital requirements.

World Council supports the Committee's proposed Alternative 1 and urges the Committee to utilize Alternative 1 in the final version of this standard.

2. CET1 Add-Back Amortized Over at Least 5 years:

World Council urges the Committee to allow institutions to amortize the add-back to CET1 capital over at least 5 years. Allowing institutions to amortize the capital add-back over 5 years will help reduce the potential shock of IFRS 9 and CECL implementation on institutional capital levels by spreading out its impact over the medium-term. A 5-years amortization period would also be consistent with the 5-year amortization period currently required by Basel II/III as the minimum allowable time period for amortization of Tier 2 capital.

A transition period of at least 5 years will also help reduce regulatory uncertainty for institutions because it will provide clear rules that will facilitate medium-term capital planning and institutional earnings retention. Further, spreading out the impact of IFRS 9 and CECL on institutional capital over at least 5 years will help mitigate the reduction in lending to consumers and businesses that typically occurs when an institution's capital levels decrease.

3. No "De Minimis" Threshold for the Add-Back:

World Council strongly opposes including a "de minimis" threshold where no capital add-back would be allowed if the amount of the add-back is less than a minimum threshold expressed as a specific amount of currency.

Establishing a de minimis threshold in absolute terms (rather than on percentage terms) would not be consistent with the principle of proportionality. Under this approach a small institution that experiences a high decrease in its capital levels on a percentage basis under IFRS 9 or CECL would not be allowed to utilize the add-back at all if it did not exceed the de minimis currency amount.

The de minimis threshold concept also raises level playing field concerns. Cooperative financial institutions would in some cases be too small to enjoy the regulatory relief presented by Alternative 1 even though presumably all large banks would have additional provisioning requirements that are high enough in absolute terms to exceed the de minimis amount and utilize the capital add-back.

[8] *See, e.g.*, Federal Credit Union Act § 216(c), 12 U.S.C. § 1790d(c) ("Net Worth Categories"), *available at* https://www.law.cornell.edu/uscode/text/12/1790d.

World Council urges the Committee <u>not</u> to include a de minimis threshold as part of the final version of this standard because it would not provide regulatory relief to smaller community-based financial institutions.

4. General Accounting Provisions inclusion in Additional Tier 1 or Tier 2 Capital

World Council supports continuing the distinction between accounting "general provisions" and "specific provisions" as well as including general accounting provisions within Alternative Tier 1 or Tier 2 capital up to 1.25% of risk-weighted assets during the transitional period and beyond (i.e. when the general provisions in question are not being added-back to CET1 capital).

The Committee's proposal to add-back to CET 1 much the increase in credit loss reserves from expected credit loss standards, as a transitional measure, recognizes the high quality of the capital that IFRS 9 and CECL will require to be added to general provisions. Please see World Council's January 13, 2017 comment letter in response to the Committee's Discussion Paper on *Regulatory Treatment of Accounting Provisions* for a more detailed discussion on the inclusion of general provisions in Additional Tier 1 capital.

We urge the Committee to include general provisions in Additional Tier 1 capital or, at a minimum, continue to include general provisions in Tier 2 capital during the transition period.

World Council appreciates the opportunity to comment on the Basel Committee's consultative document on the *Regulatory treatment of accounting provisions – interim approach and transitional arrangements*. 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