World Council

September 23, 2022

<u>Delivered Via Email: fsb@fsb.org</u>

Klaas Knot
Chair
Financial Stability Board Bank for International
Settlements CH-4002 Basel, Switzerland

Re: Exit Strategies to Support Equitable Recovery and Address Effects from COVID-19 Scarring in the Financial Sector

Dear Chairman Knot:

World Council appreciates the opportunity to comment on the Financial Stability Board's (FSB) consultative report on the Exit strategies to support equitable recovery and address effects from COVID-19 scarring in the financial sector.[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 86,000 credit unions in 118 countries with USD 3.2 trillion in total assets serving 375 million physical person members.[2]

World Council agrees with the FSB's assessment that "a premature withdrawal of support measures could produce procyclical effects, permanently reducing economic growth potential through unnecessary insolvencies and unemployment as well as affecting… balance sheets." Many were quick to determine the market was undergoing a relatively fast recovery without consideration for EMDEs or smaller financial institutions that do not have enough in liquidity buffers to offset economic challenges that coincide with COVID-19 recovery coupled with other economic disruptions.

World Council's responses to FSB's questions are below (some responses have been omitted based on applicability):

1. **How do you view the potential impacts of authorities' exit from COVID-19 support measures on equitable recovery and remaining challenges for financial stability from potential scarring effects, particularly in EMDEs? Do you agree with the conclusions of the FSB interim report?**

   Small financial institutions require flexibility in the return of capital levels based on

[1] See, Financial Stability Board; Exit strategies to support equitable recovery and address effects from COVID-19 scarring in the financial sector; July 13, 2022; at: https://www.fsb.org/wp-content/uploads/P130722-2.pdf.
[2] World Council of Credit Unions, *2020 Statistical Report* (2019), *available at* http://www.woccu.org/publications/statreport.

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accounting relief granted for payment moratoriums, IFRS 9 expected loss analysis and the use of capital buffers has provided some relief to small financial institutions such as credit unions. Some credit unions are more vulnerable than others, therefore compromising their survival in the financial market. For this reason, it is not surprising that the supervisory authorities of the financial system, in the case of supervised credit unions, are monitoring closely the levels of liquidity and equity sufficiency of the credit unions.

We encourage the FSB to continue to provide maximum flexibility within its guidance to national-level regulators to withdraw relief measures based on their localized circumstances. We are concerned over the impact and potential increase in institutional stress that a rapid withdrawal of relief will cause. Due to the consequences of the pandemic, characterized by high levels of unemployment, the deterioration of specific sectors of the economy and the loss of individual purchasing power, and the impact the war in Ukraine, inflation, rising gas prices, and other increasing costs, many financial entities may experience solvency problems in the short and medium term. Depending on the reality of each country and individual credit unions, a generalized deterioration in the quality of financial assets could generate a systemic contagion effect in the financial system of a country, or within the credit union sector.

Credit unions rely heavily on the response of international bodies regarding economic recovery, which impact many aspects of credit unions efficacy, especially in the areas of credit risk and liquidity management. Credit unions are subject to three critical factors within the credit risk field: 1. The levels of delinquency and how it is calculated, as well as the policies and processes for collection or recovery of the loans; 2. the creation of allowances for delinquent loans and their calculation; and 3. the policies and processes for charging off delinquent loans against established allowances, as well as the recovery process for charged-off loans. With respect to liquidity management impact factors, the COVID-19 crisis has increased liquidity in financial markets due to an increase in savings deposits and the contraction of the lending market. Aggregate demand and consumption have been contracted. In many countries, credit unions do not have access to the Central Bank's liquidity mechanisms because they are not part of regulated financial entities. In other cases, credit unions use liquidity mechanisms inherent to the savings and loans sector, generally managed by the federations. Further, accounting practices may vary from country to country. In general, credit unions need to establish a prudential indicator for the accumulated products receivable of the loan portfolio so as not to project funds that are not going to enter the account. Again, flexibility within the regulations is essential to support liquidity buffers and these strategic methods.

2. How have the effects from the Russian invasion of Ukraine and the changed global macroeconomic outlook altered the financial stability issues related to scarring effects from COVID-19 going forward?

   Historically, Ukraine's economic performance has trailed that of its counterparts in Central Europe. While the Ukrainian GDP over the last 20 years was growing, <2% p.a. vs. ~3.5% for Poland, the pandemic followed by the Russian invasion into the country has compounded its economic struggles, and economic recovery in the region is

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imperative. GDP losses this year are estimated at 30% to 50%. As a result of the economic downturn, state and local budget revenues are declining, while defense spending is rising. World Council works closely with Ukrainian credit unions and have directly witnessed the impact that the pandemic and the current invasion has had on these institutions. While many of their credit unions remain operational even in the face of war, regulatory relief is vital to their survival.

The invasion has had wide-reaching effects within Central Europe and globally. In 2022, global economic growth has slowed contributing to inflation and rapidly increasing gas and food prices, impacting EMDEs the most. Subjecting these areas to heightened regulatory requirements is detrimental to recovery. With new regulations related climate-change and digitization, it is critical that exit strategies consist of slow, flexible withdrawal of relief efforts.

3. **Do existing (e.g. asset quality) indicators used by firms or authorities accurately capture the underlying risks and vulnerabilities? What data would be useful for informing policy for targeting, narrowing down and phasing out of support measures?**

   Omitted

4. **In which (other) ways can financial institutions globally support equitable recovery, in particular in EMDEs? Which policy considerations may be relevant for authorities in this context?**

   World Council recognizes the FSBs support of proportional regulation and urges the FSB to continue to implement guidance that encourages proportionality. Credit unions are not influenced by stockholders, managerial preferences, or maximizing profits, therefore creating a risk adverse environment and stability during economic downturns. Moreover, their competitive rates, promotion of thrift, and contributions to community development encourage traditional banks to offer more competitive and diverse products to the marketplace, in turn benefiting the aggregate economy. Overburdensome requirements during an economic downturn create adverse effects that will impact the financing of small businesses, contributions to community development, stable credit alternatives during an economic downturn, agricultural projects, healthy market competition, and financial stability for hard working families and individuals.

World Council appreciates the Financial Stability Board's efforts to address exit strategies in support of an equitable recovery. If you have questions about our comments, please feel free to contact me at pmonford@woccu.org or +1-202-510-9347.

Sincerely,

World Council of Credit Unions, Inc.
99 M Street SE, Ste 300, Washington, DC 20003 • +1-202-638-0205 • +1-202-638-3410
www.woccu.org

Panya Monford, Esq.
Assistant General Counsel of Advocacy
World Council of Credit Unions

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