March 18, 2019

<u>Delivered via Email at fsb@fsb.org</u>

Mark Carney
Chair
Financial Stability Board
Bank for International Settlements
CH-4002
Basel, Switzerland

Re: *Feedback on the Effects of Financial Regulatory Reforms on SME Financing*

Dear Chair Carney:

World Council of Credit Unions (World Council) appreciates the opportunity to comment on the Financial Stability Board's (FSB) request for *Feedback on the Effects of Financial Regulatory Reforms on SME Financing.*[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 68,000 credit unions in 109 countries with USD 1.8 trillion in total assets serving 235 million physical person members.[2]

It is abundantly clear that the financial regulatory reforms adopted in response to the financial crisis during the 2007-2009 timeframe resulted in a more robust and complex regulatory framework. The additional complexity often filters down disproportionately to smaller, less-complex institutions such as credit unions and other community based cooperative institutions.

A recent study performed by the Credit Union National Association (CUNA) indicates regulatory costs borne by credit unions totaling $6.1 billion since the economic crisis resulting in higher loan rates, fewer services and products, longer wait times for loans

[1] Financial Stability Board's request for *Feedback on the Effects of Financial Regulatory Reforms on SME Financing*, *available at* http://www.fsb.org/wp-content/uploads/R250219.pdf..
[2] World Council of Credit Unions, *2016 Statistical Report* (2017), *available at* https://www.woccu.org/impact/global_reach/statreport.

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and less convenient service to their members.[3] Further, a recent Filene Research Institute study, focusing on United States and Canadian credit unions noted that new regulation puts the smallest credit unions at a severe competitive disadvantage.[4]

In Canada, for example, decades of policy decisions have further disproportionately affected smaller credit unions to the extent that compliance for a credit union under $250 million in assets runs approximately $75 per member versus around $22 per person for a credit union with $2 billion in assets.[5] This distortion begs for the increased proportional tailoring of the financial reforms implemented since the financial crisis to provide meaningful competition and permit the credit union sector to provide meaningful return to its members and the economy.

We concur with the Key Takeaways of the FSB Roundtable on the Effects of Reforms on SME Financing[6] that the cumulative impact of regulations on SME lending are driven by the increased complexity and compliance costs that particularly affect smaller institutions with fixed compliance costs. This is particularly true for smaller credit unions that often rely on volunteers to help run the credit unions and have volunteer boards. Margins are already thin and complexity, compliance costs, and regulatory burdens often lead to consolidation and mergers.

In this context we provide our answers to the questions.

1. **What have been the main trends in SME Financing (i.e. types of financing, volumes, prices and maturities since the financial crisis? How do these trends differ across jurisdictions (e.g. advanced vs. emerging markets economies) and sectors (e.g. high-tech vs. traditional firms), as well as by firm size (micro vs. small vs. medium-sized firms) and age (e.g. start-ups vs. mature firms).**

Data on the Canadian commercial loans is contained below. As a result, as the trends indicate SME or commercial lending growth has slowed dramatically post economic crisis. This in part coupled with increased complexity and regulatory burden hampers the ability of credit unions in Canada to maximize their potential for economic input.

[3] *See* Credit Union National Association, *2017 Regulatory Burden Financial Impact Study: An Elevated New Normal available at* https://www.cuna.org/uploadedFiles/Global/About_Credit_Unions/FINAL_4-Page_Executive_Summary_Web.pdf.
[4] *See* Filene Research Institute, *Only Up: Regulatory Burden and Its Effects on Credit Unions available at* https://www.info-pro.com/wp-content/uploads/2015/05/331_Regulatory_Burden.pdf.
[5] *See* Martha Durdin, *Real competition is needed in Canada's banking sector*, The Hill Times (November 5, 2018) *available at* https://www.hilltimes.com/2018/11/05/real-competition-needed-canadas-banking-sector/174952?hootPostID=aac37846f51d0ad333847a2b2ebee039.
[6] FSB Roundtable on the Effects of Reforms on SME Financing, Amsterdam, 12 December 2018, *Key Takeaways*, *available at* http://www.fsb.org/2019/02/fsb-roundtable-on-the-effects-of-reforms-on-sme-financing-key-takeaways/.

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Canadian Credit Union System (excluding Quebec)

Year	Commercial (incl. line of credit)	Annual Growth
2001	4,439,646,038	
2002	5,212,525,710	17.4%
2003	6,222,680,737	19.4%
2004	7,188,961,212	15.5%
2005	8,343,229,727	16.1%
2006	9,740,939,488	16.8%
2007	10,970,298,834	12.6%
2008	12,474,258,056	13.7%
2009	13,384,849,376	7.3%
2010	14,034,512,617	4.9%
2011	15,064,287,113	7.3%
2012	17,620,664,629	17.0%
2013	19,170,835,516	8.8%
2014	20,643,673,142	7.7%
2015	21,933,646,407	6.2%
2016	23,693,105,096	8.0%
2017	24,968,187,630	5.4%
2018	25,999,444,018	4.1%

Commercial loans include line of credit, and exclude commercial mortgages and agricultural loans

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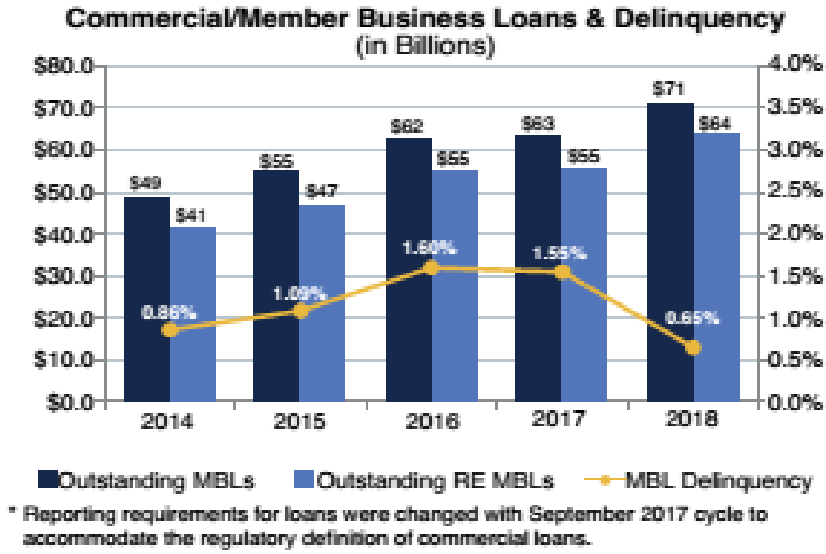

Source: NCUA Quarterly U.S. Map Review, 4th Quarter 2018[7]

In contrast, in the Unites States, the NCUA undertook a significant reform of the Member Business Regulations[8] where they reduced regulatory burden on commercial lending by moving from a prescriptive to a principle-based regulation. These reforms significantly reduced regulatory burdens for credit unions which has resulted in increased SME and commercial lending and as evidenced by the decreasing delinquency ratios, better quality loans. We do note however, that the relative market share of credit unions as compared to banks in the United States has remained fairly consistent at around 7%.

2. **What have been the main drivers of the observed trends in SME financing in recent years? How do they differ across jurisdictions, sectors, size and age of firms?**

For credit unions, the main driver of their ability to lend in the SME space has been the imposition of complexity, compliance costs, and regulatory burdens that often affect the ability of a smaller, less complex institutions to not only find the resources and the expertise. This often leads to an institution being unable to engage in SME lending. Further, the pressures from increased capital requirements can make it prohibitive from lending in this space.

Credit unions often have restrictive fields of membership and thus rarely operate on a cross-border basis. They are not "internationally active" within the meaning of Basel

[7] NCUA Quarterly U.S. Map Review, 4th Quarter 2018, *available at* https://www.ncua.gov/files/publications/analysis/chart-pack-2018-q4.pdf.
[8] NCUA Member Business Lending reforms, 80 Fed. Reg. 126 (July 1, 2015) *available at* *https://www.ncua.gov/files/comment-letters/2015/PR20150618MemberBusinessLoans.pdf*.

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rules, yet often national regulators choose to apply those standards applicable to larger, internationally applicable banks without proper proportional tailoring. This often disproportionately affects smaller, less complex institutions such as credit unions.

3. **Have financial reforms such as Basel III affected bank financing to SMEs (e.g. in terms of loan volumes, prices, maturities and collaterlisation)? If so how? How important have been their effects vis-a-vis other types of bank lending and compared to the main drivers identified in question 2.**

Yes, please see introductory comments and answers to questions 1 and 2. In particular the cumulative effect of the regulations on the complexity, compliance costs, and regulatory burdens are limiting the ability of credit unions and other community-based cooperative institutions to provide SME financing.

4. **How does the impact (if any) of financial regulatory reforms vary across banks operating in different geographies and with different size and business models?**

Credit unions often have restrictive fields of membership and thus rarely operate on a cross-border basis. They are not "internationally active" within the meaning of Basel rules, yet often national regulators choose to apply those standards applicable to larger, internationally applicable banks without proper proportional tailoring. This often disproportionately affects smaller, less complex institutions such as credit unions. Therefore, it is challenging to discern geographic differences in a particular jurisdiction, but those jurisdictions that have proportionally tailored regulations, tend to see an increase in SME lending.

5. **What other G20 financial reforms or other domestic financial regulations (if any) may have impacted financing to SMEs and how?**

Reforms with AML/CFT continue to increase compliance and regulatory costs for credit unions which indirectly affect the lending capacity of a credit union.

IFRS 9 accounting reforms that now include expected credit loss methodologies create larger loan loss reserves as they include estimates of future losses that have not yet been incurred also decrease the capacity of a credit union to lend in the SME space.

It should also be noted that SME loan securtisations that face high capital charges imposed by banks may prevent credit unions from obtaining access to capital thus reducing their ability to provide SME lending.

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6. **Have financial reforms prompted a shift in the provision of SME financing, eg. Between banks and other financial institutions (substitution effects)? If so, how?**

Changes in the behaviors of banks in the SME space can often affect the ability to compete in a particular market, as small, less complex institutions such as credit unions often do not have the economies of scale to effectively compete. Community based institutions such as credit unions, and their cooperative model, often lend themselves to better being able to serve underserved markets or rural markets where banks choose not to compete. It is however difficult to discern large scale shifts in the provision of SME financing, but we do notice the increasing presence of fintech or online SME lending entering the market space. Credit unions and other small community-based institutions often do not have he resources to compete with these types of providers.

7. **Are there any other issues or relevant factors that should be considered as part of this evaluation?**

Credit unions can play a vital role in supporting the economy by providing sources of business credit to local communities and Small and Medium-sized Enterprises (SMEs). Programs such as the Competitiveness of Enterprises and Small and Medium-sized Enterprises (COSME) in the EU can support credit unions in providing SME financing and the benefits to their local communities can be significant. SME credit guarantees can play a critical role in assisting with the provision of SME financing.

WOCCU appreciates the opportunity to comment on the FSB's request for *Feedback on the Effects of Financial Regulatory Reforms on SME Financing.* Please do not hesitate to contact me aprice@woccu.org or phone at +1 850-766-5699 should you have any questions regarding our comments.

Sincerely,

Andrew T. Price
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