World Council

April 11, 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:

World Council of Credit Unions (World Council) appreciates the opportunity to comment on the Basel Committee's *Basel III: the Net Stable Funding Ratio* (NSFR) consultative document (bcbs 271).[1] 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 USD 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. This is especially true with respect to the NSFR because the NSFR's reserve requirement increase the cost of banks holding deposits made by credit unions, which decreases the yield available to the banks' credit union customers. In the Republic of Ireland, where the NSFR has been de facto implemented beginning in 2013, Irish credit unions' yields on term deposits decreased on average by 1.5% compared to the "retail" or "small business" rates they received prior to the early NSFR phase-in.

Overview of World Council's Comments

- World Council supports the proposal to classify term deposits made by credit unions that are not small or medium enterprises (non-SME credit unions) that have 6 to 12 months residual maturity as 50% available stable funding (ASF).
- We strongly support the removal of the term "non-financial corporate" from the 50% ASF definition.
- World Council supports the proposal to assign a 100% ASF to all credit unions' term deposits in banks with more than 12 months residual maturity.
- World Council strongly supports the proposal to treat as at least 90% ASF term deposits with 1 to 12 months remaining maturity made by Small and Medium Enterprises (SMEs) as defined by Basel II and proposed NSFR footnote 6. We believe that this definition of "SME" includes SME credit unions and other SME financial institutions because neither Basel II paragraphs 273 to 274 nor this NSFR proposal limit the definition of SME to non-financial companies.
- We request clarification, however, that the Basel II and NSFR definition of "SME" includes SME credit unions and other SME financial institutions, as appears to be the Committee's intent. We are concerned that without clarification some regulators will incorrectly read "SME" for NSFR

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

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purposes to mean “non-financial SME” because the Liquidity Coverage Ratio (LCR) used the term “non-financial small business” (even though proposed NSFR footnote 6 refers specifically to the Basel II SME definition, not to the LCR).

- World Council also supports proposed footnote 7 of the NSFR 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” 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 Union Term Deposits in Banks

As noted above, World Council 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 including the proposal to include term deposits made by all credit unions that have 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 an at least 50% ASF is appropriate for non-SME credit unions’ 6 to 12 month term deposits in banks.

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, 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 both developed and developing countries are also limited in their investment powers primarily to bank deposits, loans to members, and government-guaranteed debt.

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.

SME Credit Unions’ Term Deposits in Banks and the Definition of SME

World Council strongly supports the proposal to treat 1 to 12 month term deposits made by Small and Medium Enterprises (SMEs), including SME credit unions as defined by Basel II and proposed NSFR footnote 6, as at least 90% ASF.

Paragraph 273 and 274 of Basel II[2] and this NSFR consultative document do not limit the definition of SME to non-financial companies; however, some regulators have questioned whether the Basel Committee truly intends to include financial SMEs within the NSFR's SME definition because it used the term "non-financial small business" in Paragraph 90 of the LCR,[3] notwithstanding that proposed NSFR footnote 6 refers expressly to paragraph 273 the Basel II definition of "SME" without mentioning the LCR (except with respect to the LCR's definition of "retail" deposits).

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 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 refer expressly to paragraph 274 as well as paragraph 273 of Basel II in footnote 6 of the NSFR. Paragraph 274 interprets paragraph 273 by providing a national option to use EUR 50 million or less in assets as the definition of "SME" rather than using EUR 50 million or less in annual revenue. While it may seem obvious that paragraph 274 is by implication part of the paragraph 273 SME definition, we urge the Committee to revise footnote 6 as follows to clarify these points by adding the following underlined text:

> Retail deposits are defined in LCR paragraph 73. SMEs are defined in paragraphs 273 and 274 of the Basel II framework and include financial institutions meeting the SME definition; see BCBS, *International Convergence of Capital Measurement and Capital Standards: A Revised Framework – Comprehensive Version* June 2006, available at www.bis.org/publ/bcbs128.htm.

In addition, we 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 EUR 50 million or less in annual revenues or EUR 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 USD 500 million in assets.[4]

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 perform an important financial inclusion role in both developed and developing countries. 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.

[2] 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.
[3] 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.
[4] *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.

Worldwide 55,952 credit unions had the equivalent of USD 1,693,949,441,328 in assets at the end of 2012, meaning that the average credit union asset size globally is approximately USD 30 million in assets.[5] In Ireland, the average asset size of a credit union is EUR 30 million.

Even in larger credit union systems like Canada and the US, however, the majority of credit unions are quite small. In Canada, for example, the median size of a credit union is approximately CAN 79 million in assets and, in the US, credit unions have a median asset size of only USD 22 million.

Deposits at Cooperative Centrals

World Council 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" or "corporate credit union." We therefore urge the Committee to insert the following underlined text in footnote 7 to clarify that central credit union liquidity arrangements are equivalent to central cooperative bank liquidity arrangements:

> At the discretion of national supervisors, a possible exception to this treatment is for stable deposits from cooperative banks or credit unions that are required by law in some jurisdictions to be placed at the central organisation and are legally constrained within the cooperative bank or credit union network as minimum deposit requirements.

Conclusion

We strongly support the aspects of the Basel Committee's NSFR proposal which will help address yield problems for credit unions that are bank customers but, as noted above, request clarification on the SME definition's application to SME financial institutions. Although we believe that a plain reading of the Basel II SME definition and proposed footnote 6 of the NSFR includes small credit unions and banks within the SME definition, we urge the Committee to clarify the definition of SME to include SME financial institutions expressly to prevent confusion on this issue at the national level.

Lower yields on term deposits because of the NSFR and other Basel III requirements are a concern for SME 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." Worldwide, over 2.5 billion people do not have access to financial services and the nearly 56,000 credit unions, which are mostly SMEs as defined by Basel II, play a leading role in helping these unbanked individuals gain access to banking services and improve their lives.

Without clarification from the Committee concerning the definition of SMEs with respect to small credit unions and banks, we believe that the trends of lower yields on credit unions' term bank deposits will harm the financial inclusion efforts of potentially tens of thousands of SME credit unions and tens of millions of credit union members, especially in low-income and rural areas where credit unions are often the only financial institution serving the community.

[5] World Council of Credit Unions, *Statistical Report 2012* (2013), *available at* http://www.woccu.org/publications/statreport.

Thank you very much for the opportunity to comment on the Committee's consultative document on the *Basel III: the Net Stable Funding Ratio* consultative document. 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