European Network of Credit Unions

25th April 2014

Mr Michael Thom
Policy Officer
Banks and Financial Conglomerates Unit (DG MARKT)
European Commission
DG MARKT
Rue Spa 2
1049 Brussels, Belgium

Re: The Basel lll Net Stable Funding Ratio and European Credit Unions

Dear Mr. Thom,

We would like to thank you for meeting with our delegation from the European Network of Credit Unions (ENCU) on 2nd April regarding the negative impact that the current interpretations of the European Union's (EU) approach to the Basel III Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR) is having on our member credit unions that invest in bank term deposits. Even though European credit unions will not be subject to the NSFR themselves, commercial banks in Ireland have already established their NSFR reserves despite the NSFR not being scheduled to come into force until 2015.

As we mentioned, Irish commercial banks appear to be misapplying the LCR's definition of "non-financial small business" for purposes of their de facto early adoption of the NSFR, even though the Basel Committee on Banking Supervision's (BCBS) revised version of the NSFR uses a definition of "small or medium enterprise" (SME) that includes SME financial institutions and is unrelated to the LCR's "non-financial small business" concept. Most European credit unions are less than EUR 43 million in assets and meet both the EU and BCBS definitions of "SME" even if they do not meet the LCR's definition of "non-financial small business".

We urge the Commission and other European Union policymakers to clarify as soon as possible that bank deposits made by credit unions will be eligible to be considered SME deposits for NSFR purposes if the credit union meets the EU's existing definition of "SME".

We also believe that the data on Irish credit unions' investments in bank deposits by counterparty included in Annex A of this letter demonstrates that classifying deposits made by SME credit unions as "SME deposits" for NSFR purposes will be consistent with the NSFR's more permissive available stable funding (ASF) treatment for deposits made by SMEs. This data also demonstrates that including SME credit unions' deposits within the NSFR's SME deposit definition would be safe and sound for the banks holding these deposits.

Clarification on this issue is important for the continued financial inclusion and welfare of the millions of physical persons who are members of credit unions across Europe. As not-for-profit cooperatives chartered to promote thrift, loss of investment income reduces the credit union's ability to provide financial services to its physical person members and results in the members receiving worse rates on loans and savings. Without clarification, we believe that the erroneous interpretation of the NSFR that is imposing unnecessary costs on Irish banks will continue to depress artificially the yields Irish SME credit unions receive on term deposits and further harm those credit unions' financial inclusion efforts. We are also concerned that the Irish credit unions' experience will be repeated in other Member States as Europe phases-in the NSFR officially beginning next year.

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As we discussed with you, there are two possible solutions that would help relieve the NSFR's unnecessary regulatory burdens on European banks which are indirectly harming their SME credit union customers, either:

> (1) A separate outflow class or category be included for credit union deposits, as the European Banking Authority's (EBA) December 2013 report on LCR implementation suggested[1]; or
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> (2) Ensuring that deposits made by credit unions which meet Europe's definition of "SME" can be treated as SME deposits for NSFR purposes; neither the EU's definition of "SME" nor the BCBS's "SME" definition used in the NSFR are limited to "non-financial small businesses".

The Revised NSFR's "SME" Definition Includes SME Financial Institutions

On 11th April, the ENCU filed a comment letter with the Basel Committee on Banking Supervision (BCBS), a copy of which is attached, in response to the BCBS's consultative document on the NSFR. As we noted in our comment letter,[2] the BCBS's NSFR consultative document uses the term "SME" as defined in Basel II paragraph 273, which is not related to definition of "non-financial small business" in Paragraph 90 of the BCBS's LCR document (which uses "small business" as defined by paragraph 231 of Basel II and also adds the "non-financial" requirement to the paragraph 231 "small business" definition)[3] or the EU's version of the LCR. Specifically, the BCBS definitions of the NSFR's "retail" and "SME" categories read as follows:[4]

> "Retail deposits are defined in LCR paragraph 73. SMEs are defined in paragraph 273 of the Basel II framework; see BCBS, *International Convergence of Capital Measurement and Capital Standards: A Revised Framework – Comprehensive Version* June 2006 . . . ."

Further, the BCBS definition of "SME" under Basel II paragraph 273 is generally consistent with the EU's definition of SME and does not include the "non-financial" limitation found in the LCR's "non-financial small business" definition. We have requested clarification from the BCBS regarding whether it intends for the NSFR's 90% ASF for "less stable" deposits made by SMEs to include deposits made by SME financial institutions, as appears to be the case.

This BCBS NSFR paper also removed the requirement that a non-SME institution be a "non-financial corporate" for its investments in 6 to 12 month bank term deposits to be included in the 50% ASF category, and stated expressly that this 50% ASF category includes "funding from central banks and financial institutions."[5] In light of these changes to the global NSFR standard, whether or not a company is "financial" or "non-financial" seems to no longer be relevant for NSFR purposes (even if it is relevant to the LCR).

We recognise, however, that the EU will ultimately define the NSFR with respect to its application to banks in Ireland and other EU Member States. As the EU moves forward with developing its NSFR definitions, we urge you and other European policymakers to disaggregate the LCR's "non-financial small business" definition from the NSFR's "SME" concept in a manner consistent with the BCBS standard and the EU definition of "SME" established

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[1] European Banking Authority, *Report on impact assessment for liquidity measures under Article 509(1) of the CRR* at page 57 (Dec. 2013), *available at* https://www.eba.europa.eu/documents/10180/16145/EBA+BS+2013+415+Report+regarding+LCR+impact.pdf
[2] http://www.creditunionnetwork.eu/documents/ENCU_Comment_Letter_Basel_III
[3] BCBS, *Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools* at 24 (2013), *available at* http://www.bis.org/publ/bcbs238.pdf.
[4] BCBS, *Basel III: The Net Stable Funding Ratio – consultative document* at 4 & n.6 (2014), *available at* http://www.bis.org/publ/bcbs271.pdf.
[5] *Id.* at 4.

by EU recommendation 2003/361.[6] Article 2(1) of the Annex to EU recommendation 2003/361 defines "SME" in Europe as follows:

> "The category of micro, small and medium-sized enterprises (SMEs) is made up of enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million."

As noted above, neither EU recommendation 2003/361 nor the Basel standards limit the definition of "SME" to "non-financial small businesses" and most European credit unions meet the EU's SME definition by being smaller than EUR 43 million in assets and having fewer than 250 employees.

In the Republic of Ireland, for example, 288 credit unions out of the nearly 400 total credit unions meet the SME definition by having an annual balance sheet not exceeding EUR 43 million and fewer than 250 employees, and in Northern Ireland, 91 of the 97 credit unions are below the equivalent of EUR 43 million (GDP 35 million) in assets and have fewer than 250 employees. A majority of credit unions meet the EU's "SME" definition in other Member States as well, and in Estonia, Latvia and Romania all credit unions' assets in the Member State combined are less than EUR 43 million total.[7]

Data on Credit Unions' Deposits with Bank Counterparties Demonstrates Funding from Credit Unions is Stable

The data also supports the proposition that deposits made by SME credit unions can be treated as SME deposits under the NSFR in a safe and sound manner. We believe that the data on Irish credit unions' investments in bank deposits by counterparty included in Annex A of this letter (which we have also provided to the BCBS) demonstrates that permitting SME credit unions to be considered "SMEs" for purposes of the NSFR will be consistent with the NSFR's 90% ASF treatment for deposits made by SMEs.

This quarterly data shows details of the top 10 counterparties which the Republic of Ireland credit unions have been investing their surplus funds in for each quarter since March 2011. This quarterly information is not available prior to that date. You will recall that we had also included details of the five most used counterparties in our previous letter to you on 30th July 2013.

The quarterly counterparty data contained in Annex A 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 credit unions' deposits behaved as stable, sticky funding during this period of financial stress and remained with the Irish banks. As the data illustrates, the credit unions actually increased their bank deposits during this time.

Similar quarterly data is not available for the Northern Ireland credit unions, however, year-end information for these credit unions shows that Northern Ireland credit unions had total bank deposits of GBP 300 million in 2007 and this had increased to over GBP 500 million as of September 2012. The investment options of the vast majority of Northern Ireland credit unions are effectively limited to bank deposits of less than one year maturity.

We believe that European credit unions in future financial crises will again engage in a "flight to safety" by investing their excess liquidity in local bank deposits, as this data demonstrates, especially when the credit unions meet the EU's SME definition. Members of EU credit unions increased their deposits in credit unions during the financial

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[6] European Commission, *Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises* (2003/361/EC), *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:124:0036:0041:EN:PDF.

[7] *See* World Council of Credit Unions, *Statistical Report 2012* (2013), *available at* http://www.woccu.org/documents/2012_Statistical_Report

crisis in a similar "flight to safety" and we have no reason to believe that this would be different in the future, especially considering that members' savings with credit unions are protected by the applicable national deposit guarantee scheme in most EU Member States that have a credit union movement.

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 as a legal matter. Member States' credit union laws typically limit credit unions' investment options to bank deposits, loans to members, and government-guaranteed debt. Most SME credit unions invest only in bank deposits and loans to their members because these investments are easier to manage than government bonds.

SME Financial Institutions are Vital to Europe's Financial Inclusion Efforts

Maintaining the sustainability of credit unions that meet the EU's SME definition is also essential to efforts to promote financial inclusion in Member States where credit unions operate, including Estonia, Ireland, Latvia, Lithuania, Poland, Romania, and the United Kingdom. The continued existence and operation of a successful and viable credit union movement is vital for the ordinary people of these Member States.

Credit unions play an important financial inclusion role in Europe, especially in low-income and rural areas where credit unions are often the only financial institution serving the community. 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 in these underserved areas are credit unions, many of which meet the EU's definition of SME.

SME credit unions, however, have limited economies of scale that make achieving an economically sustainable return on assets (ROA) more difficult than at a larger credit union or bank, especially if the yields they receive on their investments in bank term deposits are depressed by the regulatory compliance burdens imposed by the NSFR's reserve requirements.

We believe that, as a public policy matter, the NSFR's potential to effect financial inclusion negatively alone justifies allowing credit unions that meet Europe's SME definition receiving the more permissive ASF treatment accorded to deposits made by SMEs.

SME Financial Institutions' Relatively Small Deposits Do Not Threaten Large Banks' Liquidity Positions

We believe that the arguments for providing regulatory relief to credit unions that invest in bank deposits are extremely strong, especially when: (a) financial inclusion concerns are weighed in combination with: (b) credit unions' legal limitations on permissible investments other than bank deposits; (c) the actual behaviour of credit unions in terms of managing their bank deposits as outlined by the data in Annex A; (d) the BCBS standard; and (e) the relatively small size of any one credit union's term deposits compared to the size of the banking holding the deposits. This is especially true with respect to SME credit unions because the EU caps the size of an SME at a maximum EUR 43 million in assets.

SME credit unions are unlikely to withdraw their term deposits from a bank prematurely since they have few other investment options, rarely if ever are themselves subject to runs by their members, and can obtain emergency liquidity from other sources (e.g., the Irish League of Credit Unions's stabilisation fund) without incurring an early withdrawal penalty.

Further, any SME-sized credit union withdrawing its term deposits from a large commercial bank would be very unlikely to affect the bank's liquidity position in a material way. SME credit unions in Europe by definition have less than EUR 43 million in assets and tend to spread their term deposit investments evenly across at least four different banks (usually five or six) to limit counterparty risk. This means that in practice any one SME credit union's deposits in a European commercial bank would be less than EUR 11 million even if the SME credit union is nearly EUR 43 million in assets and 100% invested in bank deposits.

For a large commercial bank, the worst-case scenario EUR 11 million withdrawal made by an SME credit union would represent a negligible amount of the banks' total funding. In the case of Bank of Ireland, for example—which at year-end 2013 had EUR 132 billion in assets and EUR 101 billion in consumer deposits and wholesale funding[8]—a EUR 11 million withdrawal would represent only 0.01% of the banks' funding. It is difficult to imagine a scenario where a withdrawal of a deposit of this size could become a material risk to the bank's solvency.

We appreciate your continued consideration of our concerns and hope this letter and the attached data assists the Commission's efforts to achieve an outcome which helps credit unions—especially SME credit unions—continue to promote financial inclusion and thrift in the EU.

Please do not hesitate to contact either of us or Jeanette van Eijk 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
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Attachment:
Comment letter of the European Network of Credit Unions to the Basel Committee on Banking Supervision concerning "*Basel III: the Net Stable Funding Ratio - consultative document* (bcbs 271)" (11 Apr. 2014), *available at* http://www.creditunionnetwork.eu/documents/ENCU_Comment_Letter_Basel_III.

[8] Bank of Ireland Group, *Annual Report for the Year Ending 31 December 2013* at page 30 (2014), *available at* http://www.bankofireland.com/fs/doc/wysiwyg/bank-of-ireland-annual-report-for-the-year-ended-31-december-2013.pdf.

Annex A

Stocks of Irish Credit Unions' Investments in Bank Deposits: March 2011 to July 2013

Table of quarterly investment data by counterparty	
	Mar-11
Investments by counter party	**Amount €**
Bank of Ireland Group	1,394,095,321
AIB Group	1,246,970,725
EBS Building Society	1,039,105,640
Irish Life and Permanent	1,014,255,455
Royal Bank of Scotland	479,432,483
Anglo Irish Bank Corporation plc	358,749,537
Irish and EMU State Securities	233,358,720
Canada Life	214,324,943
Central Treasury Managed Fund (Cash)	162,616,466
Other	880,791,819
	7,023,701,109
	Jun-11
Investments by counter party	**Amount €**
AIB Group	1,551,698,502
Bank of Ireland Group	1,529,223,703
Irish Life and Permanent	1,084,200,556
EBS Building Society	944,462,534
Royal Bank of Scotland	479,846,571
Irish and EMU State Securities	261,364,446
Canada Life	211,853,892
KBC Bank NV	199,250,571
Central Treasury Managed Fund (Cash)	123,239,763
Other	712,127,670
	7,097,268,208
	Sep-11
Investments by counter party	**Amount €**
AIB Group	1,627,724,044
Bank of Ireland Group	1,626,560,603
Irish Life and Permanent	1,126,995,329
EBS Building Society	642,744,138
Royal Bank of Scotland	541,135,272
Irish and EMU State Securities	275,622,472
KBC Bank NV	250,043,750
Canada Life	178,593,994
Barclays	56,005,195
Other	823,164,829
	7,148,589,626

Investments by counter party	Dec-11 Amount €
Bank of Ireland Group	1,729,549,071
AIB Group	1,623,129,433
Irish Life and Permanent	1,235,640,602
EBS Building Society	568,295,022
Royal Bank of Scotland	523,255,776
Irish and EMU State Securities	281,863,979
KBC Bank NV	271,589,132
Central Treasury Managed Fund ('Cash')	161,348,256
Canada Life	155,362,844
Other	628,613,506
	7,178,647,621

Investments by counter party	Mar-12 Amount €
Bank of Ireland Group	1,681,105,162
AIB Group	1,653,721,615
Irish Life and Permanent	1,430,131,124
EBS Building Society	552,400,353
Royal Bank of Scotland	542,635,619
KBC Bank NV	342,291,675
Irish and EMU State Securities	279,331,343
Central Treasury Managed Fund ('Cash')	205,053,357
Canada Life	142,931,105
Other	609,734,105
	7,439,335,458

Investments by counter party	Jun-12 Amount €
Irish Life and Permanent	1,600,131,449
Bank of Ireland Group	1,588,479,273
AIB Group	1,579,390,822
EBS Building Society	586,448,689
Royal Bank of Scotland	562,354,479
KBC Bank NV	493,674,048
Irish and EMU State Securities	302,988,570
Central Treasury Managed Fund ('Cash')	174,504,648
Canada Life	131,383,216
Other	592,262,967
	7,611,618,161

Investments by counter party	Sep-12 Amount €
Irish Life and Permanent	1,672,584,939
Bank of Ireland Group	1,537,263,519
AIB Group	1,421,804,876
KBC Bank NV	801,685,882
Royal Bank of Scotland	644,975,070
EBS Building Society	542,292,065
Irish and EMU State Securities	338,169,387
Davy Central Treasury Managed Fund ('Cas	197,269,081
Canada Life	84,824,581
Other	528,558,641
	7,769,428,041
	Dec-12
Bank of Ireland Group	1,599,000,086
Irish Life and Permanent	1,494,271,193
AIB Group	1,349,689,747
KBC Bank NV	954,114,815
Royal Bank of Scotland	831,818,179
EBS Building Society	515,074,153
Irish and EMU State Securities	361,281,465
Central Treasury Managed Fund ('Cash')	183,747,528
Canada Life	75,376,337
Other	495,928,664
	7,860,302,167
Investments by counter party	**Mar-13 Amount €**
Bank of Ireland Group	1,681,967,361
Irish Life and Permanent	1,665,883,134
AIB Group	1,193,078,395
Royal Bank of Scotland	956,527,189
KBC Bank NV	864,147,561
Irish and EMU State Securities	483,594,580
EBS Building Society	417,470,578
Central Treasury Managed Fund ('Cash')	190,106,342
Rabobank	104,699,420
Other	517,750,618
	8,075,225,178

Investments by counter party	Jun-13 Amount €
Bank of Ireland Group	1,733,019,518
Irish Life and Permanent	1,591,554,314
Royal Bank of Scotland	1,077,119,081
AIB Group	1,070,283,384
KBC Bank NV	891,531,043
Irish and EMU State Securities	513,126,595
Rabobank	375,082,854
EBS Building Society	330,169,397
Central Treasury Managed Fund ('Cash')	208,043,458
Other	466,891,787
	8,256,821,431

Investments by counter party	Sep-13 Amount €
Bank of Ireland Group	1,655,306,742
Irish Life and Permanent	1,450,730,553
AIB Group	1,091,423,043
Royal Bank of Scotland	1,044,643,383
KBC Bank NV	756,894,571
Rabobank	733,996,495
Irish and EMU State Securities	652,283,526
EBS Building Society	318,499,721
Central Treasury Managed Fund ('Cash')	243,324,230
Other	498,861,559
	8,445,963,823