March 23, 2018

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

Re: Consultative Document: Stress Testing Principles

Dear Mr. Coen:

World Council of Credit Unions (World Council) appreciates the opportunity to comment to the Basel Committee on Banking Supervision's (Basel Committee) *Consultative Document: Stress Testing Principles.*[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]

We concur with the findings of the consultative document that indicates that stress testing frameworks that have been developed since the global financial crisis have evolved well beyond those that were envisaged since the publication of the current stress testing principles. Many of our member associations have reported "gold-plating" and excess supervision involving stress testing. To that end, the ever increasing regulatory burdens on credit unions and other community-based mutual depository institutions continues to be of great concern.

World Council therefore strongly supports the Committee's statement on page 6 of the proposal that:

> "These principles are therefore intended to be applied on a proportionate basis, depending on size, complexity and risk profile of the bank or banking sector for which the authority is responsible."

We urge the Committee to finalize this statement on proportional application of stress testing principles as proposed. While we acknowledge and agree that stress testing is an important regulatory and management tool—particularly for Systemically Important

[1] Basel Committee on Banking Supervision, *Consultative Document: Stress Testing Principles* (Dec. 2017), *available at* https://www.bis.org/bcbs/publ/d428.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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Financial Institutions (SIFIs) and complex international banks—its usefulness, and corresponding regulatory burden and costs for smaller non-systemically important credit unions becomes questionable, particularly those that are only involved in deposit taking and simple retail consumer lending. As such, these principles should be implemented in accordance with the principle of proportionality[3] such that the supervisory practices are commensurate with the risk profile and systemic importance of the supervised entity being supervised.

We appreciate that the Committee is moving to a shorter, higher-level articulation of its principles, by its own acknowledgement it will allow for a more robust development of stress testing practices. While we do not object to this approach in concept and believe it is appropriate for Global-Systemically Important Banks (G-SIBs) and Domestic-Systemically Important Banks (D-SIBs), our concern comes in the lack of clarity in the implementation for those that are neither D-SIBs or G-SIBs.

Credit Unions and other community-based cooperative depository institutions are not systemically important on a global or domestic level. Their operations are far less complex than those of G-SIBs, D-SIBs or internationally active banks and thus we question whether the supervisory usefulness of stress testing these types of community-based institutions justifies the attendant compliance burdens.

Yet what is likely to occur, absent the specific clarity in these principles, is that national authorities will tend to apply these standards without regards for proportional tailoring of a stress test to the risk or complexity of a credit union or other community-based mutual depository institution. This is particularly true in jurisdictions that contain institutions that are of large size compared to other local credit unions or where the credit union or other mutual is of large size relative to the capitalization of the local deposit insurance fund or other savings guarantee scheme.

In the United States of America, for example, National Credit Union Administration (NCUA) regulations currently require all credit unions with more than USD 10 billion in assets to undergo stress testing based on the agency's finding that these credit unions "pose the greatest risk to the [National Credit Union] Share Insurance Fund," the savings guarantee fund for US credit unions.[4] We note, however, that the NCUA itself acknowledges that the compliance burden and regulatory benefit of this testing is great

[3] *See, e.g.*, Basel Committee on Banking Supervision, *Core Principles for Effective Banking Supervision*, at ¶4 (Sep. 2012) ("[T]he Committee has sought to achieve the right balance in raising the bar for sound supervision while retaining the Core Principles as a flexible, globally applicable standard. By reinforcing the proportionality concept, the revised Core Principles and their assessment criteria accommodate a diverse range of banking systems. The proportionate approach also allows assessments of compliance with the Core Principles that are commensurate with the risk profile and systemic importance of a broad spectrum of banks (from large internationally active banks to small, non-complex deposit-taking institutions)"), *available at* https://www.bis.org/publ/bcbs230.pdf.
[4] Capital Planning and Stress Testing, 79 Fed. Reg. 24311, 24312 (Apr. 30, 2014), *available at* http://www.gpo.gov/fdsys/pkg/FR-2014-04-30/pdf/2014-09814.pdf.

and is in the process of amending and raising this threshold to a tiered approach providing relief from the stress testing requirements to those under USD 20 billion in assets.[5]

Of note in the NCUA's proposal is the agency's acknowledgement that "it is appropriate to differentiate the capital planning requirements applicable to such institutions based on their individual characteristics" such as size, complexity and financial condition as well as the credit union's ability to support sound capital planning and supervisory stress testing expectations.[6] Therefore, the primary reason for the imposition of stress testing is for the protection of the agency's savings guarantee fund and not necessarily for the proper management and oversight of the credit union per se.

The problem with this is approach that the comfort for the regulatory authority resulting from stress testing often imposes a large compliance burden on the regulated institution without providing significantly useful supervisory information. Stress testing takes significant staff time, compliance resources, and information technology resources (which are sparse in not-for-profit, member owned, volunteer-run organizations), that often includes the institution having to retain outside consultants at great expense for a community-based institution.

Put simply, stress testing community-based financial cooperatives does not usually provide prudential safety and soundness benefits that outweigh the stress testing's compliance costs imposed both on the regulated institution itself and on its supervisory agency pursuant to Pillar 2 supervisory review process. We do not believe that such outsized compliance costs are justified for either the regulated institution or its supervisor in the case of credit union or other community-based mutual depository institution that is not systemically important or even internationally active.

With a large systemically important bank, stress testing can be useful in determining how a failure might occur given the complex nature of its operations. With the simple complexity of a credit union or similar community-based financial cooperative, a stress test, particularly if the assumptions or failure scenarios utilized are unreasonably pessimistic, can result in the imposition of regulatory remedial measures that are not warranted for the risks facing the institution. Credit union resources and supervisory resources would be more wisely utilized on real risks such as credit risks or fraud which are more likely to cause problems in a credit union or similar mutual than hypothetical economic scenarios created by a supervisory authority. Stress testing is not necessary for a non-complex financial institution.

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[5] Capital Planning and Supervisory Stress Testing, 82 Fed. Reg. 50094 (proposed Oct. 30, 2017), *available at* https://www.ncua.gov/regulation-supervision/Documents/Regulations/proposed-rule-capital-planning-stress-testing-2017-oct.pdf.
[6] *Id.* at 50095.

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The compliance burden for a member-owned, not-for-profit, volunteer run organization for a stress test can be significant. The consultative document contemplates robust stress testing frameworks, with a comprehensive assessment of risks, with an increased need for specialized staff, systems and IT infrastructure, supported by granular data, subject to regular review, and run at regular intervals.[7] All of these requirements should be subject to a cost-benefit analysis before requiring a credit union to undergo such measures where the corresponding benefit from both a risk management perspective and a supervisory or safety and soundness perspective is minimal. It is difficult to see where much supervisory benefit can be obtained from onerous stress testing for a simple credit union engaged in little more than deposit taking, simple retail consumer lending, and payments activities.

Finally, we urge the Committee to consider refining the language for the "Additional points for authorities" to reinforce the concept that authorities should consider their corresponding costs and the likely benefit that they will obtain from a supervisory perspective before implementing any requirements on their regulated entities, in order further to reinforce proportional application of stress testing to regulated institutions based on their size, complexity, and cross-border operations (or lack thereof).

In conclusion, we strongly support the Committee's inclusion of the principle of proportionality in this proposal and urge the Committee to finalize this standard in a manner that ensures that supervisory practices required for stress testing are commensurate with the risk profile and systemic importance of the supervised entity. Supervisory authorities should not impose requirements appropriate for or intended for G-SIBs or D-SIBs to credit unions or other community-based mutual depository institutions that do not have the same risk or complexity.

WOCCU appreciates the opportunity to comment on the Basel Committee's *Consultation Document: Stress Testing Principles.* Please do not hesitate to contact me aprice@woccu.org or phone at +1 202-508-6776 should you have any questions regarding our comments.

Sincerely,

Andrew T. Price
Regulatory Counsel
World Council of Credit Unions

[7] All of these items are express in the Basel Committee on Banking Supervision's *Stress Testing Principles,* Consultative Document (December 2017) *available at* https://www.bis.org/bcbs/publ/d428.pdf.