



13<sup>th</sup> August 2013

Sent via email

Isabelle Vaillant  
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**Re: Basel III - Consultation Paper on Draft Implementing Technical Standards on Additional Liquidity Monitoring Metrics under Article 403(2) of the draft Capital Requirements Regulation (CRR) ("EBA/CP/2013/18")**

Dear Ms. Vaillant,

The European Network of Credit Unions (ENCU) welcomes the opportunity to comment on the European Banking Authority's (EBA) consultation paper on draft technical standards for implementation of the Basel III liquidity rules in the European Union.

Early adoption of the EBA's draft Basel III liquidity rules has resulted in commercial banks in the Republic of Ireland, and likely other Member States, reclassifying bank deposits made by credit unions from "retail" or "small business" deposits to "wholesale funding provided by other legal entity customers". As we discussed with you and Luis del Olmo Laguna on 22nd May, 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 under the EBA's Basel III rules 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 to as low as 0.6 % annual interest, which is likely to cost Irish credit unions €60 million or more a year in lost interest income. Please see the attached briefing paper from the Irish League of Credit Unions for additional details.

We urge the EBA to clarify that bank deposits made by credit unions and other partially CRD-exempt financial institutions as defined by Article 2(5) of the CRD IV<sup>1</sup> are not equivalent to "wholesale funding provided by other legal entity customers" and should be recognized as a "sticky" and stable source of funds based on the deposits' historical performance.

Credit unions and other CRD Article 2(5) institutions perform an important financial inclusion role in many Member States and we do not believe that the historical behaviour of credit unions' deposits at banks justifies classification as "wholesale funding provided by other legal entity customers". The reduction in credit unions' interest income impedes their ability to promote financial inclusion and, if not addressed immediately, may threaten the viability of some credit unions and similar financial institutions in the EU.

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<sup>1</sup> 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, Art. 2(5), available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32013L0036:EN:NOT>  
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Credit unions in the Member States of the Republic of Ireland, Poland, the United Kingdom, and Estonia are subject to comprehensive supervision on a consolidated basis by the Central Bank of Ireland, the Polish Financial Supervision Authority (KNF), the Bank of England's Prudential Regulatory Authority, and the Bank of Estonia (Eesti Pank), respectively, under credit union specific rulebooks<sup>2</sup> even though they are exempt from most aspects of the CRD and CRR pursuant to CRD Article 2(5).<sup>3</sup> These Member States' credit union specific regulations establish capital, liquidity, accounting, portfolio shaping, and other safety and soundness requirements similar to those applicable to banks but scaled to European credit unions' relatively less complex business activities, cooperative structure, and relatively smaller economies of scale. Credit unions in these Member States also have access to the national lender of last resort.

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. Credit unions, as not-for-profit cooperatives that promote financial inclusion and thrift, have business activities limited to making loans to members, accepting savings deposits from members, investing in government-guaranteed debt instruments, making bank deposits or holding bank bonds, and, in some cases, providing payments services to members. 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, especially when loan demand from members is limited as it is now.

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. These institutions are therefore only 40% lent out and are dependent on the interest they earn on the €7 billion surplus funds to pay interest and dividends on members' savings as well as to cover operational expenses, add to reserves, control for inflation, and expand services to promote financial inclusion.

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.

| Counterparty- Bank      | Origin Details                  | September<br>2012<br>€'m | September<br>2007<br>€'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                        |

We are concerned that the lower rates of interest being offered to credit unions in Ireland and likely other Member States under the pretext of the higher cost of capital associated with "wholesale funding provided by other legal entity customers" (despite the demonstrably stable nature of credit unions' bank deposits) under

<sup>2</sup> See, for example, the Prudential Regulatory Authority's *CREDs Sourcebook* for the regulations applicable to credit unions in Great Britain and Northern Ireland, available at <http://fshandbook.info/FS/html/handbook/CREDs/>.

<sup>3</sup> Other financial institutions subject to CRD Article 2(5) exist in Belgium, Denmark, Germany, Greece, France, Hungary, Latvia, Lithuania, the Netherlands, Austria, Portugal, Slovenia, Finland, and Sweden.



Basel III will lead to credit union consolidation or failures that will negatively impact underserved communities in Europe, especially in 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 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 and viable credit union movement is vital for the ordinary people of these Member States. If credit unions' and other CRD Article 2(5) institutions' income is dramatically reduced as a result of the Basel III liquidity standards, many smaller credit unions and other financial institutions with a social purpose may close or merge into larger institutions, and leave many of the more vulnerable sections of European society without access to basic financial services.

We hope this comment letter and the attached paper assists in your understanding of the issues as they are likely to affect credit unions and other CRD Article 2(5) institutions in the EU.

We sincerely hope that you will take these concerns into consideration.

Please do not hesitate to contact either of us or Justyna Slominska at +32 2 626 9500 should you have any questions regarding our comments.

Sincerely,

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