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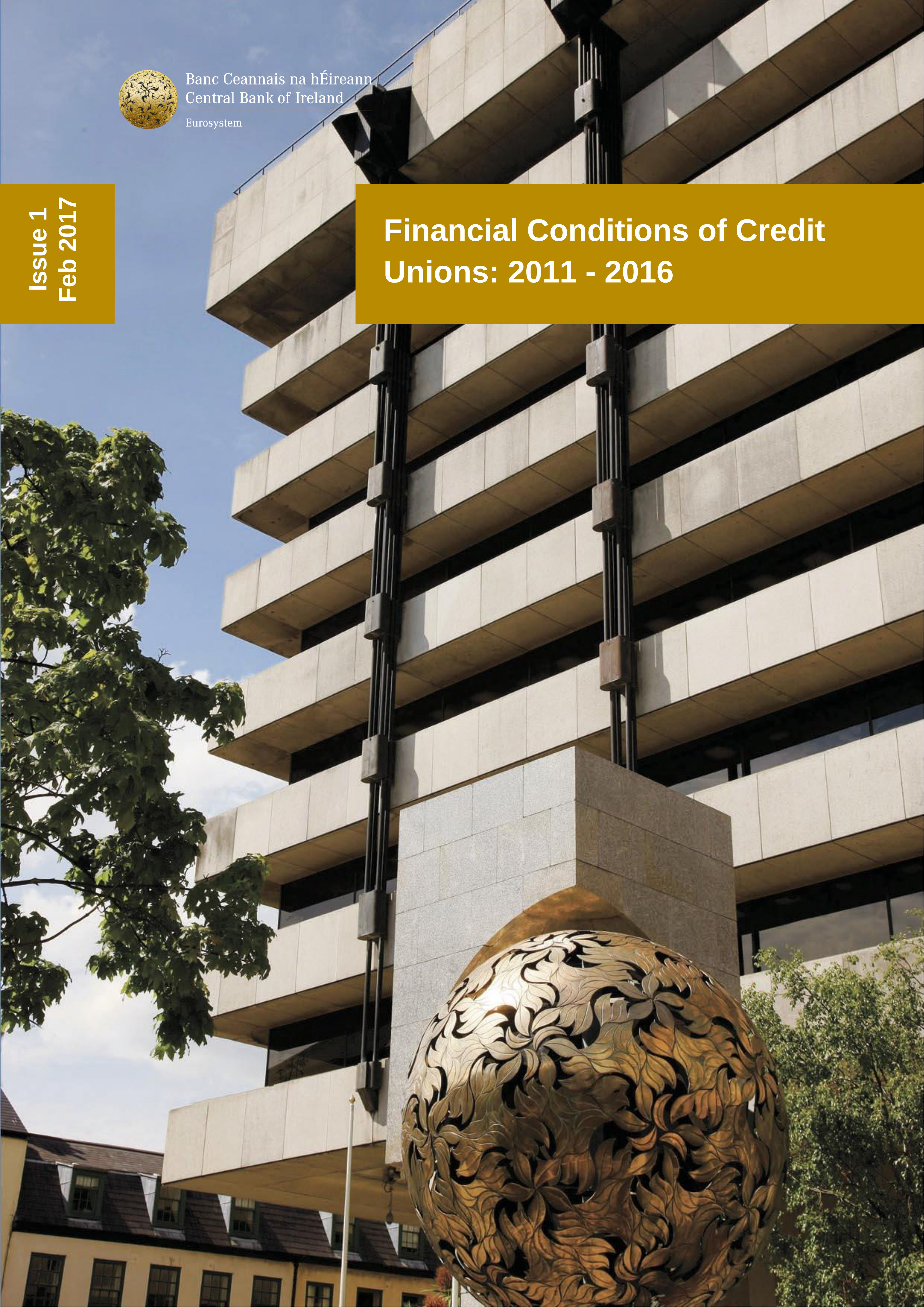
Financial Conditions of Credit Unions: 2011 - 2016



Welcome to 'Financial Conditions of Credit Unions' Publication – 1st Edition

Following on from our Credit Union News, which is a semi-annual publication, we are now introducing the 'Financial Conditions of Credit Unions' publication, which is a statistical information release with the primary focus of assisting credit unions in analysing the performance of their credit union relative to peer groups and to provide insights to credit unions on key trends that we see based on our analysis of the data submitted to us. As I referred to in the January edition of Credit Union News, a priority focus in 2017 is on embedding the benefits of restructuring and making significant progress on building the business models required for future viability and I hope that this statistical publication will help you in the analysis you undertake on your credit union.

At a sectoral level, in 2016 the overall sectoral financial position has shown some initial signs of improvement – reflected in some lending growth together with a decrease in the level of reported arrears. However, pressure remains on your business model particularly from the continued low level of total loans to assets, currently 27 per cent, and the low interest rate environment.

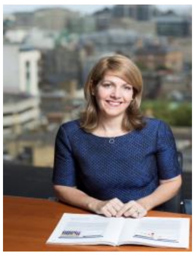
Following a decline in total loans advanced over a number of years, since 2014 there has been some increase - with a growth of 16 per cent in loans advanced over the period September 2015 to September 2016 (up from €1.9bn to €2.2bn over that period). However, despite this increase in loan advances, in terms of the impact on total loans outstanding, there has only been a slight increase over the same period (from just under €4bn to just over €4.1bn). Average arrears reported, while still high, have shown a decreasing trend – from 13.5 per cent of total loans in 2015 to 9.7 per cent in 2016. On the income side, investment income has fallen and, given that investments represent the largest asset on the balance sheet, this represents a significant vulnerability for future income.

On the costs side, while over recent years operating costs have been increasing, the falling level of reported loan impairments has contributed to a reduction in the level of total costs. While return on assets (before dividend) is currently c1.2 per cent, taking account of the likely pressures on trends for both income and costs, it could be expected that this return will reduce further. On the funding side, members' savings have continued to grow – up from €12.5bn at end-September 2015 to €13.3bn at end-September 2016 which, while an indication of member loyalty and trust in their credit unions, brings further business challenges in terms of the ability to provide a return to members on these funds.

In summary, while the figures for 2016 show evidence of some recovery including growth in lending, the challenge remains that, without other changes including development of products and services, credit unions are unlikely to develop sufficiently to ensure a sustainable business model into the future.

The data contained and presented in this publication is derived from both recurring and ad-hoc information submitted by credit unions to the Registry of Credit Unions. The recurring data is sourced from the quarterly and annual regulatory submissions which have been collated and consolidated by the Registry's Analytics Team to provide a sector-wide view of financial performance. The data range from 2011 to 2016 relate to credit union data available as at 16th February 2017.

It is planned to issue this Statistical Publication twice-yearly. We hope that you will find it a useful and informative tool. As this is the first publication, the format is likely to evolve and we welcome your comments or feedback including financial issues to be addressed in future publications. Any feedback should be provided to rcuanalytics@centralbank.ie



Anne Marie McKiernan

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Registrar of Credit Unions

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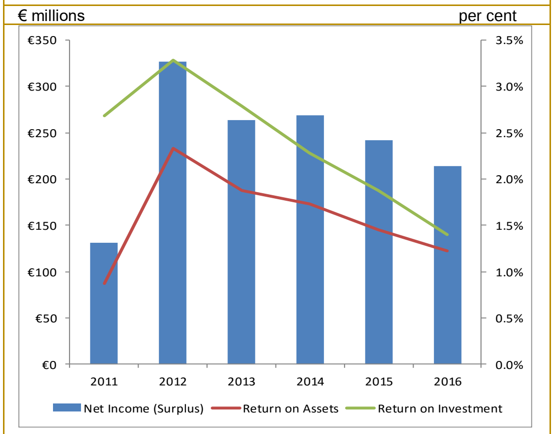
Notes

1. *Unless otherwise stated, this document refers to data available on 16th February, 2017.*
2. *Unless otherwise state, the reporting date of data from 2011 to 2016 contained in this document relates to September 30th of the relevant year*
3. *Unless otherwise states, the aggregate credit union data refer to all credit unions operating in the Republic of Ireland*
4. *Lists of registered credit unions are updated monthly and available at http://www.centralbank.ie*

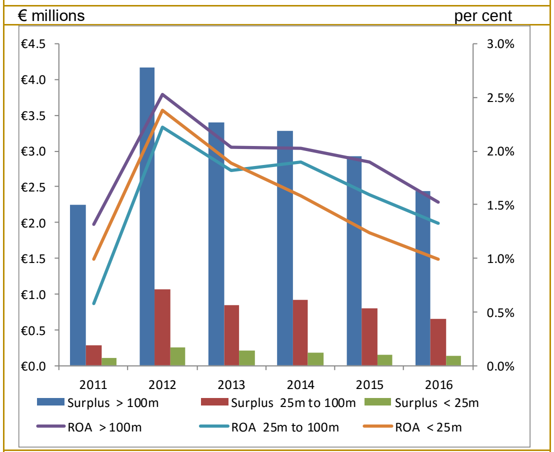
Financial Conditions of Credit Unions

Chart A1: Return on Assets



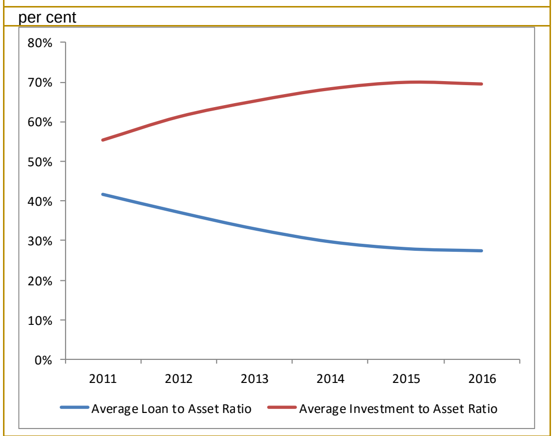
Source: RCU

Chart A2: Average Surpluses by Size



Source: RCU

Chart A3: Balance Sheet – Sector Averages



Source: RCU

1.1 Sector Overview

"Increased pace of restructuring activity in the credit union sector"

The credit union sector has undergone a period of significant restructuring, particularly in 2015 and 2016. This restructuring is mainly through consolidation with many of the cases involving smaller credit unions transferring their business and members into larger credit unions in order to derive benefits from scale and strive for a stronger future viability. Currently, the number of registered credit unions stands at 311 compared to 428 at the end of 2006. There are 286 actively trading credit unions as of 16th February 2017. This consists of 33 Industrial credit unions (combined assets size c.€2.6bn) and 253 Community credit unions (combined asset size c.€13.3bn). The top 50 credit unions by asset size account for 52 per cent of total sector assets and 51 per cent of total sector loans.

Loans and advances have increased in 2016, with sector lending (after provisions) increasing by just under €337m on the previous year i.e. 9 per cent of loans (after provisions) outstanding. However, total funding (members' shares/deposits) growth over the same period has put pressure on surpluses, regulatory capital and return to members.

1.2 Return on Assets

"Return on Assets (ROA) has been falling since 2012"

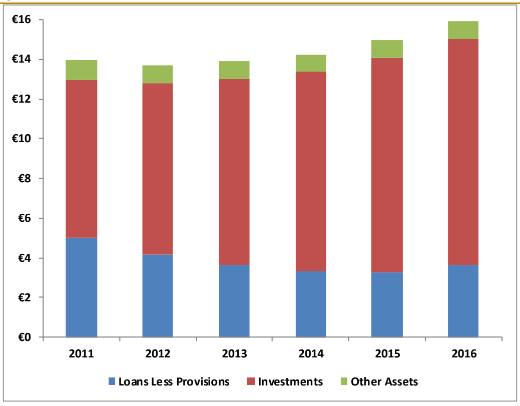
ROA has declined from 2012 to date (Chart A1)[1]. This overall trend is similar when analysed by size of credit union, although larger credit unions have higher average ROAs in 2015 and 2016 (Chart A2). There is a difference of approximately 0.5 per cent in ROA between larger credit unions (asset sizes greater than €100m) and smaller credit unions (assets sizes less than €25m).

Total sector surplus[2] has reduced by approximately €113m between 2012 and 2016, from €327m to €214m. (Chart A1). Credit unions with asset sizes of less than €25m have reported a significant decline in their average surplus between 2012 and 2016 of approximately 48 per cent – from an average ROA of 2.4 per cent in 2012, to 1 per cent in 2016. Credit unions with asset sizes of greater than €100m and credit unions with asset sizes of between €25m and €100m have reported a drop in average surplus of over 40 per cent

[1] The low ROA in 2011 is as a result of a large amount of exceptional losses, primarily in relation to investments.
[2] Surplus = Total Income – Total Expenditure; (Dividend is not included in the Surplus calculation)

Chart A4: Assets

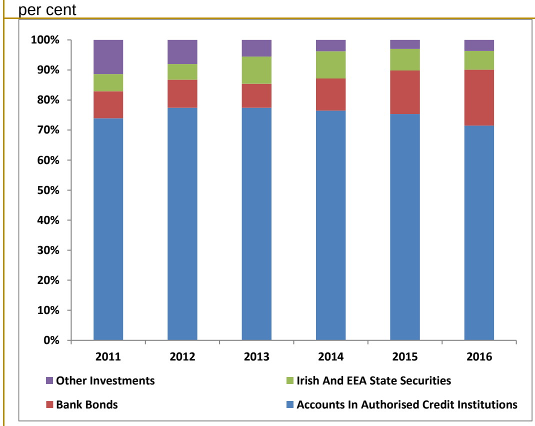
€ billions



Source: RCU

Chart A5: Average Investments

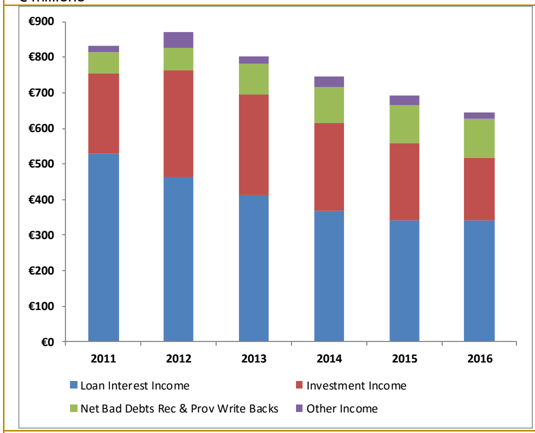
per cent



Source: RCU

Chart A6: Total Sector Revenue

€ millions



Source: RCU

over the same period. (Chart A2). The drop in reported surplus for all asset size categories can be attributed to a number of factors including i) lower levels of lending ii) lower return on investments and iii) increasing cost base.

Loan provisioning is currently at its lowest levels across the sector since 2011 and a large number of credit unions are writing back provisions (which have the impact of boosting surplus). However, despite these factors, credit union ROA continues to decrease. Future loan provisioning requirements as well as costs associated with new product development will put additional pressure on future ROA levels.

1.3 Assets

"Sector assets steadily increasing"

Total assets of the sector currently stand at €16bn as at September 2016. (Chart A4). Assets have increased by €2bn over the five-year period from 2011 while total sector net loan book has contracted by approximately 28 per cent over the same period.

The average sectoral Loan to Asset (LTA) ratio has declined from just over 40 per cent in 2011 to 27 per cent in 2016.

Investments constitute on average approximately 70 per cent of assets as at September 2016 (€11.4bn). This Investments to Assets ratio has increased from 55 per cent in 2011 to just under 70 per cent in 2016. (Chart A3). The majority of credit union investments are held in bank deposits. As of September 2016, 72 per cent of total sector investments are in Accounts in Authorised Credit Institutions (€8.2bn). (Chart A5).

1.3.1 Investments

While the Investments to Assets ratio has increased significantly, investment income has contracted annually from 2012. (Chart A6). This is driven by the decreasing rates of return from investments. The low interest rate environment in recent years is having an impact on credit union income.

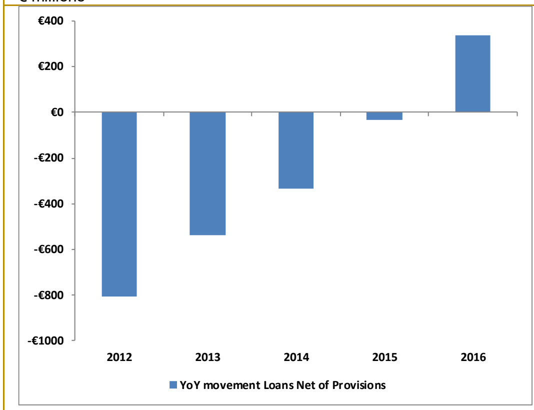
The effect is more pronounced as longer term investments mature, given that the rate of return earned on reinvesting is significantly reducing, leading to much lower cost to income margins. The increasing reliance on investment assets carries significant future revenue generating risk in the current low-interest rate environment. This is further illustrated in Section 2.1 which highlights reinvestment vulnerabilities in the sector under a specific scenario.

1.3.2 Revenue Generated from Assets

The average interest that credit unions earn on their lending has maintained at approximately 9 per cent since 2011. However, the gross loan interest income has reduced

Chart A7: Loans Year on Year Reductions/Growth

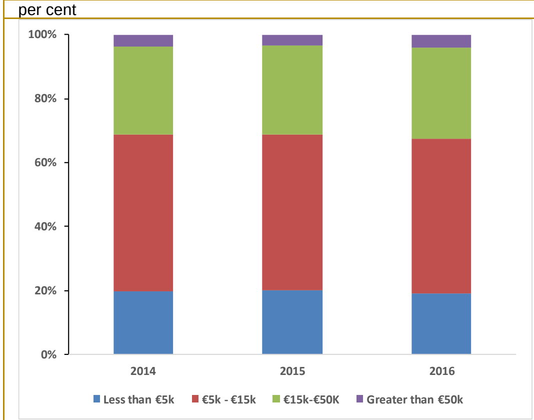
€ millions



Source: RCU

Chart A8: Gross Loans Outstanding by Loan Size

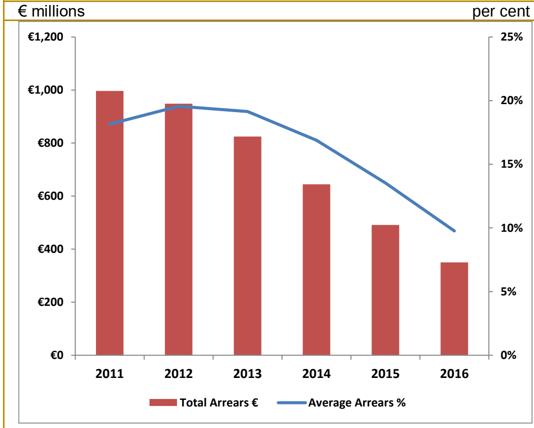
per cent



Source; RCU
Note: Credit unions commenced reporting gross loans outstanding by asset size from 2014

Chart A9: Arrears

€ millions per cent



Source: RCU

significantly from 2011 to 2016. (Chart A6). This corresponds with the reducing Loan Book over this period and has contributed to the declining ROA.

Provisioning write backs in recent years have offset this decline in income to some extent. (Chart A6).

1.4 Loans

"Year on year changes in loan balances are stabilising"

Total sector lending has contracted since 2011 with total sector loans (before provisions) falling from €5.7bn in 2011 to €4.1bn in 2016. Total sector loans (net of provisions) have fallen from €5bn to €3.6bn over the same period. The average sectoral Gross Loan to Asset (LTA) ratio has fallen from just over 40 per cent in 2011 to 27 per cent in 2016. Significant contraction in net loans outstanding took place from 2012 to 2014 with annual falls of around €800m, €540m and €330m over the 3-year period. There is some evidence of stabilisation in total net lending in 2015 and an annual growth of €337m in 2016 (Chart A7).

Under the Credit Union Act 1997 (Regulatory Requirements) Regulations 2016 lending maturity limits, gross loans outstanding with a maturity period exceeding five years must not exceed 30 per cent of all lending. Gross loans outstanding for loans with a maturity period exceeding ten years must not exceed 10 per cent of all lending.

Gross loans outstanding by loan size have remained relatively static over the three years 2014 to 2016 at c.€4bn. (Chart A8).

This is in the context where total loans to Irish households (consumer credit) have contracted from €17bn in 2011 to €12bn in 2016[3]. Credit unions have maintained a c34 per cent share of this type of lending during the period 2011 to 2016.

1.5 Arrears

"Credit quality improving but concerns remain"

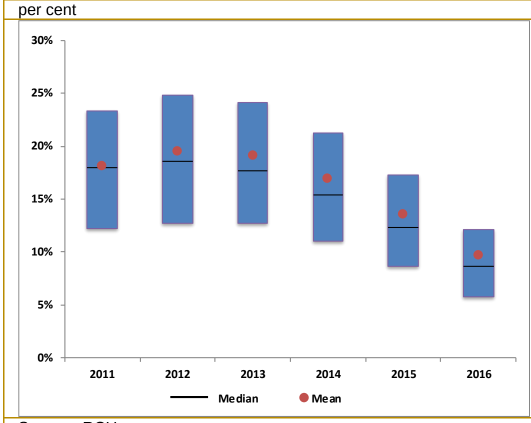
Sector wide credit quality in the loan book continues to improve, in terms of the decline in average level of arrears reported. (Chart A9). However, there are still significant arrears in the sector.

The sector average rate of arrears stands at 10 per cent of gross loans outstanding for September 2016 which equates to approximately €360m in total sector loan arrears greater than 9 weeks. This is down from 18 per cent in 2011, which equated to approximately €1bn in loan arrears at that time. Further improvements are required for many credit unions to

[3] http://www.centralbank.ie/polstats/stats/cmab/Documents/ie_table_a.5.1_loans_to_irish_households_-_purpose_and_maturity.xls

Chart A10: Arrears Ranges (Between 25th and 75th percentile)

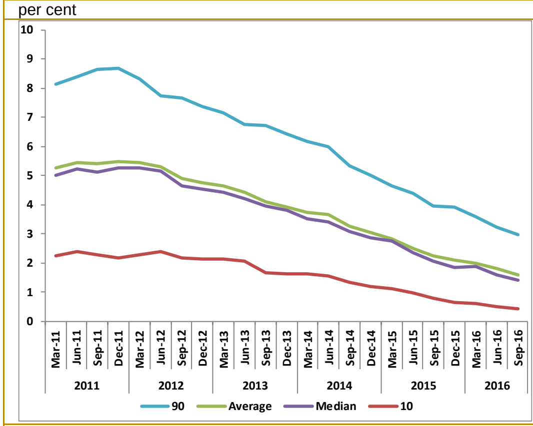
per cent



Source: RCU

Chart A11: Proportion 27 to 52 weeks arrears

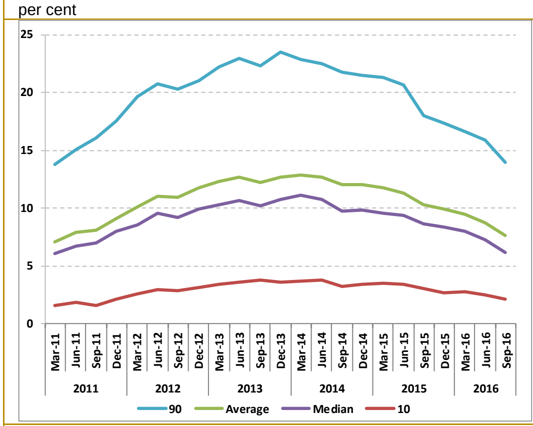
per cent



Source: RCU

Chart A12: Proportion 53+ weeks arrears

per cent



Source: RCU

achieve the World Council of Credit Unions (WOCCU) benchmark of arrears of ≤ 5 per cent of gross loans.

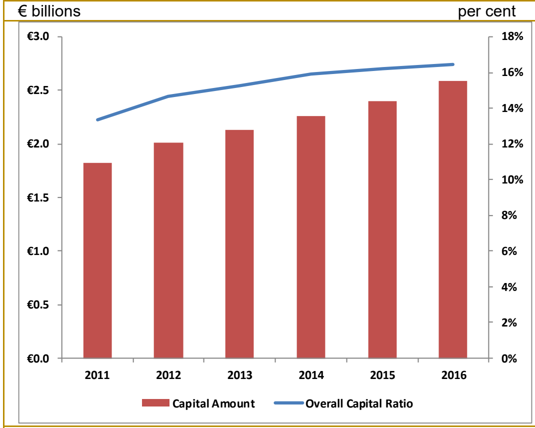
However, despite the fall in average sector arrears, this masks considerable variation among credit unions. In 2011 the 25th percentile (the best performing quarter of credit unions in terms of arrears) had average arrears of 12 per cent, while the 75th percentile (the worst performing quarter of credit unions in terms of arrears) had average arrears of 23 per cent. In 2016 the best quartile and the worst quartile arrears averaged 6 per cent and 12 per cent respectively. This highlights that, while arrears are falling across the sector, their higher level for some individual credit unions remains a cause for concern (Chart A10).

'Mid stage' arrears, which are loans in arrears for greater than 27 weeks but less than 53 weeks, have been declining gradually since 2011 (Chart A11). However, 'later stage' arrears are still a concern, i.e. loans in arrears greater than 53 weeks have seen a later peak and are declining at a much slower pace. (Chart A12).

In 2016, the average arrears for credit unions with asset size greater than €100m was 8.2 per cent, for credit unions with asset size between €25m and €100m was 9.6 per cent and for credit unions with asset size less than €25m was 10.4 per cent. (Appendix 1).

Chart A13: Capital

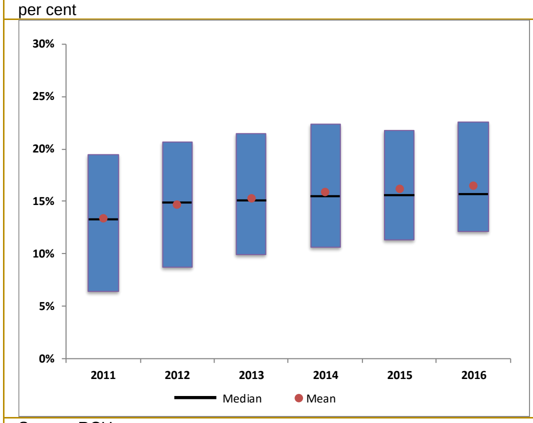
€ billions per cent



Source: RCU

Chart A14: Capital Ratio Ranges – (Between 5th and 95th percentile)

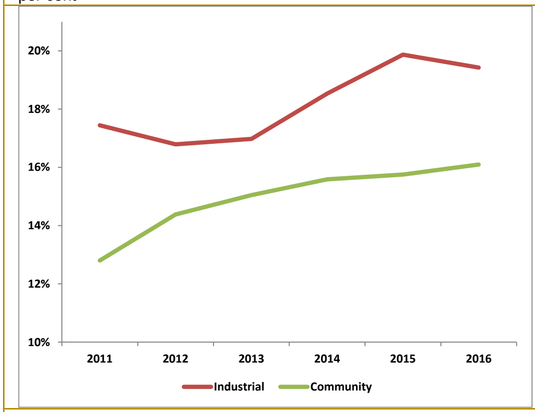
per cent



Source: RCU

Chart A15: Capital Ratio – Common Bond Type

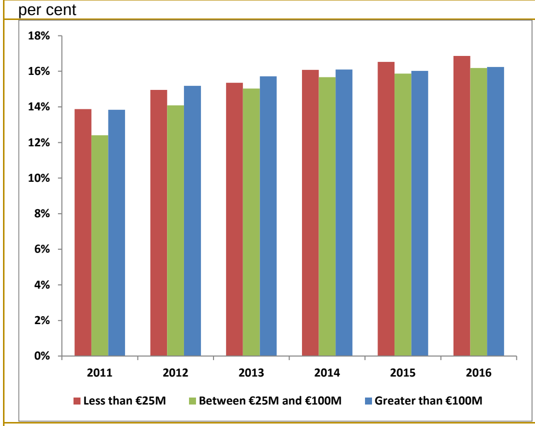
per cent



Source: RCU

Chart A16: Capital Ratio – By Asset Size

per cent



Source: RCU

1.6 Capital (Reserves)

"Ability to withstand financial stress with on average reasonably strong reserves"

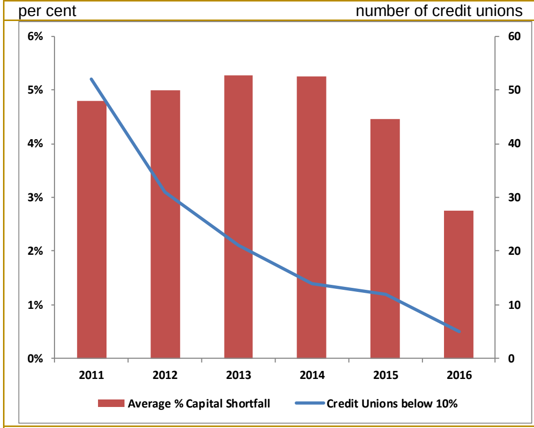
The ability of credit unions to withstand additional financial stress, as measured by total capital (reserves), is reasonably strong, with the average sector capital ratio standing at 16 per cent for September 2016 (Chart A13). The minimum regulatory reserve requirement is 10 per cent of the assets of the credit union. In 2011 the average sector capital ratio stood at 13 per cent. This ratio has increased annually over the five years from 2011 to 2016, and sector reserves currently amount to €2.6bn.

That being said, when credit unions are ordered by capital ratio from highest (best) to lowest (worst), there is evidence of considerable variation among the capital ratio of the credit unions. In 2016 the top 5 and bottom 5 per cent of credit union capital ratio values were 23 per cent and 12 per cent respectively. In 2011 the top 5 and bottom 5 per cent of credit union capital ratios were 19 per cent and 6 per cent respectively. This variability among the capital ratios of the credit unions has remained relatively constant over the five years from 2011 to 2016. (Chart A14).

Analysing average capital ratios by **common bond type** shows that the capital ratios of industrial credit unions are higher than community credit unions. The gap is on average 3 per cent over the six-year period to 2016. (Chart A15). Income in industrial credit unions has, on average, been 27 per cent greater than for community credit unions and costs in industrial credit unions have on average been 8 per cent greater than for community credit unions.

Analysing credit unions by **asset size** shows that average capital ratio across the three asset size ranges (1. Less than €25m, 2. Between €25m and €100m, 3. Greater than €100m) shows that the capital ratio has been increasing fairly uniformly for each asset size range over the previous six years. (Chart A16).

The number of credit unions reporting reserve ratios below the regulatory requirement of 10 per cent of total assets has fallen over the last six years. 3 credit unions reported a reserve ratio of below 10 per cent as at September 2016, which was a substantial decrease on 52 credit unions reporting a reserve ratio of below 10 per cent as at September 2011. The average percentage shortfall, in the reserve ratio of the 52 credit unions reporting below 10 per cent in 2011 was 4.8 per cent. The average percentage shortfall, in the reserve ratio of the 3 credit unions reporting below the regulatory requirement of 10 per cent in 2016 was 2.8 per cent. (Chart A17). Credit unions that report a total reserve position of less than 10 per cent are subject to intensive engagement from the Registry of Credit Unions, to address

Chart A17: Capital Shortfall		the financial concerns arising and to ensure protection of members' savings.
per cent number of credit unions  Source: RCU		

2.1 Reinvestment vulnerabilities in the credit union sector under a specific scenario

Credit union investments currently stand at over €11bn and represent c70 per cent of total sector assets. The scenario set out in the two graphs below, based on figures as at 30th September 2015, illustrate the vulnerabilities of credit unions' Return on Assets (ROA) to the current low interest rate investment environment. This arises given the high percentage of assets held in investments and the further significant drop in investment income that is projected to arise as longer term products mature and are reinvested at significantly lower rates.

The scenario is based on certain assumptions which incorporate;

1. an estimate of the possible future rates of return on investments[4]
2. projected dividends similar to those that were proposed at the time for the 2015 year-end; and
3. assuming the current asset mix of loans/investments remains the same over the 3-year period from 2015 to 2018.

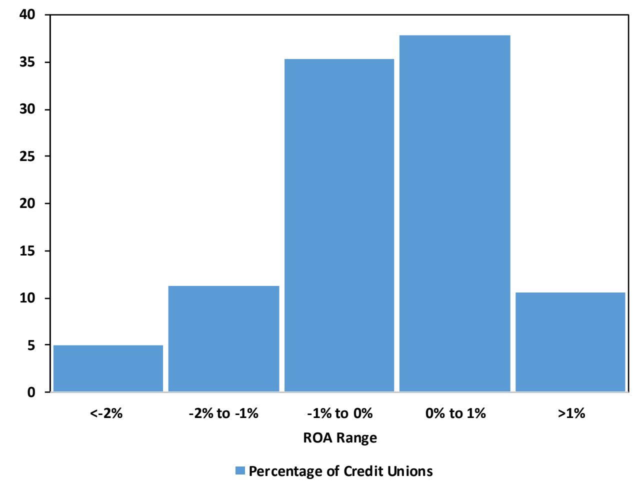
The above assumptions are aligned to current observed financial investment rates, credit unions sector dividend rates and credit union sector asset mix ratios and would be indicative of future positions (if nothing changes).

Chart A18 outlines the percentage of credit unions that would fall into each of 5 ROA groups at year-end 2018. This shows that close to 50 per cent of credit unions would report a negative ROA by 2018 under the scenario.

Chart A19 illustrates the correlation between the ROA and the return on investments. This shows that the return on investments would fall from the current level of approximately 1.8 per cent to below 0.7 per cent. This would result in a fall of approximately 1 per cent in the average ROA over the 3-year period, to give an average negative ROA of 0.1 per cent by 2018.

Chart A18: 3 year estimated return on assets (ROA) – by percentage number of credit union

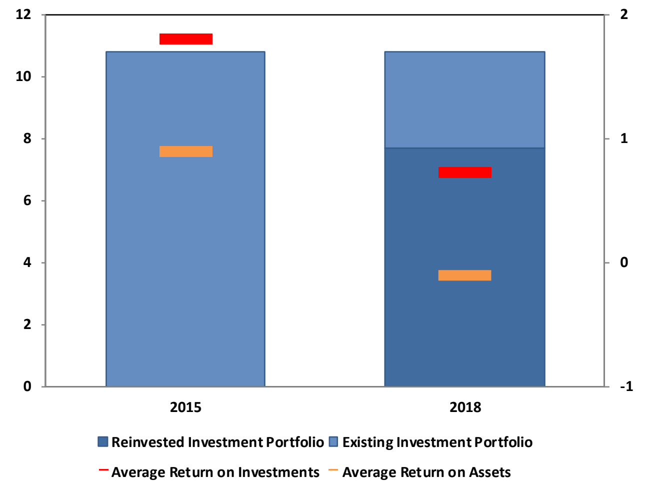
per cent



Source: RCU

Chart A19: Investment Portfolio by year and maturity

€ billions per cent



Source: RCU

[4] The future rates of return on investments relate to a scenario and are not a projection of future interest rates.

Appendix 1 – 2011 to 2016 Credit Union Sector Data Tables

	30th September 2011			
	Asset Size Bucket			Total Sector
	Less than €25M	€25M to €100M	Greater than €100M	
No of Credit Unions that Submitted Returns	**231**	**145**	**30**	**406**
Average Surplus	€0.10m	€0.29m	€2.24m	€0.32m
Total Surplus	€22.49m	€41.57m	€67.22m	€131.28m
Average Assets	€10.78m	€46.69m	€156.60m	€34.38m
Total Assets	€2.49bn	€6.77bn	€4.70bn	€13.96bn
ROA	0.99%	0.58%	1.32%	0.87%
Liquidity	49.72%	40.62%	36.27%	45.44%
Arrears	18.01%	19.02%	15.04%	18.15%
Reserves	13.88%	12.41%	13.84%	13.35%

	30th September 2012			
	Asset Size Bucket			Total Sector
	Less than €25M	€25M to €100M	Greater than €100M	
No of Credit Unions that Submitted Returns	**227**	**145**	**27**	**399**
Average Surplus	€0.26m	€1.07m	€4.17m	€0.82m
Total Surplus	€58.67m	€155.33m	€112.70m	€326.70m
Average Assets	€11.17m	€47.44m	€159.23m	€34.37m
Total Assets	€2.54bn	€6.88bn	€4.30bn	€13.71bn
ROA	2.38%	2.23%	2.53%	2.34%
Liquidity	49.28%	39.03%	38.23%	44.78%
Arrears	19.20%	20.69%	16.51%	19.56%
Reserves	14.96%	14.08%	15.18%	14.65%

	30th September 2013			
	Asset Size Bucket			Total Sector
	Less than €25M	€25M to €100M	Greater than €100M	
No of Credit Unions that Submitted Returns	**219**	**146**	**28**	**393**
Average Surplus	€0.21m	€0.84m	€3.40m	€0.67m
Total Surplus	€46.30m	€122.29m	€95.18m	€263.77m
Average Assets	€11.46m	€47.59m	€159.94m	€35.46m
Total Assets	€2.51bn	€6.95bn	€4.48bn	€13.94bn
ROA	1.89%	1.82%	2.04%	1.87%
Liquidity	52.46%	41.08%	42.95%	47.56%
Arrears	18.86%	20.14%	16.26%	19.15%
Reserves	15.35%	15.03%	15.71%	15.26%

30th September 2014				
	Asset Size Bucket			Total Sector
	Less than €25M	€25M to €100M	Greater than €100M	
No of Credit Unions that Submitted Returns	208	141	31	380
Average Surplus	€0.18m	€0.92m	€3.28m	€0.71m
Total Surplus	€37.74m	€129.71m	€101.78m	€269.23m
Average Assets	€11.68m	€48.20m	€161.39m	€37.45m
Total Assets	€2.43bn	€6.80bn	€5.00bn	€14.23bn
ROA	1.58%	1.90%	2.02%	1.74%
Liquidity	53.20%	38.64%	35.67%	46.33%
Arrears	16.87%	17.41%	14.57%	16.88%
Reserves	16.08%	15.66%	16.10%	15.93%

30th September 2015				
	Asset Size Bucket			Total Sector
	Less than €25M	€25M to €100M	Greater than €100M	
No of Credit Unions that Submitted Returns	170	135	37	342
Average Surplus	€0.15m	€0.80m	€2.93m	€0.71m
Total Surplus	€26.07m	€107.39m	€108.24m	€241.70m
Average Assets	€12.21m	€50.18m	€165.08m	€43.74m
Total Assets	€2.08bn	€6.77bn	€6.11bn	€14.96bn
ROA	1.24%	1.60%	1.90%	1.45%
Liquidity	47.29%	35.61%	34.76%	41.27%
Arrears	13.80%	13.66%	11.86%	13.54%
Reserves	16.53%	15.87%	16.02%	16.21%

30th September 2016				
	Asset Size Bucket			Total Sector
	Less than €25M	€25M to €100M	Greater than €100M	
No of Credit Unions that Submitted Returns	117	125	48	290
Average Surplus	€0.13m	€0.65m	€2.44m	€0.73m
Total Surplus	€15.77m	€80.96m	€116.93m	€213.66m
Average Assets	€13.53m	€50.52m	€167.56m	€54.83m
Total Assets	€1.60bn	€6.31bn	€8.04bn	€15.95bn
ROA	0.99%	1.33%	1.52%	1.22%
Liquidity	41.36%	32.58%	30.64%	35.80%
Arrears	10.43%	9.56%	8.20%	9.69%
Reserves	16.82%	16.24%	16.27%	16.48%

Definitions	
Average Surplus	Average of all 'Year to Date Surplus (Deficit)' reported by individual credit unions in the quarterly prudential return
Total Surplus	Total of all 'Year to Date Surplus (Deficit)' reported by individual credit unions in the quarterly prudential return
Average Assets	Average of 'Total Assets' reported by individual credit unions in the quarterly prudential return
Total Assets	Total of 'Total Assets' reported by individual credit unions in the quarterly prudential return
ROA	ROA (Return on Assets): Average of credit union ROA as calculated from data points reported by individual credit unions in the quarterly prudential returns. ROA calculation is 'Year to Date Surplus (Deficit)' divided by average of current and prior year 'Total Assets'
Liquidity	Average of credit union liquidity as calculated from data points reported by individual credit unions in the quarterly prudential returns. Liquidity calculation is the sum of 'Investments available in less than 3 months' and 'Cash and Current Accounts' divided by 'Total Unattached Savings'
Arrears	Average of credit union arrears as calculated from data points reported by individual credit unions in the quarterly prudential returns. Arrears calculation is 'Gross Loans in Arrears >9 weeks' divided by 'Total Gross Loans'
Reserves	Average of total realised reserves reported by individual credit unions in the quarterly prudential returns

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