European Network of Credit Unions

28 August 2017

Submitted Electronically
European Banking Authority
One Canada Square (Floor 46)
Canary Wharf
London E14 5AA, UK

Re: Consultation Paper: Draft EBA Report on the implementation of the Guidelines on methods for calculating contributions to DGSs.

Dear Sir or Madam,

The European Network of Credit Unions (ENCU) appreciates the opportunity to comment on the European Banking Authority's (EBA) guidelines on methods for calculating contributions to Deposit Guarantee Schemes (DGS) in the European Union.[1] Credit unions are consumer-owned, not-for-profit financial cooperatives that promote financial inclusion in underserved European communities by offering their members affordable and easily understandable financial products.

European credit unions are subject to the DGS Directive[2] even though credit unions in most Member States are exempt from the CRD IV capital requirements directive under CRD IV Article 2(5).[3] ENCU represents credit unions in Estonia, Great Britain, Ireland, Poland, The Netherlands, Romania, Ukraine and FYR Macedonia with approximately €20 billion in total assets but an average size of only roughly €20 million in assets per institution.[4]

Question 2: Do you agree with the conclusion that the methodology does not appear to lead to excessive additional reporting requirements?

The ENCU strongly supports national competent authorities having discretion to exclude and adjust the core risk indicators for sectors, such as the credit union sector, based on the legal characteristics

[1] European Banking Authority, *Draft EBA Report on the implementation of the EBA Guidelines on methods for calculating contributions to Deposit Guarantee Schemes: Consultation Paper* (July 2017), *available at* https://www.eba.europa.eu/documents/10180/1897365/Consultation+Paper+on+draft+EBA+Report+on+the+implementation+of+the+Guidelines+on+methods+for+calculating+contributions+to+DGSs+%28EBA-2017-10%29.pdf/39734329-cdc1-440e-9ed3-f038e032abdf

[2] *Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes*, 2014 O.J. (L 173) 149, *available at* http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014L0049.

[3] *Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC*, Article 2(5), 2013 O.J. (L 176) 338, *available at* http://ec.europa.eu/internal_market/bank/regcapital/legislation-in-force/index_en.htm.

[4] European Network of Credit Unions, "Credit Unions in Europe"; http://www.creditunionnetwork.eu/cus_in_europe.

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and reporting requirements of those sectors. The EBA's DGS methodology would likely impose excessive reporting requirements on credit unions without continued national discretion in this area.

Credit unions in most Member States are exempt from the CRD IV under CRD IV Article 2(5) and therefore are not subject to the CRD IV's risk-based capital measures, the Liquidity Coverage Ratio (LCR), the Net Stable Funding Ratio (NSFR) and other CRD IV-based ratios. We believe that credit unions calculating Risk-Weighted Assets, the LCR, the NSFR, et cetera, solely for purposes of DGS levy classifications would be an unwarranted regulatory burden.

We support these CRD IV-based ratios not being required with respect to DGS levies on institutions that are exempt from the CRD IV under Article 2(5), as is the current practice. Supervisors should not include ratios based on CRD IV measures when calculating DGS assessments for credit unions and other institutions that are exempt from the CRD IV under Article 2(5). In addition to being exempt from the CRD IV, credit unions in the EU are subject to a range of bespoke, nationally-determined regulatory requirements and therefore CRD IV-derived indicators and categories in capital adequacy and liquidity are not appropriate or relevant for credit unions.

Credit union rulebooks typically limit credit unions to engaging primarily in low-risk retail deposit and lending activities in a localised area. Although difficult to quantify, these restrictions reduce a credit union's risks in myriad respects compared to the business activities European commercial banks are permitted to engage in. We also believe that national competent authorities should be able to take into account credit unions' financial inclusion mission and the desirability of diversity in the financial sector, and should be able to assign institutions that promote these public policy goals a lower risk rating in order to further the public good.

National competent authorities are the best positioned to understand which local financial institutions have a social mission that promotes financial inclusion and other societal benefits. National authorities are also the policymakers who are best positioned to consider these financial institutions' contributions to civil society as a form of value in the context of DGS levies.

The ENCU strongly supports national competent authorities having discretion to exclude and adjust the core risk indicators for sectors, such as the credit union sector, based on the legal characteristics and reporting requirements of those sectors.

Question 4: Do you have any further comments on the practical and potential obstacles in the application of the Guidelines?

A) Existing DGS Guidelines Underestimate the Concentration Risk Posed to DGS Funds by Systemically Important Institutions

We urge the EBA to establish a DGS levy system that takes into account the value of an institution's Covered Deposits (CD) relative to the DGS funds' total CD liabilities or total reserves, and charges systemically important institutions a higher DGS levy marginal rate than smaller institutions.

Although existing EBA guidelines do include an analysis of an institution's potential losses for the DGS, existing guidance focuses on the makeup of an institution's assets and liabilities rather than its concentration risk to the DGS. We believe that taking into account the concentration risk posed to a national DGS by a large, individual institution such as a Global Systemically Important Bank (G-SIB) or

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Other Systemically Important Institution (O-SII) is appropriate when determining DGS levies because the failure of a single G-SIB or O-SII could potentially bankrupt a national DGS.

G-SIBs and O-SIIs typically have more than €100 billion in assets, meaning that the success or failure of a single large bank could in some cases exhaust the reserves of a national DGS fund and/or impose huge costs on the other members of the national DGS. In contrast, the aggregate €20 billion in credit union assets in the EU is divided among roughly 1000 individual credit unions—meaning an average credit union asset size of approximately €20 million in total assets—that each have a separate balance sheet, independent management, and succeed or fail on their own. Unlike G-SIBs and O-SIIs, which typically engage in more complex and risky business activities, credit unions have a very simple savings and loans business model, are self-funded and operate under highly prescriptive legislation.

In Ireland, for example, credit unions do not borrow to finance expansion. Only a handful of Irish credit unions have any external borrowings, and total borrowings make up only 0.02% of the total balance sheet. Credit unions have no exposure to high risk investments, such as derivatives, and over three quarters of Irish credit unions' investments are in bank term deposits. Counterparty risk is mitigated by a regulatory requirement to have no more than 25% of investments in any one institution. There are also strict national-level liquidity requirements to which credit unions must adhere.

A tiered DGS levy system with higher marginal rates for systemically important institutions such as G-SIBs and O-SIIs is also appropriate because small financial institutions often promote financial inclusion in underserved parts of Europe, especially rural areas. Credit unions are often the only financial institutions operating in rural areas because serving these parts of Europe is often not sufficiently profitable for most banks, and without the credit union many rural communities would have no local access to financial services.

The ENCU urges the EBA to establish DGS levy guidance that takes into account the value of an institution's CD relative to the DGS funds' total CD liabilities or total reserves, and sets higher marginal rates of DGS levies on systemically important institutions such as G-SIBs and O-SIIs.

B) The EBA's DGS Guidelines Should Recognise All Private-Sector Institutional Protection Schemes

The ENCU urges the EBA to recognise all private-sector Institutional Protection Schemes (IPS) in its DGS levy guidelines where the IPS has a history of providing support to its member institutions, whether or not the IPS in question is recognised officially by their national competent authority.

Credit union associations often operate private-sector IPS that are funded by their member credit unions and act as "stabilisation funds" to help resolve weak institutions without governmental assistance from a DGS fund or another source.

In Ireland, for example, the Irish League of Credit Unions operates an IPS called the Savings Protection Scheme. The value and benefit of the Irish Credit Union Savings Protection Scheme can be seen in the fact that 60 credit unions received Savings Protection Scheme support since the beginning of the financial crisis in 2009 (with approximately €75 million drawn down by the

credit unions from the Savings Protection Scheme). The need for this financial support from the Savings Protection Scheme was mainly due to the impact of the recession with lending defaults and write down of real estate premises which required credit unions to shore up their regulatory reserves.

Of these 60 credit unions receiving support from the Savings Protection Scheme, only two failed and triggered DGS payments, which were roughly €11.3 million and €23 million respectively. The Irish Credit Union Savings Protection Scheme likely significantly reduced the Irish DGS's liabilities that would have occurred in the absence of the Savings Protection Scheme.

We believe that private-sector IPS fund memberships for credit unions should be considered a significant factor that reduces risk to DGS funds in all Member States where such IPS funds exist, whether or not the IPS is recognised officially by the national competent authority.

C) The ENCU Does Not Support Mandatory Use of Return on Assets (RoA) as a Core Individual Risk Indicator for Credit Union; A Credit Union's Additions to Reserves Is A Better Indicator of Risk

The ENCU does not support the use of Return on Assets (RoA) as a core individual risk indicator because credit unions, as not-for-profit cooperatives, do not seek to maximise RoA. Credit unions generally also have lower RoAs than large banks because of their financial inclusion mission, lower percentage of fee income (as opposed to interest income) as a share of total income in a low interest rate environment, and their smaller economies of scale. The ENCU believes that a better measure of how a credit union's income affects its risk to a DGS fund would be the ratio of the institution's additions to retained earnings relative to its total assets, and we urge the EBA to include this ratio as an "additional risk factor" in Annex 3 of the Guidance:

(institution's additions to reserves of retained and undivided earning during the reporting period) --- (institution's total assets)

A high RoA is also only relevant to safety and soundness if the institution's net income is added to its retained earnings. Further, a high RoA often indicates unsustainable institutional growth and increased risk to the DGS fund. Small financial institutions like credit unions can also face challenges in achieving a high RoA because of their smaller economies of scale, high proportion of income from interest on loans and investments during a period of persistently low interest rates, and relatively higher expenses for personnel costs and real estate compared to other expenses (e.g., every credit union must have at least one compliance officer and branch office regardless of its asset size).

Credit union rulebooks also play a role in limiting credit unions' RoA in ways not faced by banks. For example, credit union rulebooks often include caps on the interest rates credit unions can charge (such as no more than a maximum three percent interest per month), and credit unions

face restrictions on with whom they can do business in the form of "common bond of association" laws.

The ENCU urges the EBA to revise its DGS guidance to include the ratio of an institution's additions to reserves relative to its total assets in the Annex 3 "Description of additional risk factors" for national competent authorities to use as an alternative to RoA when assessing the riskiness of a credit union to a DGS.

The ENCU appreciates the opportunity to comment on the EBA's draft guidelines on methods for calculating contributions to Deposit Guarantee Schemes. Please do not hesitate to contact me or Jim Rusagara by email at info@creditunionnetwork.eu or phone at +32 2 626 9500 or +32 488 809 437 (mobile) should you have any questions regarding our comments. Thank you and have a nice day.

Sincerely,

Michael S. Edwards
Vice President and General Counsel
European Network of Credit Unions
World Council of Credit Unions