European Network of Credit Unions

14th October 2013

Sent via email
Wayne Byers
Secretary General
Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002
Basel, Switzerland
baselcommittee@bis.org

Re: Consultative Document: *Liquidity coverage ratio disclosure standards* (bcbs 259)

Dear Mr. Byers,

The European Network of Credit Unions (ENCU) welcomes the opportunity to comment on the Basel Committee on Banking Supervision's (BCBS) consultation paper on Basel III liquidity rules. Credit unions are not-for-profit savings and loan cooperatives that promote thrift and financial inclusion, especially in low-income and rural areas. Although European credit unions are not subject to Basel III, Basel III significantly affects the operations of European credit unions' bank counterparties and those bank counterparties' relationships with credit union customers.

We are writing because adoption of the Basel III liquidity rules in the European Union (EU) has resulted in European commercial banks reclassifying bank term deposits made by credit unions from "retail" or "small business" deposits to "wholesale funding provided by other legal entity customers".

This change in deposit classification has negatively impacted EU credit unions' yields on banks deposits, caused some banks to stop doing business with credit unions, and threatens credit unions' ability to promote financial inclusion of the unbanked. Credit unions in the EU have very limited investment powers—limited primarily to investments in banks deposits, loans to members, and government-guaranteed debt instruments—and are small or medium-sized enterprises (SMEs), especially when compared to internationally active banks. EU credit unions' term deposits in banks are "sticky" and stable in large part because credit unions have few other options for investing their money.

We urge the BCBS to clarify as part of its upcoming Net Stable Funding Ratio (NSFR) revision project that credit unions and similar institutions which have very limited investment powers, or are SMEs by financial institution standards, can have their term deposits classified as "retail" or "small business" for NSFR purposes. Without this clarification, we are concerned that more banks will close credit unions' accounts or reduce the yields paid on credit unions' term deposits as Basel III is phased in across the EU.

In the Republic of Ireland, Irish commercial banks are citing the cost of capital the Basel III liquidity rules imposes on "wholesale deposits" as the reason they have reduced the interest that they will pay on credit unions' term deposits from as high as 3% annual interest to as low as 0.6 % annual interest, with an average spread between the yields on "retail/small business" and "wholesale" of 150 basis points. Please see the attached briefing paper from the Irish League of Credit Unions for additional details.

Ru du Trône 60, 1st Floor
Brussels 1050
Belgium

Tel: +32 2 626 9500
Fax: +32 2 626 9501
info@creditunionnetwork.eu

In Great Britain, at least two large banking institutions have recently announced that they will cease doing business with credit unions. We believe that these institutions have likely made a business decision that holding deposits made by credit unions is too expensive under the new Basel III rules and other regulations.

Credit unions and similar institutions with limited investment powers perform an important financial inclusion role in many Member States and we do not believe that the historical behaviour of credit unions' deposits at banks justifies classification as "wholesale funding provided by other legal entity customers". The reduction in credit unions' interest income impedes their ability to promote financial inclusion and, if not addressed immediately, may threaten the viability of some credit unions and similar financial institutions in the EU.

Unlike hedge funds and similar non-bank financial institutions, credit unions' deposits at banks are "sticky" and stable—there were no runs on European credit unions by their members, or runs on banks by credit unions, during the Global Financial Crisis of recent years—and credit unions have few other options in terms of investing their money. These limited investment options of bank deposits, loans to members, and government-guaranteed debt help reduce credit unions' risk profile but also give credit unions limited options for generating the net income necessary to maintain the credit union as an economically sustainable enterprise, especially when loan demand from members is limited as it is now.

Banks refusing to do business with credit unions at all, as is the case with at least two banks in the Great Britain, raises the possibility of credit unions being unable to find correspondent banks to provide investment, payment, settlement, and liquidity services. Unlike in some cooperative systems, EU credit unions do not have second-level "central" credit unions (i.e. no credit union "bankers' banks") and must therefore rely on commercial banks for counterparty services.

In the Republic of Ireland, for example, there are just under 400 credit unions. Twenty of these have assets in excess of €100 million, 16 have assets between €100 million and €200 million and 4 have assets between €200 million and €350 million. Two-hundred-sixty-one have assets between €10 million and €100 million and 101 have assets below €10 million. With total system assets of approximately €12 billion, the average credit union balance sheet is €30 million. The average lending ratio is 40%, so the average credit union has €18 million on deposit with a number of banks. Most credit unions spread their deposits across 5 or 6 counterparties meaning the average on deposit with each counterparty would be €3 million to €3.5 million if spread across banks equally.

Irish credit unions' bank deposits remained "sticky" and stable during the financial crisis. As shown by the below table, the five most-used bank counterparties in the Republic of Ireland between year-end 2007 and year-end 2012 saw a significant net inflow of deposits made by credit unions, not an outflow of credit union funds.

Table – Counterparty Analysis (5 most used counterparty banks' stocks of deposits by credit unions)

Counterparty- Bank	**Origin Details**	**September 2012 €'m**	**September 2007 €'m**
Bank of Ireland	Irish based Bank	1,500	700
Allied Irish Bank Group	Irish based Bank	2,000	1,200
Irish Life & Permanent	Irish based Bank	1,700	400
Anglo Irish Bank	In liquidation since early 2012	0	750
Ulster Bank	part of RBS Group	700	350
KBC Bank Ireland	part of KBC Group	800	0

This table clearly illustrates that the credit unions did not move their money away from the Irish banks during the financial crisis as many other non-retail type depositors did at that time. The counterparty table shows a range from €700 million to €2 billion deposited by credit unions in the five most used counterparties as at September 2012. These are totals for 400 credit unions, so the average on deposit by each credit union in each counterparty ranges from €1.75 million in Ulster Bank to €5 million in Bank of Ireland.

We do not believe that the withdrawal of individual deposits of this size is going to create funding problems for these banks even in a crisis. The fact that there was a significant inflow of deposits by credit unions into these banks during the recent Global Financial Crisis also demonstrates these deposits' sticky and stable nature; Irish credit unions nearly doubled their bank deposits during this period in a manner more similar to "retail" or "small business" depositors than to "wholesale" funding sources.

We strongly urge the BCBS to clarify that bank deposits made by credit unions with limited investment powers, or which are SMEs, can be classified under the NSFR as "retail" or "small business" as was the status quo ante in the EU. We are concerned that the cost of Basel III liquidity compliance for banks will lead to credit union consolidation or failures if EU credit unions' deposits remain classified as "wholesale" for NSFR purposes.

Without such clarification, Basel III implementation will negatively impact underserved communities in Europe, especially in rural areas where credit unions are often the only financial institution serving the community, including in Ireland, Poland, Great Britain, Estonia, Romania, and other EU Member States. In Ireland, for example, there are now only four retail banks operating with a branch network, and these four banks are actively reducing the number of branches they operate. The only other financial institutions offering personal savings and loans to consumers are the credit unions, and in many rural areas credit unions are the only remaining financial institutions with local branch offices. The continued existence and operation of a successful and viable credit union movement is vital for the ordinary people of these Member States.

We hope this comment letter and the attached paper assists in your understanding of how the Basel III liquidity rules are negatively impacting EU credit unions' financial inclusion mission and why clarification of the NSFR is needed as soon as possible.

Please do not hesitate to contact either of us or Anne Schneider at +32 2 626 9500 should you have any questions regarding our comments.

Sincerely,

Michael Edwards
Vice President and Chief Counsel
World Council of Credit Unions

Ed Farrell
Head of Finance
Irish League of Credit Unions
33-41 Lower Mount
Dublin 2