May 28, 2016

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

Re: Consultative Document: *Standardised Measurement Approach for operational risk* (March 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 *Standardised Measurement Approach for operational risk*.[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 57,000 credit unions in 105 countries with USD 1.8 trillion in total assets serving 217 million natural person members.[2]

World Council's Comments

- **Mandatory Application of the Standard Required Only for Internationally-Active Institutions:** World Council strongly supports the Committee's proposal to limit mandatory application of this standard to "internationally active banks." Credit unions rarely operate on a cross-border basis, meaning that they are not "internationally active" within the meaning of the Basel framework. National supervisors would therefore not be required to apply these rules to most credit unions. We urge the Committee to finalize this aspect of the standard as proposed.

- **Withdrawal of the Internal Modeling Approaches for Operational Risk:** World Council supports the Committee's proposal to withdraw the internal modeling approaches to operational risk currently utilized by large banks.

  Internal modeling approaches, in general, give the largest banks the ability to engage in capital arbitrage that undermines the premise of the Basel framework, and gives "too-big-to-fail" institutions that already dominate the market an even greater competitive advantage over smaller institutions following standardized approaches. Australia's recent Financial System Inquiry concluded that internal capital modeling rules gave that country's largest banks unjustifiably lower capital levels compared to institutions

[1] Basel Committee on Banking Supervision, *Standardised Measurement Approach for operational risk* – Consultative Document (2016), *available at* http://www.bis.org/bcbs/publ/d355.htm .
[2] World Council of Credit Unions, *2014 Statistical Report* (2015), *available at* http://www.woccu.org/publications/statreport.

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following standardized approaches.[3] Withdrawal of the internal modeling approaches to operational risk will help reduce the unfair competitive advantages that large banks' greater economies of scale give them vis-à-vis the relative costs of compliance burdens.

Q1. What are respondents' views on the revised structure and definition of the [Business Indicator]?

- **Definition of "Business Indicator:"** World Council supports the Committee's proposed revisions to the "Business Indicator" definition, which is a rough proxy for the institution's gross income minus items that would skew operational risk reserve calculations.

  We support the Committee's proposal to define the Business Indicator to exclude items that, if included, would have likely resulted in overcapitalization of institutions with high fee income, high net interest margins, or which engage in originate-to-distribute lending programs.

- **Marginal Rates for Reserves Based on Asset Size:** World Council supports the proposed five income-level-based "buckets" which are based on a percentage of income relative to the institution's Business Indicator, as well as the proposed marginal rates for reserves that increase for institutions that have higher Business Indicator income levels. For institutions with a Business Indicator income level of less than EUR 1 billion—which the Committee projects will be the case for most institutions with less than EUR 20 billion in assets, and therefore includes virtually all credit unions—the proposed reserve rate would be the lowest of the five buckets, at 0.11 relative to the total Business Indicator income amount.

  The marginal rate for the amount of Business Indicator income above each bucket's threshold would increase progressively, with the highest reserve requirement being 0.29 relative to Business Indicator income amounts over EUR 30 billion. This phased approach employing progressive marginal rates that increase with the institution's Business Indicator will help limit this standard's regulatory burdens on credit unions and other community financial institutions.

Q2. What are respondents' views on the inclusion of loss data into the [Standard Measurement Approach]? Are there any modifications that the Committee should consider that would improve the methodology?

- **Exemption from Internal Loss Multiplier for Institutions with a Business Indicator Below EUR 1 Billion:** World Council strongly supports the proposal in Paragraph 30 to exempt institutions in "Bucket 1", i.e. those that have a Business Indicator of less than EUR 1 billion, from being required to use the Internal Loss Multiplier to increase their operational reserves based on historical loss data.

[3] *See* Financial System Inquiry (Australia), *Final Report* at 61 (Nov. 2014), *available at* http://fsi.gov.au/publications/final-report/.

The Committee's analysis shows that exempting Bucket 1 institutions from the Internal Loss Multiplier will exempt most institutions that have below EUR 20 billion in assets from this aspect of the standard. Virtually all credit unions would therefore be exempt from the Internal Loss Multiplier requirement and its regulatory burdens. We urge the Committee to finalize this aspect of the standard as proposed.

World Council appreciates the opportunity to comment on the Basel Committee's consultative document on the *Standardised Measurement Approach for operational risk*. 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