World Council

October 14, 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:

World Council of Credit Unions (World Council) appreciates the opportunity to comment on the Basel Committee's *Liquidity coverage ratio disclosure standards* consultative document. World Council is the leading trade association and development organization for the international credit union movement. Credit unions operate to promote thrift and financial inclusion and, worldwide, there are nearly 56,000 cooperatively owned credit unions in 101 countries with approximately US$ 1.7 trillion in total assets. Credit union supervisors frequently apply the Basel Committee's international standards to credit unions, and credit unions are also affected by Basel Committee rules through their counterparty relationships with banks.

We are writing to call the Committee's attention to an unintended consequence of the Basel III liquidity rules in Europe and likely elsewhere which relates primarily to the Net Stable Funding Ratio (NSFR) as well as the definitions used for the Liquidity Coverage Ratio (LCR).

Early adoption of draft Basel III liquidity rules in the European Union (EU) has resulted in commercial banks in the Republic of Ireland and other EU Member States reclassifying bank deposits made by credit unions from "retail" or "small business" deposits to "wholesale funding provided by other legal entity customers." This early phase-in of Basel III liquidity standards has led Irish banks to cite the increased cost of capital related to "wholesale funding provided by other legal entity customers" deposits as a reason for reducing significantly the interest that they will pay on credit unions' term deposits. Irish banks have reduced the interest they will pay on credit unions' bank deposits from as high as 3% annual interest prior to Basel III implementation to as low as 0.6% annual interest, with the average spread between the yields banks pay on "retail/small business" deposits and "wholesale" deposits being approximately 150 basis points.

Similarly, some banks in Great Britain and the United States have recently ceased doing business with credit unions and have closed credit unions' accounts. We believe that the Basel III liquidity rules are at least a contributory factor in these account closures, if not the primary factor.

We strongly urge the Committee to clarify as part of its NSFR guidance that bank term deposits made by credit unions and similar institutions can be classified as "retail" or "small business" deposits rather than as "wholesale funding" for NSFR purposes if the institution:

a) Operates under a rulebook with very limited investment powers (regardless of asset size), as is the case with credit unions in many jurisdictions; or
b) Is a small or medium enterprise (SME) compared to internationally active banks, such as a credit union with less than US$1 billion in assets (indexed for inflation).

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Unlike hedge funds and similar non-bank financial institutions, credit unions' deposits at banks are "sticky" and stable and many credit unions have few other options in terms of investing their money. Credit unions have few other investment choices because either: (a) their rulebook limits their investment options primarily to loans to members, bank accounts, and government bonds; or (b) they are SMEs for which other types of fixed-income investments, like asset-backed securities (ABS), present undesirable levels of interest rate risk, liquidity risk, credit risk, and/or asset-liability management (ALM) complexity.

Credit unions, as not-for-profit cooperatives that promote financial inclusion and thrift, have business activities that can be very limited. In the Republic of Ireland and other EU Member States, for example, credit unions' investment powers are limited primarily to making loans to members, investing in government-guaranteed debt instruments, and making bank deposits or holding bank bonds. In the United States of America (US), federal credit unions are similarly limited in their investment options primarily to loans, deposits in banks or "central" credit unions (i.e. second-level credit union "bankers' banks," which are also termed "corporate credit unions") and government-guaranteed debt instruments. Most credit unions in developing countries are also limited in their investment powers primarily to bank deposits, loans to members, and government-guaranteed debt.

These limited business powers 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. Investments in bank term deposits also present fewer safety and soundness concerns than even government-guaranteed debt, which can present interest rate risk and ALM challenges even if these investments' credit risks and liquidity risks are reduced by the instruments' sovereign guarantee.

Even when, as in a very limited number of the jurisdictions like Australia and Canada, credit unions' investment powers are broader, the importance of term deposits in Basel III-compliant institutions remains for SME credit unions because of operational constraints, notwithstanding that a broader range of investments like ABS may be allowed legally. In Canada, for example, the median size of a credit union is approximately CAN$ 79 million in assets. This is smaller in size than many ABS and also would present levels of credit risk, liquidity risk, interest rate risk, and ALM management complexities that would be unsuited for credit unions of this size as well as for most institutions with less than several hundred million CAN$/US$ in assets.

In the US, credit unions have a median asset size of approximately US$ 22 million in addition to (or perhaps, in part, as the result of) their limited investment powers. The US Small Business Administration defines "small credit union" to include credit unions with up to US$500 million in assets; "medium-sized" credit unions would presumably include those at least twice as large as "small," or at least US$1 billion indexed.[1]

Deposits in banks made by credit unions are also typically "sticky" and stable as a factual matter, in much the same way as "retail" or "small business" deposits, as is shown by the historical behavior of credit union deposits in Irish commercial banks.

In Ireland, credit unions represent over 10% of the overall personal savings market and manage personal savings of €12 billion on behalf of their 3 million members, who have saved an average of €4,000 each with the credit union. From this €12 billion in members' savings, loans of €5 billion are outstanding to members and the balance of €7 billion is invested mainly in deposit accounts at banks.

[1] *See* 13 C.F.R. § 121.201 ("What size standards has SBA identified by North American Industry Classification System codes?"), *available at* http://www.ecfr.gov/cgi-bin/text-idx?c=ecfr&SID=1dfd59ac7509642ff31f5ed947f82e9b&rgn=div8&view=text&node=13:1.0.1.1.17.1.268.10&idno=13.

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 – Five most used counterparty banks' stocks of deposits by Irish 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

The counterparty table shows a range from €700 million to €2 billion deposited by credit unions in the five most used counterparties as of 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 would create funding problems for these banks even in a future crisis. The inflow of deposits by credit unions into these banks during the recent financial crisis further demonstrates that credit unions' deposits do not present the liquidity concerns usually associated with "wholesale" bank funding.

Credit unions generally view banks as a safe place to invest their members' savings, even in a crisis. Credit unions' limited investment options also make it less likely that they would withdraw their funds from banks during a crisis since most types of alternative investments are either prohibited by law or present similar or greater credit risks, especially given that government-guaranteed debt securities and government-guaranteed bank deposits (and/or de facto government backstops for banks) present similar credit risks.

Banks closing credit unions' accounts in Great Britain and the US—because of Basel III and perhaps other regulatory burdens as well—is also at least as much of a concern for the global credit union movement as reduced yields on term deposits. In addition to having few other options for investments, credit unions need to use banks as counterparties in many jurisdictions to have access to payment, settlement, and liquidity services.

Being shut out from access to bank correspondent services would cause problems for credit unions in virtually all jurisdictions, especially in countries where there are only a few commercial banks (e.g., Australia, Canada, Ireland) or where there are no second-level "central" credit unions or cooperative federations to act as substitutes for commercial banks as counterparties (e.g., Ireland, Poland, Great Britain, Estonia, Romania, and much of the developing world).

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Lack of access to correspondent banks and lower yields on term deposits are a concern for credit unions in all parts of the world and can negatively impact credit unions' financial inclusion efforts even in the most developed financial systems, where tens of millions of people or more remain "unbanked" in jurisdictions like the EU and US. We expect significant problems for credit unions in developed countries, including possible failures and consolidation, unless the Committee clarifies the NSFR so that bank term deposits made by these credit unions are considered "retail" or "small business" rather than "wholesale."

Credit unions in the developing world, however, are likely to face a more dire, likely existential threat from the Basel III liquidity rules without clarification to the NSFR. Worldwide, over 2.5 billion people do not have access to financial services and the nearly 56,000 credit unions play a leading role in helping these unbanked individuals gain access to banking services and build the wealth necessary to improve their lives. Credit unions in developing countries are generally less well capitalized and have fewer investment options (as a practical matter, since many banks there already will not do business with credit unions) than credit unions in developed jurisdictions like Australia, Canada, the EU, and the US. Credit unions in developing nations are also nearly always SMEs.

We are extremely concerned that Basel III implementation in the developing world could destabilize entire national credit union systems. This destabilization could potentially cause myriad credit union failures and with that the concomitant loss of members' savings and loss of access to financial services for entire communities of poor and unbanked individuals in developing countries.

Without clarification from the Committee concerning the definition of credit union deposits under the NSFR, we believe that the trends of lower yields on credit unions' term bank deposits or closures of their bank accounts will harms potentially tens of thousands of credit unions and up to 200 million credit union members in both the developed world and the developing world. That outcome would be especially tragic for the world's 2.5 billion unbanked people as well as for the low-income and rural areas where credit unions are often the only financial institution serving the community.

We sincerely hope that you will take these concerns into consideration during the Committee's upcoming revisions to the NSFR and will clarify that bank deposits made by credit unions with limited investment powers or which are SMEs can be classified as "retail" or "small business" for NSFR purposes.

Thank you very much for the opportunity to comment on the Committee's consultative document *Liquidity coverage ratio disclosure standards*. 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
World Council VP and Chief Counsel