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**Report of the Resolution and Crisis Management Division  
to the Governor of the Central Bank of Ireland  
in relation to the Proposed Resolution  
of Drumcondra and District Credit Union Limited  
26 June 2020**

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**Resolution Report on the rationale for liquidation and other matters relevant to a petition under the Central Bank and Credit Institutions (Resolution) Act 2011 (the “2011 Act”) for the winding-up of Drumcondra and District Credit Union (“Drumcondra” or “DDCU” or “the Credit Union”) under the Companies Act 2014 (the “2014 Act”).**

**To:** The Governor

**From:** The Resolution and Crisis Management Division (“RES”) of the Central Bank of Ireland (the “Central Bank”)

**Date:** 26 June 2020

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**1. INTRODUCTION**

- 1.1 This report (the “Report”) has been prepared in order to assist you in the performance of your functions under the 2011 Act in respect of the matters discussed herein. To the extent that this Report outlines a policy position or suggests a course of action, this is done for consideration and discussion purposes only and does not purport to represent an official policy view or decision of the Central Bank, whether for the purposes of the 2011 Act or any other purpose, and whether with respect to institutions named in this Report or generally.
- 1.2 This Report includes information made available to RES by the Registry of Credit Unions (“RCU”). RCU is the division of the Central Bank that is responsible for the registration, regulation and supervision of credit unions. Credit unions are mutual not-for-profit organisations whose principal activities are the acceptance of shares and deposits from, and the making of loans to, members. Credit unions are regulated in accordance with the Credit Union Act, 1997 (as amended) (the “CUA”).
- 1.3 By way of background, Drumcondra is a credit union based in Drumcondra, Dublin 9, founded in 1967. From 2011 to date, Drumcondra has been the subject of focused regulatory and supervisory engagement, which has increased in line with the identification of increased viability risks. As at 30 April 2020, Drumcondra reported a reserve position (“reserves”) of 5.40% of its total assets, substantially below the regulatory minimum of 10%.
- 1.4 Since March 2019, Drumcondra has sought to pursue a Transfer of Engagement (“ToE”) strategy as a means to address its financial difficulties. During that period, Drumcondra proactively engaged with twelve third party credit unions in relation to a potential ToE. Only one of those credit unions was willing to engage in preliminary commercial discussions and due diligence, however, despite these efforts, Drumcondra has been unable to complete a ToE to that credit union.
- 1.5 By letter to the Central Bank dated 28 May 2020 (the “28 May 2020 Letter”), Drumcondra confirmed to the Central Bank that it had exhausted all opportunities to identify a transferee credit union, and sought the collaboration of the Central Bank in order to seek a resolution of the Credit Union’s ongoing financial difficulties.

- 1.6 The purpose of this Report is to outline the facts that may assist you to determine: (a) whether it is appropriate for the Central Bank to present a petition to the High Court for the winding-up of Drumcondra; and (b) whether the Central Bank has sufficient grounds upon which to present such a petition. In addition, the Report sets out the reasons for RES's recommendation that, if the Central Bank decides to present a petition to the High Court for the winding-up of Drumcondra, the Central Bank should immediately thereafter also make an application to the High Court for the appointment of a liquidator to Drumcondra on a provisional basis pending the hearing of the petition.
- 1.7 Throughout this Report, RES refers to various documents and correspondence concerning Drumcondra that it has reviewed and considered during the course of its examination of the matters referred to herein. Regulatory directions issued to Drumcondra pursuant to section 87 of the CUA, and the responses or submissions received from Drumcondra in connection with those directions, along with all documents that RES considers material to the issues considered in this Report are available for your review at your request.
- 1.8 In this Report, RES has set out for your consideration:
- a) in Section 2, an overview of Drumcondra, including the background to the case and why action is recommended at this time;
  - b) in Section 3, an overview of RCU's engagement with Drumcondra during the period between 2011 to date;
  - c) in Section 4, RES's assessment of the reasons for Drumcondra's failure;
  - d) in Section 5, RES's assessment as to why it is appropriate that the Central Bank exercises its power under the 2011 Act and the grounds that have been satisfied, upon which to present a petition to the High Court for the winding-up of Drumcondra;
  - e) in Section 6, RES's analysis as to why it is appropriate for the Central Bank to make an application for the appointment of a liquidator to Drumcondra on a provisional basis pending the hearing of any petition; and
  - f) in Section 7, RES's recommendation on how to proceed given the information set out in the preceding sections, together with a summary of the next steps to be taken, should you decide, having considered this Report, that the Central Bank should present a petition to the High Court for the winding-up of Drumcondra and for the appointment of a provisional liquidator.

## 2. OVERVIEW

- 2.1 From 2011 to date, Drumcondra has been the subject of focused regulatory and supervisory engagement, which intensified in line with the identification of increased viability risks.
- 2.2 The extensive interaction between RCU and Drumcondra during this period is summarised in Section 3 of this Report and a table, detailing the chronology of the key events, is included at paragraph 3.5. Section 4 of the Report sets out the Central Bank's assessment of the reasons for the failure of Drumcondra and the basis for the Central Bank's view that resolution action is now required.
- 2.3 Drumcondra is in a distressed and deteriorating financial position. As at 30 April 2020, Drumcondra reported reserves of 5.40% of its total assets<sup>1</sup>. As demonstrated by Table 1 below, Drumcondra has been unable to maintain its reserves within the regulatory requirement of at least 10% of its total assets (the "reserve requirement") on a number of occasions during the period June 2012 to April 2020.

**Table 1:** Summary of Drumcondra's financial position (from June 2012 to April 2020)

€'000s	Prudential Return	Final Accounts	Final Accounts	Final Accounts	Final Accounts	Prudential Return
Period ended	June 2012	Sept 2012	Sept 2013	Sept 2014	Sept 2015	March 2016
Total assets	12,005	11,901	12,334	13,283	12,453	14,903
Fixed assets	3,027	2,995	2,955	2,928	1,382	1,370
Gross loans	4,370	4,247	3,776	3,791	3,633	3,458
Provisions for bad debts	(473)	(443)	(455)	(371)	(383)	(383)
Surplus/(Deficit)	(798)	(787)	211	174	(1,374)	1,880
Total savings	10,835	10,753	11,045	11,881	12,477	13,076
Total reserves	643	653	865	1,039	(335)	1,547
<b>Reserve position</b>	<b>5.35%</b>	<b>5.49%</b>	<b>7.01%</b>	<b>7.82%</b>	<b>(2.69%)</b>	<b>10.38%</b>
€'000s	Final Accounts	Draft Accounts	Draft Accounts	Draft Accounts	Revised Draft Accounts	Management Accounts
Period ended	Sept 2016	Sept 2017	Sept 2018	Sept 2019	Sept 2019	April 2020
Total assets	15,419	16,451	15,477	13,988	14,108	14,060
Fixed assets	1,373	1,319	884	729	848	824
Gross loans	3,979	4,262	4,615	4,622	4,622	3,949
Provisions for bad debts	(315)	(306)	(285)	(442)	(442)	(392)
Surplus/(Deficit)	2,014	34	(364)	(1,087)	(508)	(73)
Total savings	13,477	14,570	14,099	12,922	12,922	13,220
Total reserves	1,672	1,677	1,339	252	831	759
<b>Reserve position</b>	<b>10.84%</b>	<b>10.19%</b>	<b>8.65%</b>	<b>1.80%</b>	<b>5.89%</b>	<b>5.40%</b>

Notes: (1) The Final Accounts for the periods ended 30 September 2012, 2013, 2014, 2015 and 2016 were presented to the members of Drumcondra and approved at its AGM held on 3 April 2017. (2) The surplus reported by Drumcondra in the March 2016 Prudential Return and the Final Accounts for the period ended 30 September 2016 are inclusive of the ILCU funding of €1.817m which was received in January 2016. (3) Drumcondra submitted the draft September 2018 accounts on 9 September 2019. (4) Drumcondra submitted the draft September 2019 accounts on 10 January 2020 and the revised draft September 2019 accounts on 2 March 2020. (5) The management accounts for the period ending 30 April 2020, reflect 7 months of trading activity.

- 2.4 It should be noted that all credit unions in Ireland are required to maintain reserves of 10% of total assets<sup>2</sup> and that the failure on the part of a credit union to comply with

<sup>1</sup> Regulation 4 of the Credit Union Act 1997 (Regulatory Requirements) Regulations 2016 provide that "a credit union shall establish and maintain a minimum regulatory reserve requirement of at least 10 per cent of the assets of the credit union". Assets are defined to mean the total assets referred to in section 85A of the Act.

<sup>2</sup> The requirement is a key component of the prudential framework for credit unions and is designed to ensure: (a) the stability of individual credit unions and the sector overall; and (b) to protect members' savings and continuity of access to those savings. The reserves of a credit union support a credit union's operations, provide a base for future growth and protect against the risk of unforeseen losses.

the reserve requirement represents a significant threat to the orderly and prudent management and regulation of that credit union.

- 2.5 In 2015, following a €1.53m impairment to the value of Drumcondra's premises, the Credit Union sought, and later in January 2016 obtained, €1.817m of funding from its representative body, the Irish League of Credit Unions ("ILCU"), to enable it to restore its reserve requirement to the regulatory minimum of 10% of total assets. However, the Credit Union nevertheless continued to be the subject of further intensive supervisory and regulatory engagement during the period between 2018 and 2020 due to the Central Bank's continuing concerns with regard to issues relating to capital, strategic/viability, governance, credit and liquidity. Whilst the funding from ILCU successfully restored Drumcondra's reserves in line with the reserve requirement in 2016, the Credit Union was unable to maintain the required level of reserves, as demonstrated in Table 1 above.
- 2.6 It is evident, therefore, that Drumcondra's financial position between 2016 to 2020 deteriorated, for the reasons set forth in more detail in Sections 3 and 4 of this Report, due to:
- a) a further impairment to the carrying value of Drumcondra's premises located at 18 Drumcondra Road, Drumcondra, Dublin 9 (the "Premises") in 2018;
  - b) the inability of Drumcondra, following receipt of financial funding from ILCU of €1.817m in January 2016, to implement the necessary changes to its business to enable it to survive on a standalone basis and maintain the minimum regulatory reserve at the level required by law; and
  - c) the failure of Drumcondra to complete a ToE during 2019 and the early part of 2020, once it became clear that it was unable to survive as a viable credit union on a standalone basis.
- 2.7 On 18 November 2019, the Central Bank issued a Regulatory Direction (the "November 2019 Regulatory Direction") requiring the Credit Union to: (a) raise and maintain its reserves to the reserve requirement by no later than 9 December 2019; and (b) provide a statement in writing setting out the steps that it would take to ensure continued compliance with the reserve requirement.
- 2.8 Having failed to comply with the November 2019 Regulatory Direction on the 28 May 2020 Letter, Drumcondra confirmed the following to the Central Bank:
- a) the Credit Union had taken what it viewed as all reasonable steps within its powers to identify a suitable transferee credit union to advance its ToE strategy, however this strategy had proven unsuccessful;
  - b) looking forward, the Credit Union did not believe that it would be in a position to comply with the requirement to maintain a minimum regulatory reserve of at least 10% of total assets; and

- c) on the basis of the foregoing, the Credit Union requested the continued collaboration of the Central Bank to seek a resolution of the on-going financial concerns<sup>3</sup>.

2.9 In light of the above, the key views expressed in this Report are that:

- a) Drumcondra has failed to comply with, and remains in breach of, the November 2019 Regulatory Direction;
- b) although Drumcondra is not currently insolvent from a balance sheet or cash flow perspective, Drumcondra is in a financially distressed position due to its inability to raise and maintain the level of regulatory reserves required by law;
- c) Drumcondra has confirmed to the Central Bank in the 28 May 2020 Letter that it has exhausted all efforts to successfully pursue a ToE and the Credit Union has concluded that the strategy is no longer achievable;
- d) Drumcondra has therefore also exhausted all financial options available to it to raise and maintain its reserves at the required levels;
- e) the Central Bank has adequate grounds under the 2011 Act to present a petition for the winding-up of Drumcondra, and should do so as soon as possible; and
- f) the Central Bank should, as soon as possible after the presentation of such a petition, make an application to the High Court for the appointment of a provisional liquidator to Drumcondra in order to, *inter alia*, preserve Drumcondra's assets, prepare the necessary Deposit Guarantee Scheme ("DGS") file, and mitigate the risk of an unmanaged failure of Drumcondra's business pending the hearing of the petition, in the interests of its members, creditors and the public.

2.10 By way of an additional consideration, RES notes that Drumcondra has been in a state of financial distress prior to the emergence of the COVID-19 pandemic. Accordingly, Drumcondra's financial deterioration, and the actions recommended in this report, are not related to the pandemic.

2.11 Considering the various aspects of the case which are detailed in this Report, RES is of the opinion that it is in the public interest that resolution action should be taken by the Central Bank, as soon as possible, to resolve the financial difficulties of the Credit Union.

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<sup>3</sup> As is further detailed in paragraphs 3.48 and 5.4, the Credit Union did express a preference for a resolution outcome that would result in a directed transfer however, the approach to the Central Bank was carried out in "full recognition of the fact that the selection of any resolution option was the sole prerogative of the Central Bank".

### 3. REGULATORY BACKGROUND

3.1 For the purpose of this Report, RES has conducted a detailed review of RCU's extensive regulatory and supervisory file with respect to Drumcondra.

3.2 This Section of the Report comprises of the following:

- a) a table setting out the key events that occurred in the course of RCU's interactions with Drumcondra during the period between 2011 and the date of this Report;
- b) key supervisory interactions have been summarised in chronological order from 2011 to 2019 between RCU and Drumcondra; and
- c) a detailed account of the most recent correspondence between RCU and Drumcondra since October 2019, when RCU issued Drumcondra with a letter notifying the Credit Union of the Registrar's intention to issue the November 2019 Regulatory Direction.

#### **Overview of the Regulatory Engagement between RCU and Drumcondra**

3.3 Intensive regulatory and supervisory engagement between RCU and Drumcondra occurred over the course of a 9-year period from 2011 to date<sup>4</sup>. During that period, Drumcondra was subject to a number of inspections conducted by external independent experts and by RCU.

3.4 Those independent reviews, along with RCU's own inspection, identified reoccurring material issues relating to: (a) the carrying value of the Premises; (b) risks relating to non-compliance with the reserve requirement; and (c) the viability of Drumcondra's business.

3.5 Given the period of RCU's interaction with Drumcondra, for convenience, the following table sets out the chronology of key events from August 2011 to present<sup>5</sup>.

Date	Key Event
31 August 2011	As a result of the high level of arrears in Drumcondra's loan book, RCU imposed a lending restriction on Drumcondra in August 2011, which was considered necessary in order to protect members' funds. This restriction limited the maximum loan amount to €20k per individual member.
08 August 2012	Drumcondra revised the June 2012 Prudential Return and reported reserves of 5.35% as at 30 June 2012, following the identification of an impairment of €800k to the carrying value of the Premises from €3.7m to €2.9m.
28 May 2013	External independent advisor EisnerAmper was appointed by RCU to review Drumcondra's financial position and issued a report on 28 May 2013 identifying the following issues: Drumcondra's non-compliance with the reserve requirement, projected non-compliance with the reserve requirement over the period 2013 to

<sup>4</sup> While the supervisory engagement has been ongoing since 2011, the principal focus of this Section in the Report is engagement since ILCU funding was obtained in 2016.

<sup>5</sup> The terms used in the table, but not defined, have the meanings given to them elsewhere in this Report.

	2016, the carrying value of the Premises, shortfall in bad debt provisions, high risk of corporate failure, viability and lending practices.
December 2014	RCU continued to engage with Drumcondra about its increased concerns relating to the carrying value of the premises and the supportability of the Value in Use (the "ViU") <sup>6</sup> . Due to sustained and prevailing concerns regarding the issues identified in the 2013 EisnerAmper report, the same firm was re-engaged to complete a further asset review of Drumcondra in December 2014.
10 April 2015	EisnerAmper issued a report identifying issues regarding Drumcondra's high risk of corporate failure, viability, inability to maintain the reserve requirement, carrying value of the Premises, financial projections, bad debt provisions, lending practices and credit control practices.
16 July 2015	Drumcondra submitted a market valuation of the Premises to RCU, which confirmed a market value of €1.35m.
05 August 2015	Drumcondra revised the June 2015 Prudential Return to reflect the identified impairment and reported reserves of (3.38%) as at 30 June 2015.
11 September 2015	RCU imposed a regulatory direction on Drumcondra requiring it to raise its reserves to 10% of total assets and to submit a statement in writing setting out the steps its will take to ensure continued compliance with the reserve requirement.
06 January 2016	Drumcondra received €1.817m in funding from ILCU that restored reserves above 10% of total assets.
19 April 2016	Drumcondra submitted its March 2016 Prudential Return and reported reserves of 10.38% of total assets.
03 April 2017	Drumcondra's AGMs were held for the financial years 2012, 2013, 2014, 2015 and 2016.
26 September 2018	RCU completed an onsite inspection of Drumcondra, which identified sustained issues in respect of Drumcondra's financial performance, capital risk, governance risk, strategy and viability issues present within Drumcondra.
21 January 2019	Drumcondra submitted a market valuation of the Premises, which valued the Premises at €[REDACTED]
15 March 2019	Drumcondra made the strategic decision to pursue a ToE solution as a means of addressing the sustained weaknesses identified in the September 2018 engagement.
29 May 2019	Drumcondra confirmed that it made the strategic decision to pursue a ToE with [REDACTED]).
19 July 2019	A High Level Business Case was submitted to RCU to support the ToE to [REDACTED].
26 August 2019	ToE due diligence was submitted to RCU.
27 August 2019	Valuations of the Premises were submitted to RCU by [REDACTED], which valued the Premises at €[REDACTED] and €[REDACTED]
09 September 2019	Drumcondra submitted its revised 2018 audited financial statements that reflected the €[REDACTED] Premises valuation. Drumcondra reported reserves of 8.65% of total assets as at 30 September 2018.

<sup>6</sup> Under section 27 of FRS 102, value in use is the present value of the future cash flows expected to be derived from an asset. The present value calculation involves: (a) estimating the future cash inflows and outflows derived from continuing use of the asset and from its ultimate disposal; and (b) applying the appropriate discount rate to those future cash flows.

<sup>7</sup> The carrying value of the Premises as at the 30 September 2018 was [REDACTED] (before the 2019 impairment was accounted).

14 October 2019	Drumcondra confirmed that ILCU had approved €[REDACTED] in funding to support the ToE, which did not adequately restore reserves to 10% of total assets required in order to complete the ToE to [REDACTED]. The shortfall in funding to be provided was [REDACTED]. ILCU confirmed, in writing, to Drumcondra its view that an impairment to the carrying value of the Premises was not required.
21 October 2019	Drumcondra submitted its September 2019 Prudential Return and reported reserves of 2.86%, which fully reflected adjustments/impairments identified as part of the ToE process and related costs to be incurred in order to complete the ToE.
07 November 2019	Drumcondra confirmed that ILCU had appointed an external consultant to review the application for funding, which was to include a further valuation of the Premises.
18 November 2019	RCU imposed the November 2019 Regulatory Direction on Drumcondra relating to capital and business. The capital direction required Drumcondra to raise and maintain its reserves to 10% of total assets, and to submit a statement in writing setting out the steps it will take to ensure continued compliance with the regulatory reserve requirement within three weeks.
16 December 2019	The November 2019 ILCU review of Drumcondra's application for funding was submitted to RCU. The review included two further valuations of the Premises, which valued the building at €[REDACTED] and €[REDACTED]. These valuations were sought by ILCU as part of their assessment of Drumcondra's funding application.
13 January 2020	Drumcondra confirmed that ILCU had approved €[REDACTED] in funding to support the ToE, which did not adequately restore reserves to 10% of total assets as required in order to complete the ToE to [REDACTED]. The shortfall in funding to be provided was [REDACTED] and primarily related to the carrying value of the Premises and the ToE related expenditure.
16 January 2020	[REDACTED] withdrew from the ToE process with Drumcondra due to the shortfall in funding provided by ILCU which is required to complete the ToE process.
17 January 2020	RCU issued a letter that required Drumcondra to provide confirmations of the identification of a suitable transferee credit union and the provision of the requisite financial funding to comply with the November 2019 Regulatory Direction. These confirmations were due to be submitted by Drumcondra to RCU by 31 January 2020.
5 February 2020	Drumcondra provided an update on the ongoing steps it was taking in relation to the identification of a suitable transferee credit union and the provision of the requisite financial funding to comply with the November 2019 Regulatory Direction. However, this update did not include the relevant confirmations as required.
12 February 2020	As a result of the 5 February 2020 update, RCU issued a letter that provided Drumcondra an extended deadline to submit confirmations of the identification of a suitable transferee credit union and the provision of the requisite financial funding to comply with the November 2019 Regulatory Direction. These confirmations were due to be submitted by Drumcondra to RCU by 4 March 2020.
17 February 2020	In light of Drumcondra's continued failure to comply with the November 2019 Regulatory Direction and the increased risks arising from the cessation of the proposed ToE to [REDACTED], RCU issued a regulatory direction to Drumcondra that further restricted its business activities, in terms of lending and investment (the "February 2020 Regulatory Direction").

26 February 2020	Drumcondra informed RCU that it had contacted a total of 12 credit unions in relation to a potential ToE, of which Drumcondra advised that 4 remained as potential transferee credit unions. One of the potential transferee credit unions referenced was [REDACTED]
10 March 2020	RCU issued a letter that provided Drumcondra a further period to submit confirmation of the identification of a suitable transferee credit union and the provision of the requisite financial funding to comply with the November 2019 Regulatory Direction. This confirmation was due to be submitted by Drumcondra to RCU by 24 March 2020.
20 March 2020	Following a request for an extension by Drumcondra and in light of the exceptional circumstances prevailing in the State with regard to COVID-19, RCU issued a letter that provided Drumcondra a further period to submit confirmation of the identification of a suitable transferee credit union and the provision of the requisite financial funding to comply with the November 2019 Regulatory Direction. This confirmation was due to be submitted by Drumcondra to RCU by 1 May 2020.
31 March 2020	Drumcondra informed RCU that [REDACTED] had confirmed that it was not interested in pursuing a ToE and that following discussions with ILCU, Drumcondra made the decision to re-engage with [REDACTED] in relation to a potential ToE.
17 April 2020	Drumcondra informed RCU that the Savings Protection Scheme ("SPS") administration committee of ILCU had approved a recommendation of €[REDACTED] in financial funding to support Drumcondra's ToE to [REDACTED], which would be reviewed at the ILCU Board meeting in May 2020. This level of funding did not adequately restore reserves to 10% of total assets as required to complete the ToE. Drumcondra had requested ILCU to provide €[REDACTED] in order to complete the ToE, resulting in a shortfall of c. €[REDACTED].
29 April 2020	In light of the exceptional circumstances prevailing in the State with regard to COVID-19 and given that Drumcondra was awaiting confirmation from the Board of ILCU in respect of the level of funding to be provided, RCU issued a letter that provided Drumcondra a further period to submit confirmation of the identification of a suitable transferee credit union and the provision of the requisite financial funding to comply with the November 2019 Regulatory Direction. This confirmation was due to be submitted by Drumcondra to RCU by 29 May 2020.
25 May 2020	Drumcondra informed RCU that the ILCU Board had approved €[REDACTED] in financial funding to support Drumcondra's ToE to [REDACTED], which did not adequately restore reserves to 10% of total assets as required to complete the ToE. Drumcondra had requested ILCU to provide €[REDACTED] in order to complete the ToE, resulting in a shortfall in funding on offer of c. €[REDACTED].
28 May 2020	Drumcondra advised RCU by letter that it had not secured the requisite funding to restore reserves as part of the [REDACTED] ToE process, following ILCU's final response on same. Drumcondra stated that its Board had concluded that all opportunities to identify a transferee credit union had been exhausted and that Drumcondra was to comply and would continue to fail to comply with the reserve requirement. In its letter, the Credit Union sought the ' <i>continued collaboration</i> ' of the Central Bank in order to ' <i>seek a resolution of the on-going financial issues</i> '. The Credit Union did express a preference for a resolution outcome that would result in a directed transfer however it was acknowledged that assistance of the Central Bank was

	sought in “full recognition of the fact that the selection of any resolution option was the sole prerogative of the Central Bank.”
29 May 2020	RCU confirmed receipt of Drumcondra’s 28 May 2020 Letter and advised that the Central Bank would proceed to consider the use of its powers under the 2011 Act.
29 May 2020	In response to the 28 May 2020 Letter, RCU formally referred Drumcondra to RES, as RCU deemed that all supervisory options had been exhausted.

3.6 A further summary of the key supervisory interactions between RCU and Drumcondra from 2011 to date, broken into three time periods, is set out below:

#### **Summary 2011-2015**

3.7 As a result of the high level of arrears in Drumcondra’s loan book, RCU imposed a lending restriction on Drumcondra in August 2011. This restriction limited the maximum loan amount to €20k per individual member, and was considered necessary in order to protect members’ funds.

3.8 On 8 August 2012, Drumcondra submitted its prudential return for the quarter ending 30 June 2012 (the “June 2012 PR”) and reported reserves of 5.35%, which was in breach of the reserve requirement. The June 2012 PR reflected an impairment of c. €800k to the carrying value of the Premises, from €3.7m to its ViU of €2.9m, following a review conducted by Drumcondra.

3.9 Following the impairment to the carrying value of the Premises and given Drumcondra’s failure to comply with the reserve requirement, Drumcondra was subject to further regulatory engagement, which included an asset review pursuant to sections 90 and 91 of the CUA, conducted by MKO Partners (now known and hereinafter referred to as “EisnerAmper”). On 28 May 2013, RCU issued the final EisnerAmper Asset Review Report to Drumcondra (the “Final 2013 EisnerAmper Asset Review Report”) in which issues with respect to Drumcondra’s reserves, the carrying value of the Premises, bad debt provisions, a high risk of corporate failure, the viability of its business model and its lending practices were identified.

3.10 As at 30 September 2013, Drumcondra reported total assets of €12.3m, the Premises carrying value of €2.9m and reserves of €1.0m or 7.0% on its balance sheet. Given Drumcondra’s continued failure to comply with the reserve requirement, the issues identified in the Final 2013 EisnerAmper Asset Review Report and that the carrying value of the Premises amounted to €1.8m in excess of reserves (c. 23% of the total assets), RCU retained significant concerns with regard to risk to capital.

3.11 RCU continued to engage with Drumcondra regarding its concerns relating to the carrying value of the Premises and the supportability of the ViU, which led to the appointment of EisnerAmper in December 2014 to conduct a further asset review of Drumcondra pursuant to sections 90 and 91 of the CUA (the “Draft 2015 EisnerAmper Asset Review Report”). The Draft 2015 EisnerAmper Asset Review Report confirmed capital risk issues relating to Drumcondra’s ViU and again identified a high risk of corporate failure. The report also identified risks relating to the viability of the business, bad debt provisioning and lending practices. Drumcondra responded to this report by advising that it was satisfied that it had a

plan to restore its reserves and remain as a viable standalone entity. The Final 2015 EisnerAmper Asset Review Report was subsequently issued to Drumcondra.

- 3.12 During 2015, Drumcondra submitted its 2015 Strategic Plan to RCU and engaged with ILCU in regard to obtaining the financial funding necessary to restore its reserves to the reserve requirement. Following the review of the 2015 Strategic Plan, RCU continued to engage with Drumcondra regarding its concerns relating to the supportability of the ViU and the carrying value of the Premises.
- 3.13 In July 2015, Drumcondra submitted a market valuation of the Premises dated 26 June 2015, in the amount of €1.35m (the “June 2015 Valuation”). Drumcondra subsequently resubmitted its prudential return for the quarter ending 30 June 2015 (the “June 2015 PR”), which reflected an impairment of €1.53m to the carrying value of the Premises from €2.88m, to the June 2015 Valuation of €1.35m and reported reserves of (3.38%) as at 30 June 2015.
- 3.14 As a result of Drumcondra’s continuing failure to comply with the reserve requirement, on 12 August 2015, the Central Bank notified the Credit Union by letter that it was minded to issue a regulatory direction on capital to Drumcondra pursuant to section 87 (1) of the CUA. In response, Drumcondra confirmed that it was engaging with ILCU to apply for the requisite financial funding to restore its reserves. Having considered Drumcondra’s response, on 11 September 2015, RCU issued a regulatory direction letter on capital to Drumcondra pursuant to section 87 (1) of the CUA (the “2015 Regulatory Direction”) requiring Drumcondra to restore its reserves to the 10% minimum requirement by 2 October 2015. On 6 October 2015, RCU received confirmation from the National Treasury Management Agency of the transfer of ILCU SPS funding totalling €1.817m to an account in the name of Drumcondra

#### **Summary 2016-2017**

- 3.15 On 12 January 2016, Drumcondra provided confirmation to RCU of the transfer of ILCU SPS funding totalling €1.817m to Drumcondra. Subsequently, on 2 February 2016, Drumcondra indicated in a letter addressed to RCU that it was of the view that, following receipt of the ILCU funds in January 2016, the risk to the viability of the Credit Union had been addressed. However, RCU remained of the view that Drumcondra had not fully complied with the requirements of the 2015 Regulatory Direction in relation to the provision of a statement in writing setting out the steps it would take to ensure continued compliance with the reserve requirement following the restoration of its reserves. RCU subsequently engaged with Drumcondra in relation to these requirements of the 2015 Regulatory Direction, and the steps Drumcondra would take to ensure continued compliance with the minimum reserve requirement.
- 3.16 In February 2016, Drumcondra submitted a request to RCU for the removal of the lending restriction imposed on it since August 2011<sup>8</sup>. Following receipt of this request, RCU engaged with Drumcondra in relation to its reserves, and in November

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<sup>8</sup> As a result of the high level of arrears in Drumcondra’s loan book, RCU imposed a lending restriction on Drumcondra in August 2011, which was considered necessary in order to protect members’ funds. This restriction limited the maximum loan amount to €20k per individual member. Subsequently, additional concerns arose and were sustained in relation to the capital position of the Credit Union.

2016 RCU was notified by Drumcondra of a breach of that lending restriction. As a result of this breach, RCU continued to have concerns with regard to the adequacy of Drumcondra's systems and controls and the related increased risk to members' funds, and did not consider it appropriate to remove the lending restriction.

3.17 Following substantial engagement by RCU with Drumcondra on its draft financial statements, on 3 April 2017, Drumcondra held the AGMs for the years ended 30 September 2012, 2013, 2014, 2015 and 2016. The key information that was contained in the audited financial statements presented to members at these meetings can be summarised as follows:

- a) For the year ended 30 September 2012, Drumcondra reported a balance sheet of €11.9m, Premises carrying value of €2.9m and reserves of 5.49%;
- b) For the year ended 30 September 2013, Drumcondra reported a balance sheet of €12.3m, Premises carrying value of €2.9m and reserves of 7.01%;
- c) For the year ended 30 September 2014, Drumcondra reported a balance sheet of €13.3m, Premises carrying value of €2.9m and reserves of 7.82%;
- d) For the year ended 30 September 2015, Drumcondra reported a balance sheet of €12.5m, Premises carrying value of €1.3m and reserves of (2.69%); and
- e) For the year ended 30 September 2016, Drumcondra reported a balance sheet of €15.4m, Premises carrying value of €1.3m and reserves of 10.84%.

3.18 In June 2017, Drumcondra submitted a copy of a letter to RCU that had been issued to its full membership in relation to its decision to introduce a cap on members' savings of €25k, effective from 1 July 2017. Drumcondra advised RCU that its members had been informed that the rationale underlying this decision included the adverse impact of increases in members' savings on the Credit Union's ability to maintain the minimum reserve requirement.

#### **Summary January 2018 to September 2019**

3.19 During the period between February 2018 and July 2018, RCU engaged with Drumcondra on a number of supervisory matters relating to risks in terms of its capital, strategic/viability, governance, credit and liquidity. That engagement gave rise to increased concerns on the part of RCU with regard to these risks due to weaknesses identified following a review of Drumcondra's strategic plan, the reported reserves in prudential returns submitted by Drumcondra, credit function weaknesses identified in a report by Drumcondra's internal auditor and a reported breach of the minimum liquidity requirement of 20%.

3.20 As a result of these increased concerns, in September 2018 RCU conducted an onsite PRISM engagement with Drumcondra. Throughout this engagement, Drumcondra

failed to demonstrate financial and governance/operational resilience, evidenced by an inadequate strategic plan, the inability to clearly demonstrate viable measures to ensure compliance with the reserve requirement and failures within the governance framework.

- 3.21 Following the PRISM engagement, RCU formed the view that Drumcondra had immediate viability risks given that, subsequent to receipt of €1.817m in ILCU funding in January 2016, the Credit Union had failed to implement its strategic plan. RCU noted that, as a consequence of this failure, it had been necessary for the Credit Union to implement a cap on members' savings (resulting a requirement for the repayment of excess members' savings) in order to manage Drumcondra's balance sheet and maintain reserves in excess of the reserve requirement. RCU was also of the view that the Credit Union failed to demonstrate financial and governance/operational resilience.
- 3.22 RCU engaged with Drumcondra on the immediate viability risks identified in the 2018 PRISM Engagement and in January 2019, Drumcondra submitted an updated strategic plan, which outlined both a ToE strategy and a strategy to remain on a standalone basis. This updated strategic plan contained trigger points, based on financial performance, which, if and when activated, would require Drumcondra to pursue a ToE strategy and also noted that it was clear to Drumcondra that it was likely that these triggers would be hit in the coming months. In addition, the updated strategic plan confirmed that Drumcondra had made the decision to implement a further savings cap of €15k, which would be applied retrospectively.
- 3.23 In April 2019, Drumcondra confirmed that it was pursuing a ToE solution to address its significant viability risk and in May 2019, Drumcondra confirmed it made the decision to pursue a ToE to [REDACTED]
- 3.24 As part of the ToE process, an asset and due diligence review of Drumcondra was conducted by EisnerAmper, dated 23 August 2019 ("ToE Due Diligence Report"). The ToE Due Diligence Report identified:
- a) risks to the stability and viability of Drumcondra;
  - b) an impairment to the carrying value of the Premises of € [REDACTED];
  - c) the requirement for an increase in provisions for bad debts of €94,305;
  - d) an adjustment to Drumcondra's investment portfolio of €28,500; and
  - e) a risk that Drumcondra was not in compliance with the reserve requirement as a result of the impairments identified in the ToE Due Diligence Report, which would reduce Drumcondra's reserves to 8.4% as at 31 May 2019.
- 3.25 The impairment to the carrying value of the Premises arose from a market valuation conducted by [REDACTED] dated 14 August 2019 (the "[REDACTED]") as part of the ToE process. The [REDACTED] valued the Premises at € [REDACTED]

- 3.26 Following the identification of an impairment to the carrying value of the Premises and other adjustments as per the due diligence conducted as part of the ToE process, Drumcondra's August 2019 Management Accounts reported reserves of 7.68%, which failed to meet the reserve requirement. As such, Drumcondra progressed its ToE strategy with [REDACTED] to an advanced stage of the ToE process and simultaneously engaged with ILCU with regard to the requisite financial funding to restore its reserves to the reserve requirement, which is a pre-requisite to the completion of any ToE.
- 3.27 Given Drumcondra's failure to comply with the reserve requirement, RCU had immediate concerns and engaged with Drumcondra in relation to advancing its ToE solution in an expedient manner. Throughout its engagement with Drumcondra, RCU reiterated its position that Drumcondra's reserves must be restored to the reserve requirement in order for the ToE to advance to completion, which was acknowledged by all parties.

#### **Summary October 2019 to date**

- 3.28 In light of Drumcondra's failure to comply with the reserve requirement, the significant issues identified in the 2018 PRISM Engagement and the ToE Due Diligence Report, on 4 October 2019 RCU issued a letter to Drumcondra (the "2019 Pre-Direction Letter") confirming that the Central Bank was "minded to" issue a regulatory direction to Drumcondra with respect to its capital reserves and business activities<sup>9</sup>. The 2019 Pre-Direction Letter noted that Drumcondra was in an advanced stage of a ToE process and was in negotiations with ILCU regarding its application for the requisite funding to restore reserves in order to complete the ToE. RCU also indicated in the 2019 Pre-Direction Letter that it proposed to issue regulatory directions pursuant to section 87(1) of the CUA and regulatory requirement pursuant to section 85 of the CUA that, if issued, would require Drumcondra to restore its reserves to the minimum reserve requirement, restrict its lending and investment activities and maintain a minimum liquidity ratio. Drumcondra was invited to provide submissions to RCU with respect to the proposed regulatory directions and regulatory requirement by 25 October 2019.
- 3.29 During October 2019, Drumcondra and [REDACTED] engaged with ILCU regarding Drumcondra's SPS funding application to restore its reserves to 10% of total assets in order to complete the ToE. Following consideration of Drumcondra's application, the ILCU Board approved €[REDACTED] in funding to support the ToE and confirmed, in writing, to Drumcondra its view that an impairment to the carrying value of the Premises was not required. As a result, the shortfall between the funding amount approved by the ILCU Board and the amount sought by Drumcondra was c. €[REDACTED] and did not, as a result, adequately restore Drumcondra's reserves to 10% of its total assets as required to complete the ToE. Following confirmation of ILCU's decision, Drumcondra continued to engage with ILCU with a view to seeking agreement for the provision of the requisite funding to restore its reserves to 10% of total assets in

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<sup>9</sup> The 2019 Pre-Direction Letter proposed to restrict business activities to the following: (1) Maximum loan of €20k net of shares, (2) Maximum total net loans to all members in any calendar month of €200k, (3) Investments restricted to euro dominated investment accounts in credit institutions with a maximum of 90 days to maturity, and (4) Maintain a minimum liquidity ratio of 30%.

order to complete the ToE. ILCU subsequently engaged Moore Ireland to review the funding application that it had received from Drumcondra.

- 3.30 On 25 October 2019, Drumcondra submitted its response to the 2019 Pre-Direction Letter, which included the following:

*“The board of Drumcondra and district believes that the capitalisation, governance and business model challenges facing Drumcondra and district credit union will best be addressed with a Transfer of Engagement to [REDACTED]. To complete that, we need the support of the ILCU SPS fund.*

#### **Capitalisation**

*Drumcondra are actively pursuing a Transfer of Engagement project with [REDACTED]. [REDACTED] have invested heavily in the Transfer of Engagement and are following a detailed project plan, now well advanced to bring that transfer to a successful conclusion as soon as possible.*

*We are in discussion with the ILCU to obtain the necessary funding to restore our regulatory reserve to the required levels. The ILCU have indicated support ([REDACTED]) for the Transfer of Engagement, however there is a shortfall in the support offered.*

*The shortfall is associated with the Red Book building re-valuation which occurred under the TOE process. Drumcondra have communicated with the ILCU with an explanation of the revaluation and have indicated a pathway forward. We are awaiting the response from the ILCU”*

- 3.31 Following the consideration of Drumcondra’s response, RCU issued the November 2019 Regulatory Direction, which noted that Drumcondra was in an advanced stage of a ToE process in order to address the financial, governance and strategy/business model risks in Drumcondra and “will continue to work constructively with our colleagues in [REDACTED] to implement the Transfer of Engagement”.

- 3.32 In relation to the restoration of reserves, the November 2019 Regulatory Direction stated:

*“Pursuant to section 87(1) and (2) of the Act, RCU hereby directs Drumcondra to comply with the following within three weeks from the date of this letter:*

*1. The Credit Union must raise and maintain its regulatory reserve requirement (for the purposes of the 2016 Regulations) to a minimum of 10% of its total assets as at 30 September 2019 and in order to do so must raise an amount of €[REDACTED] in solvency support. This solvency support must be provided in cash form only and lodged to a bank account in the name of the Credit Union.*

*2. The Credit Union must provide to RCU a statement in writing setting out the steps it will take to ensure continued compliance with its obligations under Regulation 4 of the 2016 Regulations to maintain a regulatory reserve requirement of at least 10% of its assets.*

*The Regulatory Directions above commence on 18 November 2019 and continue in force until further notice.”*

3.33 The November 2019 Regulatory Direction also required Drumcondra to restrict its lending and investment activities and maintain a minimum liquidity ratio.

3.34 On 16 December 2019, ILCU submitted Moore Ireland’s review of Drumcondra’s SPS funding application to RCU. This review included a consideration of (a) a market valuation of the Premises which had been conducted by [REDACTED] on 21 November 2019 (the “[REDACTED] Valuation”), which valued the Premises at €[REDACTED] and (b) a market valuation of the Premises conducted by [REDACTED] on 6 December 2016, which valued the premises at €[REDACTED]. In a separate email on 16 December 2019, ILCU confirmed to RCU that:

*“In relation to the Drumcondra Credit Union’s application for SPS Capital support, I can advise that following the review of the Moore review, that the Administration recommended €[REDACTED] Capital Support for Board approval.*

*The SPS application for consideration at the January Board meeting will outline the base case financial projections, due diligence adjustments, building impairment and TOE expenses incurred. The recommendation for Board consideration facilitates the recognition of some additional TOE accruals to complete the proposed transfer. The Board’s considered position on this element will determine the final level of SPS Support approved. As advised at present the Administration Committee has recommended for Board Approval SPS Capital Support funding of €[REDACTED].”*

3.35 In an email dated 23 December 2019, RCU confirmed to ILCU that:

*“As per the existing terms of the Regulatory Directions on Capital, the Credit Union must restore its reserve position to a minimum 10% of total assets. The Credit Union is currently in breach of this Regulatory Direction on Capital. The Credit Union’s reserves must be restored to the minimum regulatory requirement of 10% of its assets, prior to the transfer of engagements completing.*

*.....The Central Bank holds significant concerns that the Credit Union’s financial position will deteriorate further given its financial performance and possible future costs/ impairments arising from the transfer process. This office remains in ongoing discussion with the Credit Union in relation to these concerns.*

*I note that the board of ILCU will be discussing the SPS Application, to include a determination on the final level of SPS support to be provided to the Credit Union, on 4 January 2020. Please forward confirmation of the board’s position in relation to the SPS Application to the Central Bank immediately following this meeting, by close of business on 6 January 2020 latest.”*

3.36 On 10 January 2020, Drumcondra submitted draft audited financial statements to RCU for the financial period ending 30 September 2019 (the “Draft 2019 Accounts”). In the Draft 2019 Accounts, Drumcondra reported reserves of 1.80%, which indicated that the Credit Union required [REDACTED] in funding to restore reserves to 10% of its total assets as at that date. The deterioration in Drumcondra’s reserves arose from an impairment to the carrying value of the Premises to reflect the [REDACTED]

Valuation of €██████, adjustments to the provisioning for bad debts, investment portfolio revaluations and costs accrued in order to complete the ToE.

- 3.37 In addition, the Draft 2019 Accounts reported a pension liability of approximately €██████ that was contingent on the completion of the ToE. This pension liability would also impact Drumcondra's reserves at the point of transfer and, accordingly, result in an increase in the level of funding that would be required to restore reserves to 10% of Drumcondra's total assets. Based on this information, Drumcondra required c. €██████ to restore its reserves to 10% of its total assets as at 30 September 2019 in order to complete the ToE.
- 3.38 On 13 January 2020, Drumcondra confirmed that the ILCU Board approved €██████ in funding to complete the ToE to ████████. This proposed funding amount did not restore Drumcondra's reserves to 10% of its total assets, as required in order to complete the ToE, and based on the Draft 2019 Accounts, the shortfall in funding to complete the ToE was c. €██████ ████████ subsequently confirmed that it was withdrawing from the ToE with Drumcondra.
- 3.39 Drumcondra subsequently revised its Draft 2019 Accounts to reflect the adjustments arising from the cessation of the proposed ToE to ████████ and reported reserves of 5.89% as at 30 September 2019. This increase in reserves related to the revaluation of the Premises from the value reported in the ████████ Valuation to the value reported in the ████████ Valuation, and the reversal of costs accrued associated with the completion of the ToE.
- 3.40 In light of the cessation of Drumcondra's proposed ToE to ████████, and in order to address its increased risk profile and continued failure to comply with the obligations under the November 2019 Regulatory Direction, on 17 January 2020, RCU issued a letter to Drumcondra confirming that it was required to: (a) identify a suitable transferee credit union to advance its ToE strategy, and (b) provide confirmation that the requisite funding will be provided in order to restore its reserves to 10% of total assets and thereby to enable it to comply with its obligations under the November 2019 Regulatory Direction. This confirmation was to be provided to RCU by 31 January 2020.
- 3.41 RCU held increased concerns based on Drumcondra's continued failure to comply with its obligations under the November 2019 Regulatory Direction and its increased risk profile, given the cessation of the proposed ToE to ████████. As such, on 24 January 2020, RCU issued a letter to Drumcondra confirming that the Central Bank intended to issue a further regulatory direction letter on business activities to Drumcondra (the "2020 Pre-Direction Letter"). RCU proposed in the 2020 Pre-Direction Letter to further restrict Drumcondra's business activities<sup>10</sup> pursuant to section 87 of the CUA. Drumcondra was invited to make any submissions it deemed relevant in response to the 2020 Pre-Direction Letter by no later than 31 January 2020.
- 3.42 On 5 February 2020, Drumcondra responded to the 2020 Pre-Direction Letter and provided an update on its progress in identifying another transferee credit union.

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<sup>10</sup> (1) Maximum loan of €10k net of shares, (2) Maximum total net loans to all members in any calendar month of €100k, and (3) Investments restricted to euro dominated investment accounts in credit institutions with a maximum of 90 days to maturity.

Subsequently, on 17 February 2020, RCU issued the February 2020 Regulatory Direction restricting Drumcondra's business activities. The restrictions, as set out in the 2020 Pre-Direction Letter, were implemented as a result of Drumcondra's continued failure to comply with its obligations under the November 2019 Regulatory Direction and its increased risk profile.

- 3.43 Throughout January to April 2020, Drumcondra provided a number of updates to RCU with respect to its progress in identifying a transferee credit union and its efforts to obtain the requisite funding from ILCU to restore the Credit Union's reserves to 10% of total assets, so that it could complete a ToE once a transferee had been identified. During this period, RCU considered Drumcondra's updates and provided extended periods of time to allow Drumcondra to advance its ToE discussions with potential transferee credit unions, in response to the exceptional circumstances prevailing in the State with regard to COVID-19.
- 3.44 Drumcondra confirmed that, following the withdrawal of [REDACTED] from the ToE process in January 2020, it had engaged with eleven further potential transferee credit unions but was ultimately unable to advance its ToE strategy. As a result, Drumcondra made the decision to re-engage in potential ToE discussions with [REDACTED] in March 2020, and submitted a revised and increased SPS funding application to ILCU in the amount of €[REDACTED].
- 3.45 Drumcondra subsequently confirmed to RCU that the ILCU Administration Committee considered its application and recommended SPS funding of €[REDACTED] subject to ratification by the ILCU Board. Drumcondra advised RCU that the ILCU Board meeting was scheduled for the first two weeks in May 2020, where its SPS funding application would be considered.
- 3.46 Given that Drumcondra was awaiting confirmation from ILCU with regard to the financial funding amount to be provided and in light of the exceptional circumstances prevailing in the State with regard to COVID-19, RCU extended the deadline for the submission of the confirmation relating to a transferee credit union and the provision of the requisite financial funding to complete a ToE, to 29 May 2020.
- 3.47 On 25 May 2020, RCU was provided with a copy of a letter that Drumcondra had received from ILCU, which stated:

*"I am writing in relation to the revised application for SPS support received by email on 10th April 2020 from Drumcondra and District Credit Union Limited (DDCU).*

*I note that DDCU has re-engaged with [REDACTED] in relation to a potential transfer of engagements and the amount of SPS support sought to facilitate this current application for a transfer of engagements is the sum of €[REDACTED] in capital support.*

*The ILCU Board considered this current SPS application at its meeting on 8th May 2020 and, after due consideration, decided against providing the amount requested of €[REDACTED].*

*The ILCU board did confirm its decision, made in January 2020, to sanction the amount of €[REDACTED] in SPS support to DDCU to facilitate a transfer of engagements*

to [REDACTED] The provision of any financial assistance from the SPS would be subject to the conclusion of a legally binding agreement documenting the terms and conditions upon which the SPS support would be provided.

I appreciate that this is not the response that you would have wished for, however please do not hesitate to contact...if the ILCU can offer any technical assistance in addition to the sum of € [REDACTED] to facilitate a transfer of engagements.”

3.48 On 28 May 2020, Drumcondra submitted the 28 May 2020 Letter to RCU, which confirmed the following:

“I would like to update you on our current position:

1. As previously advised, as we had exhausted all opportunities to identify a transferee credit union into which we could transfer our engagements, we revisited the option of transferring the engagements of DDCU to [REDACTED] (“[REDACTED]”).
2. Following this, we made a second application to the Savings Protection Scheme (“SPS”) acting through the Administration Committee of the Irish League of Credit Unions (“ILCU”) seeking adequate funding to enable the transfer with [REDACTED] to progress. We received a final response from the ILCU on 22 May 2020. Unfortunately, our application did not achieve the desired outcome, and while the ILCU were willing to provide a level of support, the level of support was neither sufficient nor adequate to enable the [REDACTED] transfer to proceed.
3. As of 30 April 2020, the management accounts of the credit union reflect assets of €14,059,883 and total reserves of €758,733. In this regards, our overall realised reserve ratio is currently 5.40%. In the 7 months to 30 April 2020, the credit union has incurred a deficit of €72,735. Furthermore, in the month of April 2020, our asset base has grown from €13,853,000 to €14,059,883. In this regard, the credit union reserves are contracting and the credit union assets are expanding, further worsening the credit union’s capital adequacy.

Having carefully considered the above, it is the position of the Board of DDCU that:

1. Based on the April 2020 Management Accounts, the credit union is not complying with the requirement set out in Regulation 4 of the Credit Union Act 1997 (Regulatory Requirements) Regulations to establish and maintain a minimum regulatory reserve requirement of 10% of the total assets of the credit union.
2. The credit union has taken what it views as all reasonable steps within its powers to identify a suitable transferee credit union to advance its transfer of engagement strategy. This has, unfortunately, been unsuccessful and DDCU has concluded that this strategy is no longer achievable. Following this, the credit union does not view, looking forward, it will be in a position to comply with the requirement set out in Regulation 4 of the Credit Union Act 1997 (Regulatory Requirements) Regulations to establish and maintain a minimum regulatory reserve requirement of 10% of the total assets of the credit union.
3. Following 1 and 2 above, DDCU would ask for your continued collaboration in order to seek a resolution of the ongoing financial concerns as the Board are minded to co-operate to the fullest extent with the CBI in seeking a resolution.

*With regard to future optionality, the Board's paramount concern is the social and economic well-being of our members. In this regard, with full recognition of the fact that the selection of any resolution option is the sole prerogative of the Central Bank of Ireland, we would express our preference for a resolution outcome that would result in a directed transfer.*

*We trust this provides your office with an update on our current position. Should you have any further queries, please do not hesitate to contact me. We look forward to hearing from you."*

- 3.49 RCU subsequently confirmed receipt of Drumcondra's 28 May 2020 Letter and confirmed that the Central Bank would proceed with the consideration of the use of its powers under the 2011 Act.

#### **Supervisory Assessment of the reasons that Drumcondra has been referred to RES**

- 3.50 Drumcondra has had elevated capital risks since 2012, primarily as a result of impairments to the carrying value of its Premises. The provision of ILCU funding in 2016 restored its reserves above the reserve requirement, however Drumcondra has been unable to maintain this position, and has faced sustained viability challenges from 2012 to date.
- 3.51 From March 2019, Drumcondra proactively pursued a single focus strategy of seeking a ToE as the solution to address its viability challenges. As at the date of this Report, Drumcondra has been unable to complete a ToE strategy due to a shortfall in the financial funding offered by ILCU. Drumcondra remains in breach of its obligations under the November 2019 Regulatory Direction because it has been unable to restore its reserves to the required level.
- 3.52 Furthermore, Drumcondra stated in the 28 May 2020 Letter that its ToE strategy is no longer achievable and that it will not be in a position to comply with the reserve requirement. Drumcondra has also confirmed that its reserves have continued to deteriorate in recent months due to its trading deficit and an increase in its asset base as per the April 2020 Management Accounts. RCU concurs with Drumcondra's stated view that it is likely that Drumcondra's reserves will continue to be depleted over the coming months due to its increasing asset base and trading deficit.
- 3.53 As a result of these issues, Drumcondra has requested the Central Bank's assistance to address its immediate viability risks, including through the use of resolution powers under the 2011 Act.
- 3.54 The COVID-19 pandemic has impacted the economy of Ireland since March 2020, initially through a reduction in the ability of a proportion of borrowers to repay credit institutions in general, including credit unions. The credit union sector, which accounts for a c. 30% share of household unsecured debt, is not immune to the financial implications of the pandemic. Based on information reported to RCU by individual credit unions, the sector has seen significantly depleted demand for credit in the form of new loans advanced and has seen an increase in the level of savings held. These trends add pressure to the ability of a credit union to generate income and to maintain reserves in the short to medium term.

- 3.55 The medium to long-term implications of the COVID-19 pandemic on the credit union sector cannot be assessed with certainty at present and may have an impact on the ability of distressed credit unions to identify transferee credit unions to progress voluntary ToE solutions. Such potential transferee credit unions may focus on overcoming business model challenges that they face on a standalone basis in the medium to long-term.
- 3.56 RCU is therefore of the opinion that, although the COVID-19 pandemic is not the cause of Drumcondra's regulatory and financial difficulties, all of which pre-date the onset of the pandemic, the current external environment arising from the COVID-19 pandemic has had a further negative impact on Drumcondra's ability to raise and maintain its reserves in order to comply with its obligations under the November 2019 Regulatory Direction.
- 3.57 Following the consideration of Drumcondra's continued failure to meet the requirements of the November 2019 Regulatory Direction and the contents of the 28 May 2020 Letter, RCU has formed the view that Drumcondra has exhausted all potential options to address its immediate risks and comply with its regulatory obligations.

#### 4. RES'S ASSESSMENT OF THE REASONS FOR DRUMCONDRA'S FAILURE

4.1 Having considered the supervisory history of Drumcondra, this Section of the Report sets out RES's assessment as to the reasons for the failure of Drumcondra. In particular, emphasis is drawn to two main areas which had a significant impact/contribution to Drumcondra's failure, being:

- a) the non-viability of the Credit Union as a standalone business; and
- b) the failure of the Credit Union to address that non-viability by means of the completion of a ToE to a suitable third party credit union.

##### **Non-viability of Drumcondra as a standalone business**

4.2 RES is of the view that the principal factors leading to Drumcondra's viability issues and it not being able to continue operating on a standalone basis, are predominately due to the following:

- a) Inability to substantially grow the Credit Union's loan book;
- b) Income and cost management;
- c) Fixed asset impairment; and
- d) Inability to implement the strategic plan developed.

##### ***Inability to substantially grow the Credit Union's loan book***

4.3 Drumcondra's core underlying business model, as with all credit unions, is the intermediation of members' savings by granting loans to other members, with surplus resources invested. The income earned from such activities should cover operating costs, ensure that the Credit Union maintains adequate reserves to comply with the reserve requirement and, if possible, the payment of a dividend to members<sup>11</sup>.

4.4 Since 2016, Drumcondra's loan to asset ratio has ranged from between 26% - 32%<sup>12</sup>, with only a moderate single digit percentage growth in the total gross book value of the loan book over this period. Furthermore, as per the March 2020 prudential return, only 13% of Drumcondra's members were borrowing from the Credit Union, indicating that there is a low level of interest for credit union services within the Drumcondra Common Bond area. The 2019 ToE Due Diligence Report also confirmed this as it states that Drumcondra: "*is relatively low lent in terms of value and borrowers numbers*".

4.5 Drumcondra experienced a declining rate of growth in the loan book during the financial year ending 30 September 2019. As is illustrated in Table 2 below, this rate of decline increased significantly in the period ending April 2020, resulting in a total decline of 15% of the gross loan book value during the first seven months of the financial year. This decline demonstrates a continued trend of reduced levels of

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<sup>11</sup> Dividends in credit unions are seen as the equivalent to deposit interest in banks.

<sup>12</sup> As per the Financial Conditions of Credit Unions, 2019: II, Issue 6, December 2019, due to elevated saving growth together with lower loan growth, the credit union sector's average loan to asset ratio was 28% as at 30 September 2019.

borrowing by members of Drumcondra. If this trend continues, it is anticipated that income generated by Drumcondra from loans to members, and trading generally, will deteriorate further. This issue is addressed in more detail in paragraphs 4.12 and 4.13.

**Table 2: Drumcondra's Statements of Financial Position from 30 September 2015 to April 2020**

€'000s	Final Accounts Sept 2015	Final Accounts Sept 2016	Draft Accounts Sept 2017	Draft Accounts Sept 2018	Draft Accounts Sept 2019	Revised Draft Accounts Sept 2019 <sup>(1)</sup>	Management Accounts Apr-20
<b>Assets</b>							
Fixed assets	1,382	1,373	1,319	884	729	848	824
Cash, bank & investments	7,799	10,300	11,077	10,159	9,022	9,022	9,616
Gross loans	3,633	3,979	4,262	4,615	4,622	4,622	3,949
Bad debt provisions	(383)	(315)	(306)	(285)	(442)	(442)	(392)
Net loans	3,250	3,663	3,956	4,330	4,180	4,180	3,557
Other assets	23	83	98	104	58	58	63
<b>Total Assets</b>	<b>12,453</b>	<b>15,419</b>	<b>16,451</b>	<b>15,477</b>	<b>13,988</b>	<b>14,108</b>	<b>14,060</b>
<b>Liabilities</b>							
Members savings	12,477	13,477	14,570	14,099	12,922	12,922	13,220
Other creditors	310	253	177	39	814	354	81
<b>Total Liabilities</b>	<b>12,788</b>	<b>13,730</b>	<b>14,748</b>	<b>14,138</b>	<b>13,736</b>	<b>13,276</b>	<b>13,301</b>
<b>Net (liabilities)/assets</b>	<b>(335)</b>	<b>1,689</b>	<b>1,703</b>	<b>1,339</b>	<b>252</b>	<b>831</b>	<b>759</b>
Loans to Assets Ratio	29%	26%	26%	30%	33%	33%	28%
YoY Increase/(Decrease) in Gross Loan Value	(4%)	10%	7%	8%	0%	0%	(15%)
Cash, bank & investments to Assets	63%	67%	67%	66%	64%	64%	68%
Provisions / gross loans %	11%	8%	7%	6%	10%	10%	10%
<b>Reserves %</b>	<b>(2.69%)</b>	<b>10.84%</b>	<b>10.19%</b>	<b>8.65%</b>	<b>1.80%</b>	<b>5.89%</b>	<b>5.40%</b>

Source: Drumcondra Financial and Management accounts.

Notes: (1) As a result of the cessation of the ToE, the Revised Draft September 2019 Accounts reflect a reversal of ToE costs previously provided in the initial September 2019 Draft Accounts illustrated above. (2) The year-on-year comparison of the gross loan book value between April 2020 and the Revised Draft Accounts as at September 2019, only compares the difference over a seven month period.

- 4.6 The decline in the total gross loan book value stands in contrast to the projected growth targets set out in Drumcondra's revised strategic plan for the period up to 2022. That plan anticipated that the value of Drumcondra's gross loan book at the end of September 2020 would be €5.3m, increasing further to €5.8m by the end of September 2021. In order achieve these targets, however, Drumcondra would need to increase the value of its loan book by 48% by September 2021, during which period the Credit Union would need to issue approximately €110k of additional loans to members per month.
- 4.7 As a result of the high level of arrears on Drumcondra's loan book, RCU imposed lending restrictions in August 2011, restricting members' loans<sup>13</sup> to €20k in excess of savings. These restrictions were considered necessary to protect members' funds. Following the receipt of funding from ILCU in 2016, Drumcondra sought a review of these restrictions. However, due to continuing concerns relating to Drumcondra's lending practices, the Central Bank did not consider it appropriate to revoke or revise the terms of the lending restrictions, which may have adversely affected Drumcondra's ability to increase the value of its loan book.
- 4.8 In 2017, Drumcondra engaged RBK Accountants to prepare a report to support discussions with the Central Bank on amending or lifting the lending restrictions. The RBK report found continued issues with regard to adherence to lending policies and inadequate segregation of duties in the process, in effect reaffirming concerns held

<sup>13</sup> At the time of the imposition of the loan restrictions to date, the average new loan in the sector ranged from €3k - €4.5k over the period 2011 to 2019.

by Central Bank. In addition, similar credit issues were identified as part of the 2018 PRISM Engagement.

- 4.9 The November 2019 Regulatory Direction further restricted the Credit Union from lending a total cumulative amount of €200k per month. The November 2019 Regulatory Direction was issued by the Central Bank in order to protect members' savings, having regard to heightened concerns with respect to Drumcondra's viability, its depleted reserves and other issues identified in the 2019 ToE Due Diligence Report. Further restrictions on lending, again due to ongoing viability concerns for Drumcondra, were also imposed as part of the February 2020 Regulatory Direction<sup>14</sup>.
- 4.10 In the opinion of RES, Drumcondra's failure to put in place effective controls to ensure adherence to appropriate lending practices has been a contributory cause of the Credit Union's inability to materially expand the value of its loan book during the period from 2016 to date. Although Drumcondra made intermittent requests to RCU during that period to review the lending restrictions imposed on the Credit Union, those requests were not supported by any compelling evidence that the issues that gave rise to the need for those restrictions had been addressed to the satisfaction of the Central Bank.

#### ***Income and Cost Management***

- 4.11 Drumcondra's inability to generate sufficient income from lending and investment activities has been a contributing factor in relation to the gradual deterioration of the financial position and viability of the Credit Union.
- 4.12 As illustrated in Table 3 below, the loan interest income growth for Drumcondra from 2015 to 2019 was limited, increasing marginally between 2% – 6% year-on-year. This limited increase, coupled with Drumcondra's investment income reduction from €120k to €52k due to the low interest rate environment in the respective period, resulted in the total income earned by the Credit Union in both 2015 and 2019 remaining static at €552k.
- 4.13 Drumcondra received €1.817m in ILCU funding in January 2016. The purpose of this funding was to enable the Credit Union to re-organise its business and re-establish itself as a viable standalone entity. However, in the period following the provision of funding by ILCU, the Credit Union has been unable to achieve any material growth in lending income, and its total income has remained static. In the view of RES, notwithstanding the significant ILCU SPS funding received in January 2016, Drumcondra has proved incapable of effectively restructuring its business, and this would strongly suggest that Drumcondra is no longer viable as a standalone credit union. As highlighted above, Drumcondra achieved limited growth in its gross loan book since 2016, which has had an adverse direct impact on the growth of loan interest income. RES is further of the view that, because income has remained almost static since 2015, and there is now a decline in the gross value of Drumcondra's loan

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<sup>14</sup> The February 2020 Regulatory Direction imposed a cap on the amount members could borrow, where the loan to be made would not exceed: (a) the amount of shares in, or on deposit with, the Credit Union held by that member (whether held jointly or on the member's own account); and (b) €10k. In addition, the Credit Union could not make total loans in a calendar month that exceed €100k cumulatively.

book, it is highly unlikely that Drumcondra could trade its way out of financial difficulty on a standalone basis through income growth.

- 4.14 Another contributing cause of Drumcondra's gradual deterioration is the increase in operating expenses for the period 2016 - 2018<sup>15</sup>. This increase, as illustrated in Table 3, is further indicative of the Credit Union's failure to re-organise itself effectively following receipt of ILCU funds in January 2016. Drumcondra's 2015 Strategic Plan aimed to reduce operating expenses at a rate of 4%, year-on-year, during respective periods. The level of increase of operating expenses experienced during this period, against what was proposed in the strategic plan, demonstrates to RES that Drumcondra does not have the capacity to manage its operating expenses effectively on a standalone basis. It is also clear to RES that the management of these costs continues to be an issue of concern with respect to Drumcondra, with operating expenses being well in excess of income recorded in the management accounts for the period to April 2020.

**Table 3: Drumcondra's Statements of Profit and Loss from 30 September 2015 to April 2020**

€'000s	Final Accounts Sept 2015	Final Accounts Sept 2016	Draft Accounts Sept 2017	Draft Accounts Sept 2018	Draft Accounts Sept 2019	Revised Draft Accounts Sept 2019 <sup>(3)</sup>	Management Accounts Apr-20
<b>Income</b>							
Loan interest	419	416	444	464	474	474	276
Other interest income	120	139	91	93	52	52	25
Other income	14	11	15	30	26	26	1
<b>Total Income</b>	<b>552</b>	<b>565</b>	<b>549</b>	<b>587</b>	<b>552</b>	<b>552</b>	<b>302</b>
<b>Operating expenses</b>							
Salaries and wages	162	170	195	195	183	183	105
Management expenses	232	301	332	328	1,000	631	253
Depreciation	38	29	46	44	37	37	24
<b>Total operating expenses</b>	<b>432</b>	<b>500</b>	<b>573</b>	<b>567</b>	<b>1,220</b>	<b>851</b>	<b>383</b>
<b>Operating (Loss) / Profit</b>	<b>120</b>	<b>65</b>	<b>(24)</b>	<b>20</b>	<b>(669)</b>	<b>(300)</b>	<b>(81)</b>
<b>Exceptional items</b>							
ILCU funding	-	(1,817)	-	-	-	-	-
Impairments	1,513	-	-	406	248	38	-
Bad debt provisions	12	(68)	(10)	(21)	157	157	(51)
Write offs	22	25	15	42	71	71	77
Recoveries	(55)	(89)	(63)	(43)	(59)	(59)	(35)
<b>Total exceptional items</b>	<b>1,494</b>	<b>(1,949)</b>	<b>(58)</b>	<b>384</b>	<b>418</b>	<b>208</b>	<b>(8)</b>
<b>Total Expenses</b>	<b>1,926</b>	<b>(1,448)</b>	<b>515</b>	<b>951</b>	<b>1,638</b>	<b>1,059</b>	<b>375</b>
<b>Net (Loss) / Profit</b>	<b>(1,374)</b>	<b>2,014</b>	<b>34</b>	<b>(364)</b>	<b>(1,087)</b>	<b>(508)</b>	<b>(73)</b>
Dividend	-	-	-	-	-	-	-
<b>Key ratios</b>							
Loan Interest/Total income %	76%	74%	81%	79%	86%	86%	91%
Cost Income ratio <sup>(1)</sup>	349%	(256%)	94%	162%	297%	192%	124%
Cost Income ratio <sup>(2)</sup>	78%	88%	104%	97%	221%	154%	127%

Source: Drumcondra Financial and Management accounts.

Notes: (1) Cost income ratio including exceptional items; (2) Cost income ratio excluding exceptional items; (3) The surplus reported by Drumcondra in the Final Accounts for the period ended 30 September 2016 is inclusive of the ILCU funding of €1.817m; (4) As a result of the cessation of the ToE, the Revised Draft September 2019 Accounts reflect a reversal of ToE costs previously provided in the initial September 2019 Draft Accounts illustrated above; and (5) The management accounts for the period ending 30 April 2020, account for 7 months of trading activity.

- 4.15 Bad debt provisions, which are an indicator of a credit union's ability to manage its loan book, have also been a source of concern. As presented in Table 2 above, bad debt provisions as a percentage of gross loans declined from 11% after the receipt of the 2016 ILCU funding, to 6% in 2018. As part of the 2019 ToE Due Diligence Report, a requirement for an additional bad debt provision of €94k was recommended. This increased the bad debts provisions as a percentage of gross loans to 10% in the 2019 financial statements, further negatively impacting upon the overall trading position

<sup>15</sup> 2019 has been disregarded for this comparison due to Drumcondra recording costs from the failed ToE as an operating item.

of Drumcondra. The percentage remains the same as of the date of the April 2020 management accounts.

- 4.16 On the basis of the foregoing, and in particular noting the inability of Drumcondra to generate additional income, coupled with the growing operational costs, Drumcondra has struggled since 2016 to achieve an operating profit sufficient to allow the Credit Union to remain viable on a standalone basis. This limited level of operating profits has also had a material adverse impact on the ability of Drumcondra to maintain its reserves in excess of the regulatory requirement. Based on these ongoing trends, and as highlighted in the April 2020 management accounts which report an operating loss of €81k, it is difficult to envisage Drumcondra improving its trading position over the course of the coming years. This highlights the need for action to be taken in respect of Drumcondra in the interests of its members.
- 4.17 The absence of a financial surplus has also resulted in Drumcondra not issuing a dividend to members since 2010. A payment of a dividend in the medium term may be required to motivate members to utilise the Credit Union's full range of services and reward saving. RES would be concerned that the continued failure of the Credit Union to issue a dividend could result in a reduction of the income generating customer base of Drumcondra.

#### ***Fixed Asset Impairment***

- 4.18 As outlined in Section 3, Drumcondra previously valued the Premises using the ViU accounting technique. The Central Bank raised concerns over an extensive period as to whether the assumptions underpinning Drumcondra's fixed asset valuation were reasonable and supportable. The 2015 Asset Review Report supported the Central Bank's concerns and recommended that Drumcondra re-value the Premises in its balance sheet to reflect fair market value. Drumcondra subsequently engaged a real estate services firm to perform a property valuation, which concluded that the Premises had a market value of €1.35m. Prior to this, the Premises had been recorded in Drumcondra's accounts as having a value of €2.88m. Accordingly, the revaluation of the Premises required an impairment of €1.53m to be recognised in Drumcondra's 2015 financial statements. This impairment was the primary reason for the requirement of funding from ILCU in 2016.
- 4.19 It was necessary for Drumcondra to record a further impairment in the value of the Premises following the [REDACTED] Valuation, which was conducted in connection with the ToE process with [REDACTED] in 2019. During that process, four property valuations were undertaken in respect of the Premises, resulting in values ranging from €[REDACTED] to €[REDACTED]. Drumcondra ultimately decided that the [REDACTED] Valuation of €[REDACTED] was the more reasonable value. As illustrated in Table 3 above, the recognition of this impairment resulted in Drumcondra amending and reflecting an impairment of €[REDACTED] in its 2018 draft financial statements in September 2019 and as a consequence thereof, the Credit Union reported reserves of 8.65%, indicating that its reserves had fallen below the regulatory requirement of 10% for the first time since January 2016.
- 4.20 RES is of the view that the level of impairment of the value of the Premises is one of the primary causes of Drumcondra's financial distress.

***Inability to implement the strategic plan developed***

- 4.21 Drumcondra presented the 2015 Strategic Plan up to the year ending September 2019, outlining how it would ensure continued compliance with the reserve requirement following the receipt of funds from ILCU in January 2016. The strategic plan included forecasted trading positions, scheduled Board activities and risk analysis. Drumcondra further provided an updated 2018 Strategic Plan forecasting to the period ending September 2020. RCU had considered concerns around this plan and engaged with Drumcondra on its content. As indicated in Section 3, the Central Bank completed a PRISM Engagement in 2018 and found significant concerns in relation to Drumcondra’s strategic planning process due to the errors in the Revised 2018 Strategic Plan, the lack of strategic direction and the fact that Drumcondra had failed to achieve previous strategies. RES is of the view that, taken as a whole, these failures demonstrate that Drumcondra is no longer viable as a standalone credit union.
- 4.22 Following intensive engagement between the Central Bank and Drumcondra, an updated version of the 2018 Strategic Plan was presented in January 2019. As part of this strategic plan, Drumcondra defined a set of economic targets or triggers, as outlined below, in relation to the performance of the business. If these targets were not met, then the Credit Union would determine whether it could continue as a stand-alone entity, and whether a ToE strategy should be employed.

**Table 4:** Economic Triggers to activate ToE strategy

Annualised Loan Book Growth Must Exceed %	Annualised Savings Growth Must Not Exceed %	The Capital Ratio Must Exceed %
8%	2%	10.50%

- 4.23 As part of the submitted revised Strategic Plan the Board of Drumcondra advised: *“During the course of the development of this strategy, it became increasingly clear to the Board and Management of Drumcondra, that there is clear and present likelihood that the economic triggers will be activated over the coming months, and there is a high degree of probability that DDCU will seek a transfer of engagements as a result. For this reason, during the preparation of this strategy, the credit union decided to make initial steps to advance a transfer of engagement optionality.”* At a meeting between the Board of Drumcondra and RCU on 26 February 2019, there was an acknowledgment that the economic targets had not been reached, based on the submitted prudential return for the quarter ending 31 December 2018. Drumcondra were therefore taking steps to advance a ToE strategy.
- 4.24 RES is satisfied and agrees with the overall conclusion of Drumcondra that the entity is no longer viable on a standalone basis, given: (a) the declining gross loan book; (b) the income and cost management concerns; (c) the level of fixed asset impairments; and (d) an increasing cost base. RES believes that Drumcondra is not in a position to restore its capital position to the required regulatory level and is, thus, not capable of continuing to trade on a standalone basis.

**Failure to complete a Transfer of Engagement**

- 4.25 In early 2019, as is set out in detail in paragraph 4.23, Drumcondra recognised that there was a high degree of probability that the Credit Union could not continue as a standalone entity, and would need to implement a ToE, particularly in light of its

recognition that there was a likelihood that the economic triggers set out in the strategic plan would be activated.

- 4.26 Throughout 2019 Drumcondra attempted to engage with potential transferees and focused on two credit unions: [REDACTED] and [REDACTED] (“[REDACTED]”). As outlined in Section 3, [REDACTED] was identified as the preferred transferee and engaged in advanced due diligence. That due diligence exercise established that funding of c. €[REDACTED] would be required to restore the reserve position of Drumcondra in advance of the ToE. Accordingly, Drumcondra applied to ILCU for SPS funding of this amount. ILCU commissioned a review of the application<sup>16</sup> and ultimately decided in January 2020 that funding of €[REDACTED] would be the maximum amount that it would be willing to provide to support the ToE process. On foot of ILCU’s decision, [REDACTED] advised that it would not be in a position to complete a ToE and it subsequently withdrew from the process.
- 4.27 Following the withdrawal of [REDACTED] from the ToE process, Drumcondra again reached out to [REDACTED], and to a number of additional credit unions, with a view of assessing interest in completing a ToE. In total, Drumcondra have advised RCU that it engaged with twelve<sup>17</sup> credit unions in the greater Dublin commuter region, however, no credit union formally engaged in a ToE process, with the exception of [REDACTED]. Following the lack of interest expressed by any of the credit unions approached, Drumcondra and [REDACTED] re-commenced ToE discussions in April 2020 and decided to re-seek funding support from ILCU in order to complete the ToE. Given the passage of time and additional losses having been incurred, the revised funding application sought €[REDACTED]m to restore Drumcondra’s capital position and complete the ToE. ILCU again advised that it would be willing to provide the maximum funding of €[REDACTED] to support the transfer, and as a result, Drumcondra and [REDACTED] were unable to complete the ToE.
- 4.28 Consequently, Drumcondra has failed to show that there is any realistic prospect of completing a ToE or meeting its reserve requirement. Drumcondra has failed to provide the Central Bank with any meaningful ToE proposal or any solution to address its difficulties. RES is of the view that the Central Bank has provided Drumcondra with substantial time to rectify its reserve position and Drumcondra has now exhausted all options to address its immediate risks and comply with its regulatory obligations.
- 4.29 As a result of the above assessment, RES is of the opinion that Drumcondra is not in a position to continue to trade on a standalone basis. Furthermore, its inability to complete a ToE and the acceptance in the 28 May 2018 Letter by the Board of Drumcondra that it will not be able to comply with the obligations set out in the November 2019 Regulatory Direction, illustrates that Drumcondra is a failing institution. For the reasons that are identified and explained in greater detail in Section 5, RES is of the view that it is highly unlikely that Drumcondra would be able

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<sup>16</sup> This due diligence included the appointment of Moore Ireland to review the application and instructing two independent valuations on Drumcondra’s premises.

<sup>17</sup> This total number includes engagement with [REDACTED] and [REDACTED]

to identify a transferee, even if it were provided with additional time to approach other credit unions.

- 4.30 On the basis of the foregoing, and having assessed that the Credit Union is not a viable entity, it is incumbent on the Central Bank to take action and exercise its powers under the 2011 Act with respect to Drumcondra.

5. **RES'S ASSESSMENT AS TO WHY LIQUIDATION IS THE APPROPRIATE APPROACH**

- 5.1 As at April 2020, Drumcondra reported reserves of 5.4%, which it acknowledged does not comply with the 10% reserve requirement applicable to all credit unions. The reduction in Drumcondra's ability to generate income, sufficient to meet its day-to-day operational costs and comply with the 10% reserve requirement, calls into question the sustainability of Drumcondra's business and its ongoing viability.
- 5.2 RES has set out clearly, in Section 4 of this Report, its concerns regarding Drumcondra's viability and the primary factors that led to its failure as a credit union. These concerns are also shared by the Board of Drumcondra, who sought to complete a ToE strategy to address these risks. These viability concerns were reiterated in the 2019 ToE Due Diligence report.
- 5.3 RES is of the view that Drumcondra has exhausted all going-concern options to address its financial difficulties and it is now also clear that Drumcondra has accepted this position in light of the 28 May 2020 Letter issued by the Credit Union to the Central Bank, which outlined that:
- a) the Credit Union had taken what it viewed as all reasonable steps within its powers to identify a suitable transferee credit union to advance its ToE strategy, however this strategy had proven unsuccessful;
  - b) looking forward, the Credit Union did not believe that it would be in a position to comply with the requirement to maintain a minimum regulatory reserve of at least 10% of total assets; and
  - c) on the basis of the foregoing, the Credit Union requested the continued collaboration of the Central Bank to seek a resolution of the on-going financial concerns.
- 5.4 Furthermore, in the 28 May 2020 Letter, Drumcondra stated that while its "*paramount concern is the social and economic wellbeing of our members and with full recognition of the fact that the selection of any resolution option is the sole prerogative of the Central Bank of Ireland*", the Credit Union's preference is for a resolution outcome that would result in a directed transfer.
- 5.5 It is, as a result, necessary for the Central Bank to intervene to resolve Drumcondra by exercising its powers under the 2011 Act. This Act provides the Central Bank with a number of options where a credit union is determined to be non-viable, including the following;
- a) under Part 4 of the 2011 Act, the Central Bank has the power to establish a bridge bank into which Drumcondra's business, assets and liabilities could be transferred on a temporary basis with a view to transfer to a third party transferee as soon as is practicable; or
  - b) under Part 5 of the 2011 Act, the Central Bank has the power to make a proposed transfer order and apply to the High Court for an order

transferring all of the assets and liabilities of Drumcondra to a third party institution that is willing to accept such a transfer; or

- c) under Part 6 of the 2011 Act, the Central Bank can seek to appoint a Special Manager to Drumcondra in order to take over the functions of its Board and the management of Drumcondra's business; or
- d) under Part 7 of the 2011 Act, the Central Bank can seek to present a petition for the winding-up of Drumcondra.

5.6 In order for options (a), (b) and (c) to be deployed, the Central Bank must demonstrate that certain intervention conditions are accordingly met.<sup>18</sup>

5.7 It is also important to note that it is only in situations where an approach other than liquidation (Part 7) is, in the Central Bank's view, "*relevant in the circumstances*"<sup>19</sup> that the alternative resolution tools listed at (a), (b) and (c), can be utilised.

### **Bridge Bank**

5.8 A bridge bank allows for certain assets and liabilities of a failing or failed entity to be transferred into a new entity which will hold the assets and liabilities on a temporary basis, with a view of their transfer to another person as soon as practicable. In order to facilitate the transfer to a third party, the creation of a bridge bank would also require capital funding from the Credit Institutions Resolution Fund (the "CIRF"). With regard to Drumcondra, in considering the interest expressed to date in terms of its ToE strategy, it is unlikely that another financial institution would be willing to take control of the assets and liabilities of the Credit Union, absent of additional financial support. RES therefore believes that the creation of a bridge bank to accept a transfer of Drumcondra's business, liabilities and assets would not be in the public interest and would be unlikely to facilitate a successful resolution of Drumcondra. In addition thereto, RES is of the view that the costs necessary to establish a Bridge Bank, which would ultimately be drawn from the CIRF, would exceed both the costs of completing a Directed Transfer<sup>20</sup> and any costs that are likely to be incurred in relation to the winding-up of Drumcondra.

### **Directed Transfer**

5.9 As outlined in Section 3 and 4 of this Report, Drumcondra has made numerous attempts to secure a ToE. However, despite approaching twelve credit unions and submitting two separate funding applications to ILCU to support this ToE strategy, Drumcondra has failed to achieve a successful completion of a ToE process. The most recent attempt to complete such a ToE with ██████████ concluded unsuccessfully in May 2020.

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<sup>18</sup> Please see Annex I for further details on the early intervention conditions and the grounds for the appointment of a liquidator.

<sup>19</sup> As per section 9(5) of the 2011 Act.

<sup>20</sup> Under a Bridge Bank, the costs outlined under paragraph 5.13 could be seen as the minimum amount required in order to restore the capital position of Drumcondra prior to any transfer of the assets and liabilities. Additional costs to be incurred would include the establishment of the bridge bank and the ongoing management / operational expenditure etc.

5.10 Having particular regard to the prolonged efforts made to pursue a transfer to [REDACTED] RES has formed the view that Drumcondra is unlikely to be able to identify a suitable alternative transferee to successfully complete a ToE, and by implication this impacts the ability of RES to complete a directed transfer strategy under Part 5 of the 2011 Act, for the following reasons:

- a) Twelve credit unions, including those operating in close proximity have been approached by Drumcondra and, with the exception of [REDACTED] did not express an interest in advancing discussions to complete a ToE. Therefore, it would be difficult for the Central Bank to identify any additional candidates that would both have an interest and are considered to be a suitable candidate<sup>21</sup> to complete a Directed Transfer.
- b) Concerns regarding Drumcondra's viability and in particular current trends with regard to the contraction of the loan book and trading deficits. These matters have been discussed in detail in Section 4 of this Report and have been key factors in the trading difficulties experienced by Drumcondra. Furthermore, these matters are likely to be a cause of concern and increase the financial incentive sought as part of any directed transfer due to the negative impact that could result on the balance sheet and profitability of a combined entity.
- c) The recent increase in total savings held by Drumcondra would also have a negative impact on the completion of a directed transfer. A continued increase in shares would increase the amount of total reserves to be held to ensure compliance with regulatory requirements.
- d) Any due diligence exercise conducted as part of a directed transfer is likely to identify a similar funding requirement to restore the reserve position of Drumcondra as sought by the Credit Union in April 2020. The funding amount proposed to be made available by ILCU, in the amount of €[REDACTED] would not be expected to be sufficient to complete such a process. In addition, as outlined in paragraph 5.13 below, any incentive sought in a Directed Transfer is also likely to be in excess of the net cost of a liquidation process.
- e) As per the revised financial statements for the year ended 30 September 2018, the Premises had a carrying value of €[REDACTED]. Valuations obtained during the due diligence process ranged from €[REDACTED]. The ultimate impairment agreed under a directed transfer arrangement would impact the amount of the financial incentive sought.
- f) The current adverse business environment caused by the ongoing COVID-19 pandemic poses challenges for all credit unions and may diminish the appetite of any suitable candidate to participate in a directed transfer process.

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<sup>21</sup> Suitability is determined mainly in the context of geographical location, scale/ size, and the financial and operational capability to accommodate such a transfer.

- 5.11 In assessing the use of resolution tools, RES is also mindful of the overall role of the Central Bank in the management and administration of the funds that are available and could be utilised in a resolution action, being the CIRF and the DGS. Consideration is given to the principle of fair burden sharing in the use of the funds to the ultimate contributors to each fund and the State, in its role in the backstop agreement for both funds, where there is insufficient financial means in the deployment of a resolution action.
- 5.12 Having regard to the above, RES has developed a best estimate of potential costs for a directed transfer, which would require the use of funds available from the CIRF, against the level of costs and estimated realisation of assets which are anticipated to be incurred through the winding-up of the Credit Union.
- 5.13 RES has assessed that:

- a) The cost to complete a transfer would be expected to be in excess of €[REDACTED]. The base cost is set at a minimum of €[REDACTED]m<sup>22</sup>, being the amount requested to restore the capital position of Drumcondra prior to the ToE with [REDACTED] completing. On the basis of;
- i. the passage of time and the increased credit risk;
  - ii. further legal costs incurred in order to complete a directed transfer;
  - iii. additional operating losses incurred since April 2020; and
  - iv. exceptional costs potentially relating to further provisions and impairments caused by the wider economic effects of COVID-19;

An incentive fee sought by any potential transferee would also be likely to increase the April 2020 funding amount. In addition, the Central Bank's legal costs associated with the directed transfer would be payable by the CIRF. It is therefore likely that the total CIRF exposure would be in the region of c. €[REDACTED] to successfully complete a directed transfer action.

- b) In a liquidation scenario, the DGS would be triggered in order to compensate members for the amounts held at the date of the appointment of the liquidator. The DGS would then become a preferential creditor in any return of funds from the realisation of the Credit Union's assets. In terms of asset realisation, the most difficult aspect to predict accurately in a liquidation scenario would be the disposal of the remaining loan book. As part of RES's assessment, it is assumed a realisation rate of [REDACTED]<sup>23</sup> of the remaining gross loan-

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<sup>22</sup>This figure is based on the amount of funding that Drumcondra sought from ILCU, which was necessary to facilitate any further negotiations with [REDACTED] regarding a ToE.

book<sup>24</sup> would be achieved. The estimated loss to the DGS following the realisation of all assets and the costs incurred in the liquidation being discharged would range from € [REDACTED]

- c) In order for the total aggregate loss for creditors to be equal to the projected cost of a directed transfer, being € [REDACTED] it is estimated that a [REDACTED]% return on a sale of the gross loan portfolio after attached shares would be required<sup>26</sup>. Even in a highly stressed environment, it is unlikely that the sale would earn a return below or equal to this rate. If it were forecasted that such a return was to occur, it would be likely that a liquidator would manage the loan book directly to earn a greater return.
- d) Therefore, the cost of liquidation and any exposure to the DGS fund is likely to be significantly less than the cost of a directed transfer, and the funding of this action through the CIRF.

5.14 On the basis of the rationale contained in points a) to d) above, and in light of Drumcondra being unable to successfully complete a ToE to date, RES has formed the view that a directed transfer of Drumcondra's business, liabilities and assets to another credit institution under Part 5 of the 2011 Act, would not be in the public interest and is currently not a suitable resolution option for the Central Bank to pursue at this time.

#### ***Special Management***

5.15 RES has also considered the appointment of a Special Manager to Drumcondra to take over the functions of its Board and the management of its business under Part 6 of the 2011 Act. However, RES is of the view that the issues faced by Drumcondra are predominantly financial in nature, in particular relating to its reserve shortfall, rather than governance issues which a Special Manager would usually be engaged to address. It is reasonable to conclude, therefore, that a Special Manager would not be able to address and rectify Drumcondra's financial position, and on that basis, this resolution approach is not viewed as viable or suitable in the circumstances.

#### ***Overview of the assessment of Resolution Options available under Parts 4, 5 and 6 of the 2011 Act***

5.16 RES has determined that the resolution options available under Parts 4, 5 and 6 of the 2011 Act are not suitable in this case, and on the basis of the regulatory history detailed in Section 3, RES has formed the view that it is necessary and appropriate to petition for the winding-up of the Credit Union.

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This range of valuation would therefore be viewed as reasonable. The current adverse economic environment may have an impact on this value, but at this stage it is difficult to accurately model the extent of such an impact.

<sup>24</sup> As part of the calculation of the gross loan book in liquidation, loan repayments from attached share set-off on NPLs was excluded. This is not expected to materially impact the range of valuation.

<sup>25</sup> Please see Annex II for a stressed balance sheet as at the 31 March 2020 in a liquidation scenario.

<sup>26</sup> For the purpose of clarity, to reach a loss in the liquidation at a rate equal to the amount sought under a ToE of € [REDACTED] would require the loan book to be disposed of at a rate of [REDACTED]% of its current value. This level of a loss would be deemed to be unlikely to materialise at this juncture.

### ***The Grounds for Liquidation***

5.17 The 2011 Act provides the Central Bank with powers to present a petition for the winding-up of a credit institution (including a credit union) under any of the five grounds specified in section 77, being that:

- a) in the opinion of the Central Bank, the winding-up of that credit institution would be in the public interest;
- b) the credit institution is, or in the opinion of the Central Bank may be, unable to meet its obligations to its creditors;
- c) the credit institution has failed to comply with a direction of the Central Bank;
  - i. in the case of the holder of a licence under section 9 of the Central Bank Act 1971, under section 21 of that Act, or
  - ii. in the case of a building society, under section 40 (2) of the Building Societies Act 1989, or
  - iii. in the case of a credit union, under section 87 of the Credit Union Act 1997;
- d) the credit institution's licence or authorisation (as applicable) has been revoked and (in the case of the holder of a licence under section 9 of the Bank Act 1971) that it has ceased to carry on banking business; or
- e) the Central Bank considers that it is in the interest of persons having deposits (including deposits on current accounts) with that credit institution that it be wound-up.

5.18 Having considered:

- a) That Drumcondra is in a financially distressed position and is in continuing breach of the November 2019 Regulatory Direction;
- b) That Drumcondra has, as at the date of this Report, failed to provide the Central Bank with a meaningful plan to address its reserve shortfall;
- c) The alternative resolution options available to the Central Bank under the 2011 Act are not suitable in this case; and
- d) The matters raised by the Credit Union, in its 28 May 2020 Letter, as outlined in paragraph 5.3;

RES is of the view that the presentation of a petition for the winding-up of the Credit Union is the most appropriate course of action to take in the circumstances.

5.19 In the opinion of RES, three of the grounds for liquidation, as set out above at paragraph 5.17, are relevant to the Central Bank's consideration as to whether the

grounds to petition the High Court for the winding-up of Drumcondra have been met, namely that;

- a) The Credit Union has failed to comply with a direction of the Central Bank issued under section 87 of the Credit Union Act 1997;
- b) The winding-up of the Credit Union is necessary in the interests of persons having deposits; and
- c) The winding-up of the Credit Union is in the public interest.

***Ground (a): Failed to comply with a direction of the Central Bank***

- 5.20 As set out above, one of the grounds for liquidation is that the credit institution failed to comply with a direction of the Central Bank made pursuant to section 87 of the CUA. As outlined in paragraph 3.31, following ongoing regulatory concerns and 2019 Pre-Direction Letter, RCU issued the November 2019 Regulatory Direction pursuant to section 87 of the CUA seeking the Credit Union to restore its regulatory reserve position to the minimum 10% requirement.
- 5.21 Drumcondra remains in breach of the November 2019 Regulatory Direction with its reported reserve position in April 2020 being 5.4%. The Credit Union also indicated that it does not believe that it will be in a position to comply with the requirement to maintain a minimum regulatory reserve of at least 10% in its 28 May 2020 Letter.
- 5.22 As already discussed, the requirement of Drumcondra to hold reserves of 10% of total assets is a statutory obligation, established to provide a base for future growth, to protect the risk of unforeseen losses, and to ensure the continuity and protection of members' savings. The inability of the Drumcondra to raise and hold sufficient reserves is, therefore, a significant concern of the Central Bank.
- 5.23 RES is satisfied that Drumcondra has failed to comply with the November 2019 Regulatory Direction and failed to provide a plan setting out how it will comply with the terms of the Direction.

***Ground (b): The winding-up of that credit institution is necessary in the interests of persons having deposits***

- 5.24 Drumcondra is classified as a small credit union by asset value, as it has assets less than €40m<sup>27</sup>. Based on the most recent prudential return as at the 31 March 2020, Drumcondra has a balance of c. €14m and 5,095 members. The membership only represents 5.3% of the Dublin Central constituency and 0.9% of the Dublin City Council population. Notwithstanding the evidence that the Credit Union is an important local community organisation, the above statistics illustrate that membership is not significant on a regional or national level.
- 5.25 The members of Drumcondra are not aware of its current or recent financial position, and have no knowledge of the impact of recent loan and premises impairments, which have further eroded its reserves. Given its weakened financial position, and to prevent the potential destabilising consequences that might arise were its financial

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<sup>27</sup> Financial Conditions of Credit Unions, 2019: II, Issue 6, December 2019.

position made public, Drumcondra has been unable to hold an AGM since 3 April 2017<sup>28</sup>.

- 5.26 Drumcondra's members have not received a dividend, the equivalent of interest payments received by depositors in banks and other credit institutions, since the year ended 30 September 2010. As a result, Drumcondra's members have lost the opportunity to earn a return by depositing their savings with the Credit Union. Members could have benefited from earning a higher rate of return by depositing their money with another credit institution through deposit interest or the receipt of dividends. Furthermore, the opportunity loss in this regard will continue, as there is no realistic possibility of Drumcondra providing a dividend to its members in the near future.
- 5.27 Additionally, Drumcondra has a limited range of financial services, in light of the self-imposed savings limit of €15k and a daily deposit limit of €3k implemented in February 2019. And as a result of the breaches in its regulatory requirement, as outlined in Section 3, it cannot make a loan to an individual member in excess of €10k above shares whether secured or unsecured with a limit on monthly lending capped at €100k.
- 5.28 A number of neighbouring credit unions have a common bond that partially overlaps with the common bond of Drumcondra<sup>29</sup>. In the event that Drumcondra is wound-up, this may facilitate the provision of credit union services to a portion of the existing member base in the short term. Over the medium to long term, a local credit union may seek to extend its common bond to fully cover the Drumcondra common bond.
- 5.29 It is not possible to identify the number of Drumcondra's members who have alternative banking relationships with other credit institutions. Based on previous experience, it is probable that a portion of the members do not have access to a bank account at the point of winding-up. As such, the liquidation is likely to lead to some of the Credit Union's members not having access to alternative retail financial services in the short term.
- 5.30 It is important to note, however, that the members of Drumcondra will be able to avail of alternative retail financial services providers locally if the Credit Union is wound-up. Retail-banking branches are available in the Drumcondra area and include an AIB, EBS, Permanent TSB and Bank of Ireland. There are also two Post Office branches situated in Drumcondra, where members can avail of a variety of retail banking and payment services. It can be noted that all banking branches and/or financial service providers in the area are operational despite COVID-19 restrictions. Given that impacted members have a number of alternative financial services in the immediate area, Drumcondra is not viewed as a critical service provider by RES.

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<sup>28</sup> The AGM on the 3 April 2017 was held following receipt of the ILCU funding in January 2016 which restored the Credit Union's reserve position, and held in respect of the financial years ended 30 September 2012, 2013, 2014, 2015 and 2016.

<sup>29</sup> The following credit unions operate close to or have an element of overlap on the common bond of Drumcondra: Member First Credit Union Limited, Ballygall Credit Union Limited, Phibsboro & District Credit Union Limited, Community Credit Union Limited, Larkhill & District Credit Union Limited, Cabra Credit Union Limited, Fairview Credit Union Limited and Progressive Credit Union Limited.

- 5.31 On the appointment of a liquidator (including a provisional liquidator), all duly verified eligible deposits (in the form of members' savings and deposits) covered by the DGS up to €100k per depositor<sup>30</sup>, would be paid out to the members. Any members' savings or deposits not covered by the DGS would only be repaid by a liquidator to the extent that liquidation resources are sufficient to repay such savings or deposits, ranking on a *pari passu* basis alongside general creditors in the liquidation<sup>31</sup>. It is important to note that as the DGS will be a preferential creditor under the 2014 Act, it is unlikely that any depositor that does not receive a full payment from the DGS would be entitled to any proceeds from the liquidation, unless there is full repayment to creditors.
- 5.32 Following the appointment of a liquidator (including a provisional liquidator), it is intended that a DGS compensation payment would be made to a member in respect of that member's duly verified eligible deposits by means of a crossed cheque (i.e. a cheque that, in general, can only be lodged to an account, not cashed), which is posted to the member's address within 15 working days. The DGS aims to issue compensation payments to duly verified eligible depositors, as early as possible, within the statutory deadline.
- 5.33 It is in the interest of Drumcondra's members to have access to a fully functioning credit institution which is managed on a prudent basis. Drumcondra cannot, however, be viewed as a fully functioning entity as it is not able to offer its members full access to the range of services usually offered by credit unions. An additional benefit of a DGS pay-out would, therefore, be that the members of Drumcondra are obliged to deposit their savings with another institution which can offer full credit union/financial services.
- 5.34 Having considered the aforementioned factors and taking into account certain concerns identified, RES is of the opinion that it is in the interests of depositors that Drumcondra be wound-up for the following reasons:
- a) The DGS pay-out will result in members depositing their savings with other institutions that, unlike Drumcondra, are not financially distressed.
  - b) The DGS pay-out will result in members being able to access, through alternative financial institutions, a full range of financial services that are reasonably expected to be provided to members of a credit union, but which are not being provided to Drumcondra's members at present.
  - c) The DGS pay-out will result in members having to deposit their savings with other institutions that may result in Drumcondra's members receiving a return on their savings, either by means of a dividend or interest payment, in entities that have annual financial statements approved by their members or shareholders.

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<sup>30</sup> The DGS Regulations address who is to be identified as the person to be compensated in respect of certain types of deposit (e.g. those to which more than one person is entitled and those where the named depositor is not absolutely entitled to the deposit). On the basis of the last savings file obtained by the Central Bank, no member of Drumcondra is identified as having eligible deposits in excess of the DGS limit.

<sup>31</sup> The most recent prudential return of Drumcondra indicates that the maximum amount of savings held by an individual member is less than €30k.

***Ground (c): The Winding-up of the Credit Institution is in the Public Interest:***

- 5.35 RES is of the view that, on balance, a liquidation of Drumcondra is in the public interest for the reasons set out below.

***The orderly liquidation of a credit institution reflects a properly functioning market***

- 5.36 The liquidation of a failed, or failing entity, is part of the normal functioning of a market economy. The realisation and distribution of capital, as a result of a liquidation, allows stakeholders to better maximise their capital employed, instead of it remaining and being destroyed in the failing entity. The winding-up of an inefficient entity is also an incentive and indicator to the market to continue to innovate, adapt and employ capital in an orderly manner and if they fail to evolve, they too could deteriorate and be wound-up. However, it is not always possible to liquidate a failed entity without creating some consequences for the broader economy, such as the risk of contagion or the loss of public faith in the financial sector. The onus is, thus, on the Central Bank to limit the risk to the economy if a credit union is to be wound-up.
- 5.37 RES has already set out the reasons why it believes that (a) Drumcondra is a failing entity in Section 4, (b) the resolution options under Parts 4, 5 and 6 of the 2011 Act are not appropriate to resolve the Credit Union and (c) the liquidation of Drumcondra is, in consequence, the most preferable option for its members. The Central Bank has already carried out three liquidations under the 2011 Act in the credit union sector: Berehaven Credit Union Limited in July 2014, Rush Credit Union Limited in November 2016 and Charleville Credit Union in October 2017. Although the circumstances in these previous cases differ in many respects, there are similarities in relation to the necessity to liquidate and in this regard, a precedent is available.
- 5.38 It is also important to note that in the previous cases of the liquidation of a credit union, there was no contagion in the wider credit union sector arising from the exercise of powers under the 2011 Act by the Central Bank. RES thus believes that an orderly liquidation of Drumcondra involving, where required, the prompt pay-out of eligible depositors by the DGS facilitated by the appointment of a provisional liquidator, is likely to limit the prospect of contagion in the wider credit union sector and broader economy (albeit there can be no guarantee that there will not be contagion arising from a liquidation of Drumcondra).

***An orderly winding-up of a credit union serves the interest of the credit union sector***

- 5.39 Liquidation in the case of Drumcondra may also encourage enhanced regulatory compliance across the credit union sector, to the benefit of the sector, its members and the wider public. Since Drumcondra revised its financial statements for the year ended 30 September 2018 in September 2019, it has been unable to raise its reserve position to the regulatory reserve requirement of at least 10% of total assets. The importance of the regulatory reserve requirement is explained in paragraph 2.4. The Central Bank cannot allow a situation to persist whereby a credit union is in breach of the reserve requirement, and it also serves to highlight to the credit union sector that the application of the reserve requirement is to be adhered to in all circumstances.

### **COVID-19 Considerations**

- 5.40 It is important to note that RES has taken care to assess the impact of COVID-19 on the Credit Union and whether it is necessary and appropriate to seek the winding-up of the Credit Union during what is accepted to be an adverse economic period. In determining that it is necessary to petition for the winding-up of Drumcondra at this time, RES has noted, in particular, the following relevant factors:
- a) As demonstrated in Section 3, the Central Bank has had regular extensive supervisory and regulatory engagement with the Credit Union since 2015, at which point the Drumcondra required and later obtained €1.817m of ILCU funding;
  - b) Drumcondra's financial performance has not improved since the capital injection of €1.817m in January 2016, and has evidently been in a distressed financial position for some time;
  - c) In January 2019, long before the genesis of COVID-19 (which had a national impact from February 2020), the Credit Union acknowledged that it was not viable on a standalone basis and the only option available that would allow it to remain viable would be to successfully complete a ToE strategy;
  - d) From March 2019 to May 2020, numerous efforts were made to complete a ToE strategy, however, all such efforts were ultimately unsuccessful for reasons outlined in Section 3. As Drumcondra could not complete a ToE in a normal economic climate, the Central Bank is of the view that it would be significantly more difficult to attempt to complete a ToE during, and in the aftermath of, the current adverse economic climate, caused as a result of COVID-19, as any potential transferee credit unions will be focused on overcoming its own business model challenges on a standalone basis; and
  - e) The Central Bank was also caused to issue a number of Directions on the Credit Union, most notably the November 2019 Direction, which the Credit Union has indicated that it would be unable to comply with.
- 5.41 It is most noteworthy that all of the aforementioned actions, and related concerns of the Central Bank on Drumcondra, arose prior to the outset of the COVID-19 pandemic in Ireland. RES is therefore of the view that the reasons for the failure of Drumcondra are readily identifiable, as have been set out in detail in Section 4, and that the financial deterioration of the Credit Union cannot be attributed to the pandemic.
- 5.42 Despite the foregoing, when the impact of COVID-19 was felt nationally, and the Government introduced measures to prevent the spread of the virus, the Central Bank granted the Credit Union an extended period of time to explore the options available with the aim of addressing its viability weaknesses. Once all of the potential options were exhausted, Drumcondra issued its 28 May 2020 Letter to the Central Bank requesting assistance in resolving its financial issues.

- 5.43 RES recommends the liquidation of Drumcondra as the appropriate method to provide for an orderly pay out from the DGS, an orderly procedure for the realisation of Drumcondra's assets, and to facilitate the repayment of available funds to the DGS and other creditors of Drumcondra.

## 6. THE REQUIREMENT FOR A PROVISIONAL LIQUIDATOR

- 6.1 RES has in Section 5 of this Report set out in detail the reasons why it believes that Drumcondra should be wound-up.
- 6.2 RES also believes that it is necessary for a provisional liquidator to be appointed immediately, pending the hearing of the petition for the winding-up of Drumcondra, as the provisional liquidator will be able provide immediate protection over the assets of the Credit Union. Where so it is ordered by the High Court, the provisional liquidator can also commence the works necessary to achieve the statutory objectives of a liquidator as provided by the 2011 Act, being in particular;
- a) to facilitate the Central Bank in ensuring that each eligible depositor receives the prescribed amount payable from the DGS; and
  - b) to wind-up the affairs of the designated credit institution, so as to achieve the best results for that recognised credit institution's creditors as a whole.
- 6.3 The provisional liquidator will also have a crucial role in terms of minimising the risk of a run on deposits, which may occur once it becomes public knowledge<sup>32</sup> that a petition for the winding-up of Drumcondra has been presented. If a run on deposits were to commence, RES is of the view that it would be very difficult to halt and may result in the uncontrolled and disorderly closure of the Credit Union. The occurrence of this risk is additionally heightened in the current financial climate due to the implications of COVID-19, and by the fact that Drumcondra's members are not aware of the true financial position of the Credit Union.<sup>33</sup>
- 6.4 Whilst it is accepted that the appointment of a provisional liquidator may have a potentially detrimental effect on Drumcondra's business and may, regardless of the outcome of the full hearing of the petition, result in the permanent cessation of its trade, RES is of the view that the appointment is necessary for the following reasons:
- a) a provisional liquidator, being an independent Court-appointed practitioner with proven experience in dealing with corporate entities in financial difficulty, would be able to manage the cessation of Drumcondra's business in an orderly, planned and controlled manner, thereby mitigating the risk of a disorderly closing of the business and reducing any confusion that may ensue;
  - b) a provisional liquidator would be able to manage and effectively communicate the effect of the action taken by the Central Bank to all stakeholders at Drumcondra, including its Board, employees and members;
  - c) a provisional liquidator would have the ability to safeguard, secure and preserve Drumcondra's assets, books and records pending the hearing of the petition, and would be able to make the appropriate applications to the High Court where necessary to achieve this objective; and

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<sup>32</sup> By way of the obligatory notification and publication requirements placed upon the Central Bank in terms of the resolution/ liquidation actions of regulated entities.

<sup>33</sup> Drumcondra's members are not aware of its true financial position, as the last AGM took place on 3 April 2017, and the last set of published financial statements for the Credit Union were for the financial year end 30 September 2016.

- d) most importantly, the appointment of a provisional liquidator will also result in the invocation of the DGS and enable the provisional liquidator to immediately begin work on the provision of information to the Central Bank to enable eligible deposits to be repaid from DGS funds within the prescribed period of not more than 15 working days.

***Role of the provisional liquidator in facilitating a timely DGS pay-out***

- 6.5 The provisional liquidator plays a key role in facilitating a timely DGS pay-out by obtaining control over the operations and business, as well as the books and records, and thus can provide the DGS with the list of eligible savers and depositors in Drumcondra and the amounts that they are due under the scheme. This will ensure that a compensation payment is duly paid to verified eligible depositors as soon as possible, and within the statutory timeframe.
- 6.6 RES understands that no member of Drumcondra has aggregate deposits in excess of the DGS €100K compensation coverage limit. Accordingly, RES expects that all duly verified depositors of Drumcondra should be repaid in full under the DGS within 15 working days of the appointment of the provisional liquidator.
- 6.7 The provisional liquidator would also be in a position to effectively communicate with and reassure key employees and contractors that they will be paid for the work that they will be required to do to facilitate a DGS pay-out.
- 6.8 If a provisional liquidator is not appointed, the DGS payment may not be made as promptly. In such circumstance, this could result in (a) an unmanaged failure of Drumcondra; and (b) an undermining of the public confidence in the DGS which is essential to the stability of the financial sector generally.

***Requirement for the provisional liquidator to have the power to facilitate DGS payments***

- 6.9 As outlined above, if the Central Bank decides to make an application to the High Court for the appointment of a provisional liquidator to Drumcondra, and the High Court is satisfied to make such an order, this will trigger the commencement of the period within which eligible deposits must be repaid to members under the DGS Regulations.
- 6.10 RES is of the view that, given the tight timeframe within which such payments must be made, it is of critical importance that the High Court also grants the provisional liquidator the power to take all necessary steps to ensure that the DGS payments are made within the required timeframe. RES notes that section 80 of the 2011 Act specifies that the first and primary objective of a liquidator is to facilitate the Central Bank in ensuring the efficient and effective operation of the DGS payment. The interests of creditors are identified as the second, and subordinate, objective of the liquidator.
- 6.11 RES is of the view therefore that it is critically important that a provisional liquidator is granted the necessary powers to facilitate the making of DGS payments to members as quickly and efficiently as possible, and that if such powers are not granted to a provisional liquidator, there is a very real and material risk that the DGS process will be seriously delayed, if not ineffective.

**7. RECOMMENDATION AND NEXT STEPS**

- 7.1 RES believes that for all of the reasons set out in Sections 5 and 6 of this Report, it is necessary to wind-up Drumcondra in order to protect the interests of its members, to preserve confidence in the credit union and the wider banking sector, and to avoid the risk of a disorderly closure.
- 7.2 With regard to the latter, in order to avoid the real risk of an unplanned closure or a damaging run on deposits once the filing of the winding-up petition becomes known, RES recommends that an application for the appointment of a provisional liquidator be made on the same day as filing the winding-up petition. Such an application for a provisional liquidator is necessary, amongst other things, to allow for the preparation of a file to support the DGS pay-out in a timely manner, to support the credibility of the DGS, and to protect the assets of the Credit Union.
- 7.3 If, having considered all of the information in this Report, you determine that: (a) liquidation is the appropriate course of action in respect of Drumcondra; and (b) the Central Bank has sufficient grounds on which to seek to have a provisional liquidator appointed to Drumcondra, RES will request that our external legal advisors instruct Counsel in relation to this matter, in preparation for issuing a petition to the High Court.

## Annex I: Resolution and Liquidation Conditions under the 2011 Act

The 2011 Act provides the Central Bank with a number of resolution options, to include:



