



11<sup>th</sup> April 2014

Sent via email

Wayne Byers

Secretary General

Basel Committee on Banking Supervision

Bank for International Settlements

CH-4002

Basel, Switzerland

baselcommittee@bis.org

**Re: Basel III: the Net Stable Funding Ratio - consultative document (bcbs 271)**

Dear Mr. Byers,

The European Network of Credit Unions (ENCU) welcomes the opportunity to comment on the Basel Committee on Banking Supervision's (Basel Committee) consultation paper on the Net Stable Funding Ratio (NSFR).<sup>1</sup> 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, credit unions in Europe and elsewhere are extremely concerned about the NSFR's potential impact on credit unions which invest in term deposits held by banks which are subject to the NSFR.

De facto early adoption of the original version of the NSFR by banks in the Republic of Ireland has resulted in Irish 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."

Although Irish credit unions' deposits in banks are both stable and "sticky"—see, for example, the quarterly data on Irish credit unions' investments by counterparty included in Annex A of this comment letter, below—the spread between the yields Irish credit unions receive on bank term deposits and yields offered by banks on term deposits made by retail or small business customers are more than 1%. This loss of yield has threatened the ability of some credit unions to promote financial inclusion; these institutions have no choice but to invest their excess liquidity in bank term deposits, even when yields are low, because of their limited investment options permitted under national credit union laws.

**Summary of ENCU's Comments**

- ENCU supports the proposal to classify term deposits made by credit unions that are not small or medium enterprises (non-SME credit unions) with 6 to 12 months residual maturity as 50% available stable funding (ASF), and all credit unions' deposits of more than 12 months residual maturity as 100% ASF. We strongly support the removal of the term "non-financial corporate" from the 50% ASF definition and believe that the proposed revisions to the NSFR better reflect the true liquidity risks presented to a bank holding term deposits made by a non-SME credit union.
- ENCU strongly supports the proposal to treat 1 to 12 month term deposits made by Small and Medium Enterprises (SMEs) as defined by Basel II and proposed NSFR footnote 6, which includes SME financial institutions such as credit unions, as at least 90% ASF.

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<sup>1</sup> Basel Committee on Banking Supervision, *Basel III: the Net Stable Funding Ratio -- consultative document* (2014), available at <http://www.bis.org/publ/bcbs271.htm>.



- We believe that the NSFR including within its definition of “SME” small credit unions and other financial SMEs is critical to promotion of financial inclusion by small financial institutions in Europe and around the world, especially in low-income and rural areas. We request clarification that the Basel II and NSFR definition of SME includes SME credit unions and banks, as appears to be the Committee’s intent.
- We also urge the Committee to update its definition of SME to: (a) be indexed for inflation; and (b) include an SME definition which better takes into account depository institutions’ leverage than does the Basel II paragraph 273-274 SME definition of €50 million or less in annual revenues or €50 million or less in assets. For example, the United States’ Small Business Administration has defined a “small credit union” or “small bank” as one with less than US\$ 500 million in assets.
- An SME definition based on the number of employees, such as fewer than 250 employees without regard to assets or annual turnover, would also be a logical way to define an SME financial institution.
- ENCU also supports proposed footnote 7 of the NSFR paper allowing national authorities the option to exempt from the 0% ASF treatment “stable deposits from cooperative banks that are required by law in some jurisdictions to be placed at the central organisation and are legally constrained within the cooperative bank network as minimum deposit requirements.” We urge the Committee, however, to include the term “credit union” in addition to “cooperative bank” in this footnote because credit unions are also a form of cooperative depository institution that utilizes the central cooperative structure (usually called a “central credit union”).

#### **Non-SME Credit Unions’ Term Deposits in Banks**

As noted above, ENCU supports the proposal to classify term deposits made by credit unions that are not small or medium enterprises (i.e. non-SME credit unions) that have 6 to 12 months residual maturity as 50% ASF. We also support the proposal to include term deposits made by all credit unions with more than 12 months residual maturity as 100% ASF.

We strongly support the deletion of the term “non-financial corporate” from the 50% ASF definition, and believe that at least 50% ASF is appropriate for non-SME credit unions’ 6 to 12 month term deposits in banks. We also believe that the data included in Annex A, below, on Irish credit unions’ investments in bank deposits between March 2011 and September 2013 (the most recent quarter available) supports the proposition that such funds should be treated as at least 50% ASF.

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 March 2011.

Credit unions and similar institutions with limited investment powers perform an important financial inclusion role in many European Union (EU) Member States and we do not believe that the historical behaviour of credit unions’ deposits at banks justifies classification lower than 50% ASF for term deposits with 6 to 12 months remaining maturity. We believe that a higher ASF than 50% is justified by this data and credit unions’ limited investment options, especially in the case of term deposits made by SME credit unions, as discussed below, since credit unions rarely withdraw their term deposit investments prematurely.

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.

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 assets of approximately €12 billion, the average Irish credit union balance sheet is €30 million. The average lending ratio is 40%, meaning that the average Irish credit union has €18 million on deposit with a number of banks. Most credit unions spread their deposits across 5 or 6 counterparties so the average on deposit with each counterparty would be €3 million to €3.5 million if each counterparty were used equally. We do not believe that the withdrawal of individual deposits of this size, as the data illustrates, is going to create funding problems for these banks even if that unlikely event were to arise.

### **SME Credit Unions' Term Deposits in Banks and the Definition of "SME"**

ENCU strongly supports the proposal to treat term deposits made by Small and Medium Enterprises (SMEs), including SME credit unions as defined by Basel II and footnote 6 of this NSFR paper, as at least 90% ASF.

Paragraph 273 and 274 of Basel II<sup>2</sup> and this NSFR consultative document do not limit the definition of SME to non-financial companies, however, questions have been raised in Brussels regarding whether the Basel Committee truly intends to include financial SMEs within the NSFR's SME definition.

We believe that there is confusion regarding this issue because the Committee used the term "non-financial small business" in paragraph 90 of its Liquidity Coverage Ratio (LCR) paper<sup>3</sup> even though the term "SME" as defined by Basel II is clearly not related to the LCR's definition of "non-financial small business" (which is based on the paragraph 231 of Basel II "small business" definition, not on the "SME" definition in paragraph 273 of that standard). In addition to the plain language of the Basel II SME definition not being limited to non-financial companies, the term "SME" is clearly independent of the term "non-financial small business" because "SME" includes medium-sized enterprises as well as small ones.

We believe that the NSFR including SME credit unions and banks within its definition of "SME" is critical to promotion of financial inclusion by small financial institutions in Europe and around the world. We request clarification that the Basel II and NSFR definition of SME includes SME credit unions and banks, as appears to be the Committee's intent.

We also urge the Committee to update its definition of SME to: (a) be indexed for inflation; and (b) include an SME definition which better takes into account SME depository institutions' leverage than does the Basel II paragraph 273-274 SME definition of €50 million or less in annual revenues or €50 million or less in assets.<sup>4</sup> For

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<sup>2</sup> Basel Committee on Banking Supervision, *International Convergence of Capital Measurement and Capital Standards: A Revised Framework; Comprehensive Version* at ¶¶ 273-74 (2006) [hereinafter Basel II], available at <http://www.bis.org/publ/bcbsca.htm>.

<sup>3</sup> Basel Committee on Banking Supervision, *Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools* at ¶ 90 (2013), available at <http://www.bis.org/publ/bcbs238.pdf>.

<sup>4</sup> Basel II at ¶¶ 273-74.



example, the United States' Small Business Administration has defined a "small credit union" or "small bank" as one with less than US\$ 500 million in assets.<sup>5</sup>

An SME definition based on the number of employees, such as fewer than 250 employees without regard to assets or annual turnover, would also be a logical way to define an SME financial institution.

Credit unions and similar institutions that are objectively SMEs when compared to larger commercial banks and perform an important financial inclusion role in many parts of Europe and the rest of the world. SME financial institutions face significant difficulty in terms of maintaining positive net income because their smaller economies of scale are less able to afford the expenses imposed by regulatory burden and needed investments in business equipment and other technologies.

Without clarification that a credit union or similar financial institution can be considered a SME under the NSFR, 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 credit union movement is vital for the ordinary people of these EU Member States.

#### **Deposits at Cooperative Centrals**

ENCU supports proposed footnote 7's provision of a national option to treat cooperative banks' liquidity deposits at central cooperatives with less than 6 months remaining maturity as greater than 0% ASF. Credit unions and similar financial cooperative federations around the world use the same cooperative "bankers' bank" structure for liquidity management, which is often called a "central credit union." We therefore urge the Committee to insert "or credit unions" after "cooperative banks" in footnote 7.

Thank you for the opportunity to comment on the Basel III: *the Net Stable Funding Ratio - consultative document*. 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,

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Vice President and Chief Counsel  
World Council of Credit Unions

Ed Farrell  
Head of Finance  
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<sup>5</sup> 13 Code of Federal Regulations § 121.201 (2013), <http://www.ecfr.gov/cgi-bin/text-idx?c=ecfr&rgn=div5&view=text&node=13:1.0.1.1.17&idno=13#13:1.0.1.1.17.1.268.10>.



## Annex A

### Stocks of Irish Credit Unions' Investments in Bank Deposits: March 2011 to September 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
	<b>7,023,701,109</b>
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
	<b>7,097,268,208</b>
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
	<b>7,148,589,626</b>



Dec-11	
Investments by counter party	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
	<b>7,178,647,621</b>
Mar-12	
Investments by counter party	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
	<b>7,439,335,458</b>
Jun-12	
Investments by counter party	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
	<b>7,611,618,161</b>



Sep-12	
Investments by counter party	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
	<b>7,769,428,041</b>
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
	<b>7,860,302,167</b>
Mar-13	
Investments by counter party	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
	<b>8,075,225,178</b>



Jun-13	
Investments by counter party	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
	<b>8,256,821,431</b>
Sep-13	
Investments by counter party	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
	<b>8,445,963,823</b>