



## **Basel III Liquidity Standards—Implications for Irish Credit Unions**

### **Background - Irish Credit Unions**

Credit unions are not for profit financial cooperatives which are managed by voluntary boards of directors. There are just under 500 credit unions affiliated to Irish League of Credit Unions (ILCU), 400 in the Republic of Ireland and 100 in Northern Ireland. There are 3 million members of credit unions on the island of Ireland out of a total population of 5 million.

Credit unions in the Republic of Ireland are regulated by the Central Bank of Ireland and credit unions in Northern Ireland are regulated by the Financial Conduct Authority and the Prudential Regulation Authority. Credit unions are part of the Irish/UK Deposit Guarantee Schemes and consequently credit unions have the appropriate funds on deposit with the Irish Central Bank and the Prudential Regulation Authority in the UK. Credit unions in the Republic of Ireland are also part of the European Central Bank's Minimum Reserve Requirement (MRR) and consequently have the appropriate funds on deposit with the Irish Central Bank for this.

Credit unions manage personal savings of €12 billion on behalf of their 3 million members. From this €12 billion members savings, loans of €5 billion are outstanding by members and the balance of €7 billion is invested in mainly deposits accounts in banks.

The total savings held by households in Ireland is €92 billion and the total amount of consumer credit advanced to households excluding loans for house purchase is €14 billion. So credit unions represent over 10% of the overall personal savings market and over 33% of the personal lending market in Ireland.

Because credit unions are only 40% lent out, they are very dependent on the interest they earn on the €7 billion surplus funds they have, to break even and to pay dividends, i.e. a return on members savings.

As a fallout from the financial crisis there are now only four retail banks operating in Ireland with a branch network and these four banks are actively reducing the number of branches they operate. The only other financial organization offering personal savings and loans are the credit unions. Therefore the continued existence and operation of a successful and viable credit union movement is vital for the ordinary people of Ireland, especially those who live long distances from a bank branch or those who cannot fulfill their financial needs over the internet.

### **Classification of Deposits & Relevance to Credit Unions**

Heretofore, banks have broadly treated credit union funds as stable deposits which have attracted competitive rates of return. Under Basel III a number of different classes or funding sources are identified. Classes can largely be divided into retail (placed by a natural person) and wholesale (placed by a legal entity).

Based on Basel III criteria, deposits from credit unions fall into the wholesale category Non-Bank Financial Institutions (NBFIs). The implications of this reclassification are:

- **Liquidity Coverage Ratio (LCR):** The LCR assigns a specific run-off rate to each source of funding. A run-off rate reflects the amount of funding due to mature in next 30 days which is not rolled over and therefore is withdrawn from the bank. The NBFI class attracts a run-off rate of 100%.
- **Net Stable Funding Ratio (NSFR):** In order to establish the available amount of stable funding of a bank, the NSFR assigns a factor to each source of funding, called the availability factor. This factor represents the proportion of the balance today that is expected to be available to the bank in one year in order to fund longer term assets. Accordingly, certain behavioural assumptions are built into the availability factor relating to expectations regarding funding withdrawal. The NBFI class has been assigned an availability factor of 0%.

The most valuable sources of funding are those regarded as most stable and sticky, i.e. those that are unlikely to be withdrawn from the bank. Those funds will therefore have lower run-off rates in calculating outflows for the purposes of the LCR and high availability factors in calculating available amounts of stable funding under the NSFR.

Stable retail funding is perceived as the most valuable source of funding to a bank and is likely to attract the highest deposit rates. Conversely, less stable wholesale funds, perceived as less valuable to banks, will attract lower deposit rates and so deposits from credit unions will no longer be as attractive to the banks, especially those deposits with maturities of less than one year.

Our analysis over recent years, indicates that wholesale deposit rates have been 2% per annum lower than the rates offered to credit unions for similar maturity profiles. With in excess of 60% of the overall balance sheets or €7 billion in surplus funds in credit unions this differential in rates if it were to continue would result in a reduction in income of €140m per annum to credit unions. This would put considerable pressure on credit unions ability to break even, never mind to pay dividends to their members.

The average dividend rate paid to members as a return on their savings has been 1% over the past three years. If a 2% reduction in the income earned on the €7 billion invested surplus funds was to materialise as a result of deposits being reclassified as wholesale then these dividends would be wiped out and credit union members would get no return on their €12 billion savings.

### **Grounds for Credit Unions to Seek Reclassification**

The ILCU believes that there are a number of reasons why credit union deposits should not be classified as wholesale NBFI's.

- The €7 billion surplus funds in Irish credit unions is actually owned by the 3 million members who have saved an average of €4,000 each with the credit union. So it's retail money in effect.
- This money has always behaved as if it were retail in that it has been "sticky" and stable. The members have left it with the credit union through good and bad times and the credit unions have left it on deposit with the banks.



- As referred to above there are now only four retail banks operating in Ireland with a branch network. The only other financial organization offering personal savings and loans are the credit unions. This restricts ordinary peoples ability to move their savings from one institution to another and so makes the credit unions deposits with banks very stable.
- There was no run from the credit unions by the members or from the banks by the credit unions during the Global Financial Crisis of recent years.
- Credit Unions have a very simple business operating model compared to other asset managers or pension fund managers or money market fund managers. They are each run by a voluntary board of directors who are not financial market experts. With the small number of deposit taking banks operating in Ireland the deposits are left with the banks even in uncertain times.
- The credit unions are restricted in what they can invest their surplus funds in. They can only invest in Government or Bank bonds or bank deposits. Because of this and the ever declining bond yields over 80% of surplus funds are in bank deposits.
- Basel III provides for certain run-off rates or parameters to be determined at national level.
- In their comments and answers to listed questions from the recent EBA discussion papers, the EBA Banking Stakeholder Group in replying to question 17 felt that it would be appropriate to allow derogations from the application of outflow rates on the basis of uniform strict criteria in some cases such as when the behavior of depositors depends on country-specific factors, like ‘historical’ preferences or legal frameworks.

We hope this paper assists in your understanding of the issues as they are likely to affect Irish credit unions.

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