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To: The Committee of European Banking Supervisors

The postulated changes whereby inter-bank exposures would be subject to a 25% capital adequacy requirement would result in smaller institutions such as ours being put out of business. We would not even be able to hold a sterling current account with one bank.
Our Capital Base is £7.5m and we hold customer deposits of currently £39m of which £15m is lent to customers. Approximately £5m of liquidity is held in British Government debt instruments matching our paid up share capital.

Therefore we have a little in excess of £25m of which £20m is held in Certificates of Deposit purchased from the top echelons of UK banks. CDs are not traded but held in a pattern of regular maturities as a component of our liquidity reserve.
On a monthly basis we receive instructions from a very important customer to make trade payments amounting to between £15m and £35m. For prudential reasons we receive these funds prior to releasing payment instructions to our clearing banker: The Royal Bank of Scotland.
The funds received from our customer are then placed on a small number of short term deposits with members of the panel of banks referred to above. Funds, under the current UK payment standards, are placed for 2 working days.
Board level dispensation enables us to increase our individual limits from £7.5m per bank to £15m for these short term purposes.

The CEBs proposals of placing a weighting of 25% on interbank lending are both seriously flawed in concept and would have a disastrous effect on the running of our business or of any small bank with liquidity to invest. We are certainly not alone in this.
Simply put:
a) Due to the postulated changes there are not enough credit worthy banks to place the funds with at peak times.
b) At "standard" times the deposits that we could place would be too small to place in CDs and would still need a large number of counterparties many of which would necessarily be of low credit quality. This, in itself, would greatly increase risk.
c) Due to the large number of transaction that would be involved, administration would be costly, cumbersome and the greater number of deals and number of exposures would very significantly increase operational risk.
d) Fragmentation of deposits would also very significantly increase credit risk due to the need to use small low rated or unrated banks.

e) The proposals will not enhance but will destroy liquidity: as demonstrated by recent events this is a far greater risk to the international finance systems than credit risk. No realistic amount of capital would have changed that.

In summary: we view this proposal as misconceived, ill thought out and, in itself, will present a significant threat to both the availability and prudential management of liquidity.
These proposals should be abandoned before great damage is done: the inevitable consequence of implementation.

I urge CEBS to take a step back and think again about the real issues behind the recent debacle: very poor credit judgement on the risks associated with significantly opaque packaged securities resulting in serious losses. The consequence was a lack of liquidity due to two factors: Those with liquid funds needed the money to cover their own positions compounded by concerns at the basic credit worthiness of other counterparties. Capital was not the issue!

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Peter Westby,
General Manager