Fianna Fáil submission on the Investment Framework for Credit Unions

Introduction

Fianna Fáil believes that Credit Unions are a vital part of the local community and must be supported if they are to survive. If Credit Unions do not survive, particularly the smaller ones in rural communities a massive service for communities will have gone. Currently, Credit Unions are facing a very precarious future. In a low interest rate environment and with the regulatory environment that prevents longer term lending the opportunity for Credit Unions to receive adequate returns is severely restricted.

It is due this scenario that Credit Unions have looked to investments to obtain the returns they need to keep running. Unfortunately they have found more burdensome restrictions on this front as well. It is difficult to see in the current environment how Credit Unions are to obtain substantial returns to survive.

It is patently clear that the reform is needed in the regulation on Credit Unions. This has been the case for some time and Fianna Fáil believes that the rate of reform from the Central Bank has not been swift enough and has not adequately engaged with the sector in order to bring about the reforms needed.

It is also clear that there are major issues facing compliance in the Credit Union sector. Fraudulent behaviour at a minority of Credit Unions has served to damage the image of Credit Unions as a whole and has stifled badly needed reform for the sector.

It is essential that this issue is rectified so that meaningful reform can take place that ensures the survival of Credit Unions in communities in Ireland.

Fianna Fáil welcomes the fact that the Central Bank is asking for submissions on reforming the regulations surrounding Credit Unions and we hope that this engagement continues.

Lending

Fianna Fáil believes that one cannot refer to the Investment Framework without also mentioning the restrictions on lending for Credit Unions. Because Credit Unions are restricted to providing shorter term loans which typically have a lower return, they must in turn look to investments to try and obtain sufficient return. So currently, Credit Unions are receiving deposits and increasingly have very few opportunities to gain a return for their members from investments or lending.

The Central Bank's mandate is quite rightly to protect members of Credit Unions. However, the current environment will only succeed in diminishing the interests of member's over time.

Fianna Fáil believes that an overarching review of the lending restrictions, the investment restrictions and the de4posit restrictions must take place. Each of them are inextricably linked.

Bank Bonds

Under current bank regulations certain types of bank bonds (bank bonds subordinated to any Senior Bonds) are subject to a "bail in" clause. This means that in the event of the issuing financial institution failing and needing State assistance the holders of these type of bonds will take a hit.

Therefore these types of Bank Bonds would be considered more risky. The Central Bank plans to update the regulations in order to prohibit the investment by Credit Unions in such bonds.

This is to protect the members of Credit Unions from this type of risk. However, there are a number of issues. Firstly, must worryingly the Central bank is not asking for views on this change. It has not and will not, it appears, consult with the various Credit Union groups.

Fianna Fáil believes that as part of this submission the views on such potential changes should be taken on board and further consultation should take place.

Secondly, such a move is likely to restrict the ability of Credit Unions to invest in Bank Bonds. The scope for investment is already heavily restricted and such a move is likely to lead to lower returns for Credit Unions.

Banks will naturally prefer to issue bonds with a "bail in" element to it. They will not be so inclined to issue other types of debt. Therefore the scope for investment is going to be even more curtailed.

The risk involved with these investments lie with the individual Credit Union. It is correct that these investments would not be appropriate for every Credit Union. Fianna Fáil believes that there should some sort of tiered regulation, whereby larger credit unions with the expertise can invest in this type of Bank Bond.

Bonds issued by Supranational Entities

Fianna Fail welcomes the intention to increase the scope of investments available to Credit Unions. The ability for Credit Unions to invest in entities like the European Investment Bank and other supranational organisations will enahance the ability of Credit Unions to diversify their investment portfolio and therefore reduce the risk for their members.

However, it is unclear if such a move will lead to enhanced returns for Credit Unions. That said Fianna Fáil would welcome such a change.

Again the limits suggested by the Central Bank are going down the "one size fits all" route again. Not all Credit Unions are the same. Some Credit Unions are small and some are large, some have the expertise and some do not. For this reason Fianna Fáil believes that there should be tiered regulation.

This would allow the appropriate Credit Unions to proceed with such investments at levels that are reasonable and can obtain an adequate return.

Corporate Bonds

This is very much the same story for Corporate Bonds. Any move to increase the scope for Credit Unions to invest is to be welcomed. Again Grade "A" Corporate Bonds at the moment do not offer a significant return so from that side it is unclear if it will improve the return Credit Unions can get from such investments.

Perhaps the Central Bank should look at increasing the scope of Corporate Bonds to include Bonds just below Grade "A". These Bonds will tend to give more of a return but with slightly extra risk.

Again the limits suggested are blanket restrictions. Any meaningful reform needs to take a tiered approach.

Investments in Tier 3 Approved Housing Bodies (AHB's)

Fianna Fáil believes that Credit Unions should be allowed to invest in Approved Housing Bodies. Currently, there is a large amount of deposits that the Credit Unions have and they are unable to invest in AHB's that can improve the provision of housing in their local area.

There is of course risk involved with investing in AHB's. The Irish League of Credit Unions believes that a Special Purpose Vehicle which pools investments from a large number of Credit Unions is the most appropriate way to proceed.

This would be a good way to better manage the risk of failure. Instead of a Credit Union taking 100% of the risk they will be taking a far less proportion than that.

Again however, there are certain Credit Unions that have the size and expertise to invest in AHB's on their own. If their expertise and capability is sufficient and they have the appropriate measures in place to manage the risk, then the Central Bank should look at ways for allowing this to happen.

Again not all Credit Unions are the same. For many small Credit Unions it would appear that the proposal from ILCU's would be most appropriate.

Conclusion

Overall Fianna Fáil welcomes that the Central Bank is open to the possibility of loosening the Investment restrictions currently in place for Credit Unions. Any enhancement of the opportunities for Credit Unions to invest their member's money wisely and profitably is vital if the Credit Union movement as we know it is to survive.

In many towns and villages across the country the Credit Union represents vital element for those communities. It is for this reason that we need to support the Credit Unions. While reform needs to happen both on the Credit Union side but also on the Central Bank side, it is patently clear that without reform the future of the Credit Union movement is very bleak indeed.

Appendix – regulations on Investment and Lending for Credit Unions

INVESTMENT RESTRICTIONS

Classes of Investments

25. (1) A credit union may only invest in euro denominated investments in the following:

a) Irish and EEA State Securities;
b) accounts in credit institutions;
c) bank bonds;
d) collective investment schemes;
e) shares of and deposits with other credit unions;
f) shares of a society registered under the Industrial and Provident Societies Act 1893 to 1978.

(2) The Bank may prescribe from time to time, in accordance with section 43 of the Act, further classes of investments in which a credit union may invest its funds which may include investments in projects of a public nature. Investments in projects of a public nature include, but are not limited to, investments in social housing projects.

LENDING RESTRICTIONS

Concentration Limits

12. A credit union shall not make:

(a) a commercial loan, where such a loan would cause the total amount of outstanding commercial loans of the credit union to exceed 50 per cent of the credit union's regulatory reserve,

(b) a community loan, where such a loan would cause the total amount of outstanding community loans to exceed 25 per cent of the credit union's regulatory reserve, or

(c) a loan to another credit union, where such a loan would cause the total amount of outstanding loans to other credit unions to exceed 12.5 per cent of the credit union's regulatory reserve.

Large Exposure Limit

13. (1) A credit union shall not make a loan to a borrower or a group of borrowers who are connected which would cause the credit union to have a total exposure to the borrower or group of borrowers who are connected of greater than €39,000 or 10 per cent of the regulatory reserve of the credit union.

(2) Where an exposure to a borrower or group of borrowers who are connected exceeds the limit set out in paragraph (1), the credit union must hold the amount of the exposure that is in excess of the limit in a realised reserve, separate from the regulatory reserve of the credit union.

(3) The requirement specified in paragraph (2) shall not apply, to exposures existing at the time of commencement of these Regulations, for a period of 2 years from the commencement of these Regulations.

Maturity Limits

14. (1) A credit union shall not make a loan to a member:–

(a) for a period exceeding 5 years if, were the loan to be made, the total gross amount outstanding in relation to all loans with more than 5 years to the final repayment date would exceed –

(i) 30 per cent of the total gross loan book balance outstanding at that time in relation to all loans made by the credit union, or

(ii) if the Bank so approves in writing, 40 per cent of the total gross loan book balance outstanding at that time in relation to all loans made by the credit union, or

(b) for a period exceeding 10 years if, were the loan to be made, the total gross amount outstanding in relation to all loans with more than 10 years to the final repayment date would exceed –

(i) 10 per cent of the total gross loan book balance outstanding at that time in relation to all loans made by the credit union, or

(ii) if the Bank so approves in writing, 15 per cent of the total gross loan book balance outstanding at that time in relation to all loans made by the credit union.

(2) The Bank may impose on approval, for the purposes of subparagraph (a)(ii) or (b)(ii) of this Regulation, any condition that the Bank considers appropriate.

(3) A credit union shall not make a loan to a member for a period exceeding 25 years.