Committee of European Banking Supervisors
CP 16 Consultation on Review of Large Exposures Rules

I am writing on behalf of Airdrie Savings Bank to make comment on the proposals contained in Chapter 8 of the above Consultation Paper regarding Interbank Exposures and in particular the proposal to remove the exemption for large exposures to banks and building societies with less than one year's maturity.

I would preface our more detailed comments with the overall comment that it is not too extreme to say that this would be disastrous for Airdrie Savings Bank as the imposition of such a limitation would have the effect of severely restricting our ability to trade.

By way of background, Airdrie Savings Bank was established in 1835 and is now the last remaining savings bank in the UK. We provide a range of banking services to personal and small to medium size business customers including savings, money transmission and lending. Our total assets as at 31 October 2007, our most recent year end, were £130 million. At the same date, our capital (comprising our reserves as we are a mutual business with no share capital) was £14.1 million and so 25% of our capital base amounts to approximately £3.5 million. Our only source of funds is customer retail deposits, amounting to £115 million at 31 October 2007, and our overall funds are deployed on the basis of £33 million through customer advances, £28 million on fixed interest securities and £64 million on deposit with other banks. We operate only in sterling and within the boundaries of the UK.

The proposal would have effects on Airdrie Savings Bank in two areas, as follows –

a) Operational Level –

(i) We are not a clearing bank and so we are a customer of one of the major Scottish Banks. Just as with any non-banking commercial concern we maintain accounts with them to enable us to operate our business on a day to day basis. To deal with present levels of business we maintain balances of £10 million on current account which facilitates movements of funds on behalf of our customers as well as providing us with liquidity on an immediate access basis. While as a separate issue we could deal theoretically with the specific issue of liquidity by operating instant access accounts with a range of banks, we simply could not operate this working account on a day to day basis within an individual bank limit of £3.5 million in view of the constraints that would place on our ability to move and receive funds on behalf of our customers as well as meet their day to day requirements. On that basis alone, our ability to trade would be unduly and unfairly restricted. By way of illustration, we are at present negotiating for a £6 million deposit from a retail customer; if successful we would be unable to accept the deposit into our account.

(ii) While we would clearly have our ability to compete for new deposits restricted by the proposal, as illustrated above, at an operational level I

accept that we could in theory operate across a number of banks perhaps 4 or 5. However, we do not know at any point in time what funds our customers are paying in or drawing out and so it would be extremely difficult to plan which accounts to use each day. Under our current basis our customers know how to remit funds to us and this would become unworkable if we are unable to give them any clarity as to which account to use, quite apart from the unnecessary increase in risk of funds going astray or being delayed in any way. Quite simply, this aspect would become so messy that our more significant customers would become fed up and move their business to other banks.

(iii) Finally, at an operational level the current situation enables us to operate our working accounts with our bankers on a cost effective basis as the service charges they levy upon us are mitigated by the sizeable balances held both on current account and on fixed deposits on durations of up to one year. While we have not discussed this aspect directly with our bankers, on the basis of past discussions we believe that our service charges could at least double as a consequence of the proposed change.

b) Investment Level –

(i) Spreading our deposits over a larger range of banks – potentially 25 in number - on the basis of operating within a maximum of £3.5 million per bank would, we believe, lead to a significant reduction in the interest rates we will be able to obtain for those deposits, potentially of the order of 0.25%, assuming no compromise on our current quality stance.

(ii) We seek to place our deposits only with major UK banks with the highest credit ratings. Any requirement to find approximately 25 such highly rated institutions with which funds could be placed would inevitably result in increased credit risk and an adverse impact on our capital adequacy.

(iii) Dealing with approximately 25 institutions compared with the five major UK banks with which we currently deal would clearly involve considerable additional management resource which would carry unwelcome extra cost.

Additional Costs

While it is impossible to estimate the potential loss of business from the proposal, we would estimate the potential additional costs as –

Additional staff costs to manage interbank relationships - £30,000
Increased bank service charges - £50,000
Reduced interest income - £160,000

Total impact - £240,000

Our pre-tax profit last year was £656,000 so the effects would be material and would inevitably result in reduced interest rates for our customers as well as likely reductions in customer service as a consequence of having to release staff to reduce costs.

Conclusion

By way of concluding comment, we would contend that this proposal would be completely unworkable for institutions of our type and size and would seriously discriminate against such institutions. The proposal in our case is also disproportionate to the risks which we present to the market as a whole as it would be fair to say that with total assets of £130 million we hardly appear on the radar screen of the UK banking market, far less the overall European market. While we accept that a reasonable degree of risk spreading is appropriate in this context, we view the proposal as representing an excessive solution.

For what it is worth, our suggestion by way of compromise is that if there has to be a limitation then, at least for small institutions below a size to be defined this should be modified to mitigate against any restrictions on trade. In our case we could operate within a level of two times capital per institution and while we already have our own quality restrictions we would also accept such a restriction imposed by regulation. Indeed, there is already in effect such a restriction in place through the capital adequacy regime and the variable risk weightings based on counterparty credit risk.

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