



November 17, 2017

Sent via email

Governor Katsunori Mikuniya
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c/o Bank for International Settlements
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Re: Research Paper – *Resolution Issues for Financial Cooperatives: Overview of Distinctive Features and Current Resolution Tools*

Dear Governor Katsunori:

World Council of Credit Unions (World Council) appreciates the opportunity to comment to the International Association of Deposit Insurers on the Association's draft research paper *Resolution Issues for Financial Cooperatives: Overview of Distinctive Features and Current Resolution Tools*.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 physical person members.²

1. Demutualization Should be a Last Resort for Resolving Financial Cooperatives and Should be Discussed after the Overview of Resolution Tools

World Council urges the Association to revise the final version of its research paper on resolution of financial cooperatives to include demutualization only as a last resort, i.e. only in the rare circumstances when a resolution via a merger or purchase and assumption transaction with another financial cooperative is not possible.

Specially, we urge the Association to place the paper's discussion of "Demutualization" after the paper's discussion of the "Overview of Resolution Tools" and to emphasize that demutualization is a disfavored resolution approach. Maintaining the availability of cooperative financial services to ordinary physical persons and small and medium

¹ International Association of Deposit Insurers, *Resolution Issues for Financial Cooperatives: Overview of Distinctive Features and Current Resolution Tools* (July 2017), available at http://www.iadi.org/en/assets/File/Public_Consultation/Resolution_Issues_for_Financial_Cooperatives_Overview_of_Distinctive_Features_and_Current_Resoultion_Tools.pdf.

² World Council of Credit Unions, *2015 Statistical Report* (2016), available at https://www.woccu.org/documents/2015_Statistical_Report_WOCCU.



enterprises (SMEs) is important for promoting financial inclusion in all types of communities, especially rural districts and poor urban areas that are underserved by commercial banks because of a perceived lack of profitability. Financial cooperative systems also contribute importantly to diversity in the financial sector and, because of their mission to serve their members rather than to maximize profits, help promote financial stability through a conservative business outlook stressing long-term viability and community banking.

We are concerned that the draft paper lists “Demutualization” in proposed Section 5.1 of the paper before the “Overview of Resolution Tools” in proposed Section 5.2. Placing demutualization as the first discussion part of this paper implies that demutualization is the Association’s preferred methodology for resolving financial cooperatives. While we recognize that occasionally a financial cooperative may be too large for another financial cooperative in the jurisdiction to absorb, these cases are rare and typically limited to systemically important institutions.

We believe that demutualization should only be considered in the rare situation where there are no other financial cooperatives in the jurisdiction that can absorb the problem institution even with supervisory financial assistance or state aid. Business combinations between two financial cooperatives should be preferred over demutualization because financial cooperatives’ purpose of serving their members at fair rates, instead of maximizing profits, better promotes financial inclusion and the availability of credit to SME businesses, especially in areas that are underserved by commercial banks.

We urge the Association to emphasize that demutualization of a financial cooperative should be considered only as a last resort and to place the paper’s discussion of “Demutualization” after the paper’s “Overview of Resolution Tools”.

**2. Mergers and Purchase and Assumptions Between Financial Cooperatives
Should be the Preferred Methods for Resolving Weak Cooperative
Financial Institutions in Order to Promote the Financial Inclusion of
Underserved Communities**

World Council urges the Association to emphasize that business combinations between financial cooperatives—including mergers and purchase and assumption transactions—should be looked to as the preferred methods of resolving weak cooperative institutions in the final version of its research paper on resolution issues for financial cooperatives. Specifically, we urge the Association to include mergers and purchase and assumption transactions between cooperatives as the first resolution tools discussed in the final version of this paper’s “Overview of Resolution Tools.”

Mergers between credit unions or other types of financial cooperatives are a common method for resolving problem financial cooperatives. Financial cooperatives, because of their cooperative corporate structure and philosophy of service provision instead of



World Council of Credit Unions

profit maximization, promote financial inclusion in ways that commercial banks do not in wealthy, middle-income and developing countries alike.

Credit unions and other financial cooperatives exist not for profit, not for charity, but to serve their members by promoting thrift and providing financial services at fair rates. Mergers between a well-capitalized financial cooperative and a critically undercapitalized one maintain the availability of cooperative financial services to the acquired institutions' members and communities. Financial cooperative systems also contribute importantly to diversity in the financial sector and help promote financial stability through a conservative business outlook stressing long-term viability and community banking.

Maintaining the availability of cooperative financial services to ordinary physical persons and SME businesses is important in all types of communities, but is especially crucial for rural districts and poor urban areas that are often underserved by commercial banks because of the limited margins involved in serving the residents of these areas. For example, a financial cooperative—because of its corporate purpose to serve its member-shareholders rather than to generate profits for investors—is generally less likely to close an acquired institution's less-profitable branch offices in rural districts or poor urban areas than a commercial bank would.

In many cases a financial cooperative will seek a merger partner on a voluntary basis after becoming aware of its weak financial position but well before the point of non-viability. In the Republic of Ireland, for example, many smaller credit unions have recently or are in the process of voluntarily merging into larger credit unions to achieve greater economies of scale in a process facilitated by a temporary Irish statutory body called the Credit Union Restructuring Board (ReBo).³

When a voluntary merger is not possible, financial cooperative regulators often have authority to conduct a "supervisory" merger without the approval of the institution's management or members. Supervisory mergers can either be assisted with state aid or unassisted, depending on the condition of the institution being resolved.

Purchase and assumption transactions are another form of supervisory business combination to resolve a financial cooperative that is a gone concern, and the draft paper discusses purchase and assumption transactions in Section 5.3.7. We believe that other financial cooperatives should be the preferred acquirers in the case of a purchase and assumption transaction whenever possible in order to preserve the availability of cooperative financial services to the resolved institution's community.

³ See, e.g., Colin Gleeson, "Fraction of money for reform of credit union sector used: Credit Union Restructuring Board to be wound down after Government report," *Irish Times*, June 16, 2017, available at <https://www.irishtimes.com/business/financial-services/fraction-of-money-for-reform-of-credit-union-sector-used-1.3122636> ("It was a huge achievement for ReBo to complete 82 projects involving 156 credit unions across 24 counties and to accomplish this in a tight timeframe using only circa €20 million.")



In the United States of America, for example, the US National Credit Union Administration serves as the federal prudential supervisor of 5,696 federally insured credit unions⁴ and it took 18 credit union resolution actions in 2016,⁵ 21 credit union resolution actions in 2015,⁶ and 18 credit union resolution actions in 2014⁷ (which are the most recent three years for which year-end data is available; the agency also publishes information on its website concerning credit union closures since at least 2009).⁸

The National Credit Union Administration also administers the federal savings guarantee system for credit unions through the agency's National Credit Union Share Insurance Fund (NCUSIF). The NCUSIF insures credit union members' accounts to US\$ 250,000 per member per account and is backed by the full faith and credit of the United States.⁹

The National Credit Union Administration took 47 supervisory actions with respect to the resolution of federally insured credit unions from 2014 to 2016, as follows:

- Four of these failures were resolved through supervisory mergers without financial assistance;¹⁰
- Eleven failed credit unions were resolved through supervisory mergers with financial assistance from the NCUSIF;¹¹

⁴ National Credit Union Administration, *Credit Union Data Summary 2017 Q2* (July 2017), available at <https://www.ncua.gov/analysis/Pages/call-report-data/reports/paca-facts/paca-facts-2017-Q2.pdf>.

⁵ "Supervisory Actions - (Closed Credit Unions) in 2016;" <https://www.ncua.gov/services/Pages/closed-credit-unions/2016.aspx> (last visited Nov. 17, 2017).

⁶ "Supervisory Actions - (Closed Credit Unions) in 2015;" <https://www.ncua.gov/services/Pages/closed-credit-unions/2015.aspx> (last visited Nov. 17, 2017).

⁷ "Supervisory Actions - (Closed Credit Unions) in 2014;" <https://www.ncua.gov/services/Pages/closed-credit-unions/2014.aspx> (last visited Nov. 17, 2017).

⁸ "See Closed Credit Unions;" <https://www.ncua.gov/services/Pages/closed-credit-unions.aspx> (last visited Nov. 17, 2017).

⁹ Share Insurance Fund Overview; <https://www.ncua.gov/services/Pages/share-insurance.aspx> (last visited Nov. 17, 2017) ("The National Credit Union Share Insurance Fund is the federal fund created by Congress in 1970 to insure member's deposits in federally insured credit unions. Administered by the National Credit Union Administration, provides members with at least \$250,000 of insurance at a federally insured credit union. The Share Insurance Fund is backed by the full faith and credit of the United States. Credit union members have never lost a penny of insured savings at a federally insured credit union.")

¹⁰ See Supervisory Actions - (Closed Credit Unions) in 2016;" <https://www.ncua.gov/services/Pages/closed-credit-unions/2016.aspx> (last visited Nov. 17, 2017).

¹¹ See "Supervisory Actions - (Closed Credit Unions) in 2016;" <https://www.ncua.gov/services/Pages/closed-credit-unions/2016.aspx> (last visited Nov. 17, 2017); "Supervisory Actions - (Closed Credit Unions) in 2015;" <https://www.ncua.gov/services/Pages/closed-credit-unions/2015.aspx> (last visited Nov. 17, 2017); "Supervisory Actions - (Closed Credit Unions) in 2014;" <https://www.ncua.gov/services/Pages/closed-credit-unions/2014.aspx> (last visited Nov. 17, 2017).



World Council of Credit Unions

- Fourteen failed credit unions were resolved through supervisory purchase and assumption transactions with another credit union;¹²
- Eight credit unions were placed in “conservatorship,”¹³ a form of restructuring without members’ approval, similar to the legal procedures discuss in Section 5.3.4 of the draft paper, where the National Credit Union Administration replaces the credit union’s management and operates the institution under government administration, often until a merger or liquidation is conducted;¹⁴
- Seventeen small credit union were liquidated; these liquidated institutions ranged in asset size from between US\$ 27,039 in total assets to US\$ 8.9 million in total assets.¹⁵ In these cases the credit union members’ insured savings were paid to the members by the NCUSIF and National Credit Union Administration administered the liquidated institutions’ assets; and
- Two credit unions previously placed into conservatorship liquidated voluntarily.¹⁶

Notably, none of these 47 credit union resolution actions occurring between 2014 and 2016 involved a demutualization or a business combination with a commercial bank. Rather, all closed credit unions with more than US\$ 9 million in assets were either combined with another credit union or placed into government conservatorship where the National Credit Union Administration operates the credit union, typically until the agency finds a merger partner or returns the institution to its members after correcting material weaknesses.

¹² National Credit Union Administration, “First African Baptist Church Federal Credit Union Closes” (Nov. 29, 2016), available at <https://www.ncua.gov/newsroom/Pages/news-2016-nov-first-african-baptist-church-federal-credit-union-closes.aspx> (“At the time of its liquidation and subsequent purchase and assumption by American Heritage Federal Credit Union, First African Baptist Church Federal Credit Union had assets of \$76,188 and served 261 members, according to its most recent Call Report.”)

¹³ See “Supervisory Actions - (Closed Credit Unions) in 2016;” <https://www.ncua.gov/services/Pages/closed-credit-unions/2016.aspx> (last visited Nov. 17, 2017); “Supervisory Actions - (Closed Credit Unions) in 2015;” <https://www.ncua.gov/services/Pages/closed-credit-unions/2015.aspx> (last visited Nov. 17, 2017); “Supervisory Actions - (Closed Credit Unions) in 2014; <https://www.ncua.gov/services/Pages/closed-credit-unions/2014.aspx> (last visited Nov. 17, 2017).

¹⁴ See, e.g., National Credit Union Administration, *Examiner’s Guide*, Ch. 29 (2016), available at <https://www.ncua.gov/Legal/GuidesEtc/ExaminerGuide/chapter29.pdf> (“Conservatorships generally should not exceed 12 to 24 months. To ensure recovery or resolution within a realistic time frame, the region[al office] develops a written plan to resolve immediate problem areas and documents its prospects for the credit union’s future.”).

¹⁵ See “Supervisory Actions - (Closed Credit Unions) in 2016;” <https://www.ncua.gov/services/Pages/closed-credit-unions/2016.aspx> (last visited Nov. 17, 2017); “Supervisory Actions - (Closed Credit Unions) in 2015;” <https://www.ncua.gov/services/Pages/closed-credit-unions/2015.aspx> (last visited Nov. 17, 2017); “Supervisory Actions - (Closed Credit Unions) in 2014; <https://www.ncua.gov/services/Pages/closed-credit-unions/2014.aspx> (last visited Nov. 17, 2017).

¹⁶ National Credit Union Administration, “New Bethel Federal Credit Union Closes” (Aug. 5, 2016), available at <https://www.ncua.gov/NewsRoom/Pages/NW20150805NewBethel.aspx>.



The National Credit Union Administration also has published publicly available guidance on credit union resolutions through mergers, purchase and assumption transactions, and so forth, in the agency's *Examiners' Guide* Chapter 29 ("Special Assistance, Letters of Understanding And Agreement, Conservatorships, and Special Actions") and Chapter 31 ("Liquidations")¹⁷ and in the agency's *National Supervision Policy Manual*.¹⁸

We believe that voluntary and supervisory mergers and purchase and assumption transactions between two financial cooperatives are powerful mechanisms that resolve problem institutions without changing the cooperative structure of the weak institution or significantly impacting the level of cooperative financial services available to the institution's members.

We urge the Association to include mergers and purchase and assumption transactions between cooperatives as the first resolution tools discussed in the final version of this paper's "Overview of Resolution Tools."

3. Recent Basel Committee and Federal Canadian and EU Rules Have Increased Cooperatives' Ability to Recapitalize

We urge the Association to update the Recapitalization discussion in Section 5.3.3 of the final version of this paper to include financial cooperatives' increased flexibility to issue Common Equity Tier 1 (CET1) shares under recent Basel Committee on Banking Supervision guidance¹⁹ as well as Canada's Office of the Superintendent of Financial Institutions' (OSFI) recently updated Capital Adequacy Requirements regulation²⁰ that authorized Canadian federally chartered credit unions to issue CET1 shares. The European Union has authorized co-operative banks to issue CET1 shares as well.

These new instruments are precisely the "new forms of shares" referred to in the second paragraph of Section 5.3.3. that can be the solution to the traditional challenge of recapitalizing a financial cooperative.

In September 2016, the Basel Committee authorized increased discretion for national-level supervisors to authorize financial cooperatives to issue CET1 capital in the Committee's final *Guidance on the application of the Core Principles for Effective*

¹⁷ National Credit Union Administration, *Examiner's Guide*, Ch. 29 & 31 (2016), available at <https://www.ncua.gov/regulation-supervision/Pages/manuals-guides/examiners-guide.aspx>

¹⁸ National Credit Union Administration, *National Supervision Policy Manual* (July 2015), available at <https://www.ncua.gov/Legal/GuidesEtc/GuidesManuals/SupervisionManual.pdf>.

¹⁹ See Basel Committee on Banking Supervision, *Guidance on the application of the Core Principles for Effective Banking Supervision to the regulation and supervision of institutions relevant to financial inclusion* at page 22, note 55 (Sep. 2016), available at <https://www.bis.org/bcbs/publ/d383.htm>.

²⁰ See Office of the Superintendent of Financial Institutions (OSFI) of Canada, Capital Adequacy Requirements (CAR) Chapter 2, § 2.1.1.1 (Dec. 2016), available at http://www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/CAR17_chpt2.aspx



*Banking Supervision to the regulation and supervision of institutions relevant to financial inclusion, as follows:*²¹

Member shares issued by mutual and cooperative banks could be treated as common equity for regulatory purposes provided that they meet the permanence and loss absorption criteria, as per BCBS (2011). This issue is under discussion in conjunction with the evolution of international capital standards. National regulators are encouraged to use their discretion to adjust their capital definitions and other elements of regulatory capital requirements to align with emerging guidance and sound practices. (emphasis added)

Canada and the European Union have already authorized financial cooperatives to issue CET1 shares.

In December 2016, Canada's OSFI promulgated an updated version of the agency's Capital Adequacy Requirements regulation—Canada's Basel III capital requirement rules applicable to Canadian banks and federally chartered credit unions—that authorized federally chartered Canadian credit unions to issue CET1 shares that are equivalent to joint-stock company common stock for regulatory capital purposes. The CET1 perpetual capital shares authorized by Canada's OSFI have the following key characteristics:²²

- Perpetual duration;
- Absorbs losses that exceed retained earnings;
- Takes losses prior to lower-tiered capital items like subordinated debt;
- Non-withdrawable;
- Uninsured;
- Does not have a pre-set dividend rate and dividends are issued (or not) based on the credit union's profitability, but dividends can be subject to a contractual cap;
- No mandatory redemption features, but can be bought back by the federally chartered credit union with prior supervisory approval: "A federal credit union may, with the prior consent of the Superintendent, purchase or redeem membership shares provided there are no reasonable grounds to believe that the payment would cause the institution to be in contravention of capital adequacy or liquidity requirements."

²¹ Basel Committee on Banking Supervision, *Guidance on the application of the Core Principles for Effective Banking Supervision to the regulation and supervision of institutions relevant to financial inclusion* at page 22, note 55 (Sep. 2016), available at <https://www.bis.org/bcbs/publ/d383.htm>.

²² See *id.*



In addition, cooperative banks in the European Union are authorized to issue CET1 shares under the European Union's Capital Requirements Regulation and implementing delegated acts.²³

We urge the Association to update the Recapitalization discussion in Section 5.3.3 of the final version of this paper to include the Basel Committee's updated guidance on CET1 shares issued by financial cooperatives as well the OSFI Capital Adequacy Requirements regulation authorizing Canadian federally chartered credit unions to issue CET1 cooperative shares and the European Union's regulation allowing cooperative banks to issue CET1 shares.

4. Supervisory Tools Before the Point of Non-Viability Should be Emphasized

World Council believes that a discussion of supervisory tools available for prompt corrective action of financial cooperatives prior to the point of non-viability would be a useful addition for users of the final version of the Association's research paper on resolution of financial cooperatives.

In most cases, financial problems at a cooperative depository institution can be addressed at an early state through prompt corrective action measures including capital building plans through increased earnings retention and/or issuance of capital shares, such as the US National Credit Union Administration's "Prompt Corrective Action" regulations²⁴ and rules on "Net Worth Restoration Plans."²⁵

Under these National Credit Union Administration rules, an undercapitalized credit union can have its asset growth restricted and must generally add an amount equal to at least 0.1% of total assets to their reserves per financial quarter until they are "well capitalized" (which is defined as a 7 percent leverage ratio relative to total assets). Many undercapitalized credit unions shed assets to "spin down" and meet their regulatory capital requirement to be "well capitalized" by reducing the denominator of their capital ratio instead of by increasing the numerator.

The agency can require the institution to exit unprofitable lines of business and can use supervisory contracts, such as Documents of Resolution or Letters of Understanding and Agreement, to require the institution to correct unsafe and unsound practices.

The National Credit Union Administration also has published publicly available guidance on credit union Prompt Corrective Action measures, administrative sanctions, and so forth, in the agency's *Examiners' Guide* Chapter 17 ("Prompt Corrective

²³ See European Commission, *Commission Delegated Regulation (EU) No 241/2014 of 7 January 2014 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for Own Funds requirements for institutions (Text with EEA relevance)*, 2014 O.J. (L74) 8, available at <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:32014R0241>.

²⁴ 12 C.F.R. §§ 702.201-702.205, available at <https://www.law.cornell.edu/cfr/text/12/part-702/subpart-B>.

²⁵ 12 C.F.R. § 702.206, available <https://www.law.cornell.edu/cfr/text/12/702.206>.



World Council of Credit Unions

Action”), Chapter 29 (“Special Assistance, Letters of Understanding And Agreement, Conservatorships, and Special Actions”), and Chapter 30 (“Administrative Actions”)²⁶ and in the agency’s *National Supervision Policy Manual*, especially Chapter 1 (“Administrative Remedies”) and Chapter 14 (“Prompt Corrective Action”) of that supervision policy manual.²⁷

We urge the Association to include a discussion in the final version of this paper on prompt corrective action measures for financial cooperatives prior to the point of non-viability, such as Net Worth Restoration Plans, “spinning down” by reducing assets, and supervisory contracts.

We believe that the inclusion of these supervisory tools in the final version of the paper would be a useful addition for users of the final version of the Association’s research paper on resolution of financial cooperatives. Discussion of these prompt corrective action measures, etc. will help promote safety and soundness by helping prudential supervisors correct material weaknesses at financial cooperatives prior to the point of non-viability.

World Council appreciates the opportunity to comment to the International Association of Deposit Insurers on its draft research paper *Resolution Issues for Financial Cooperatives: Overview of Distinctive Features and Current Resolution Tools*. If you have questions about our comments, please feel free to contact me at medwards@woccu.org or +1.202.508.6755.

Sincerely,

A handwritten signature in black ink that reads "Michael S. Edwards".

Michael S. Edwards
VP and General Counsel
World Council of Credit Unions

²⁶ National Credit Union Administration, *Examiner’s Guide*, Ch. 17, 29 & 30 (2016), available at <https://www.ncua.gov/regulation-supervision/Pages/manuals-guides/examiners-guide.aspx>

²⁷ National Credit Union Administration, *National Supervision Policy Manual*, at 1-29, 319-358 (July 2015), available at <https://www.ncua.gov/Legal/GuidesEtc/GuidesManuals/SupervisionManual.pdf>.