SUBMISSION FROM

THE CREDIT UNION DEVELOPMENT ASSOCIATION

IN RESPONSE TO

The Central Bank of Ireland's Consultation on Potential Amendments to the Fitness and Probity Regime for Credit Unions CP113

9th November 2017

CUDA (Credit Union Development Association) welcomes the opportunity to provide commentary in response to the Central Bank of Ireland's Consultation on Potential Amendments to the Fitness and Probity Regime for Credit Unions. This organisation and its Owner Member Credit Unions acknowledge the comprehensive research and time that was assigned to the development of this Consultation Paper.

What is CUDA?

CUDA is a progressive representative and development association working on behalf of member-owned, member-directed and professionally managed Credit Unions in Ireland.

CUDA acts as a catalyst for the growth, development and expansion of its owner member Credit Unions. In summary, CUDA supports its owners achieve their strategic objectives.

Our Purpose

The main purpose of CUDA is to support Credit Unions, who are members of CUDA, in delivering their promise to their members; that promise is to be the most reliable, trustworthy financial partner who will deliver value to their members.

Our Principles

1. CUDA is an incorporated entity. Working with its members and acting in their best interests. CUDA has clearly defined democratic governance, a bottom up approach that reflects *we're all in this together*.

2. CUDA is financially strong achieved through providing value for money to its members. We are conscious of the need to be commercial, with two levels of membership based on rules reflecting the segmented audience, however, we will not allow commercial considerations to undermine our purpose.

3. CUDA is ethical and acts with integrity and honesty. We encourage our owner member Credit Unions to be a model of ethical compliance.

4. CUDA supports the further growth and development of the co-operative Credit Union model and forward-looking Credit Unions. We lead by example with clear direction, and take direction from Credit Unions' strategic objectives, delivering best practice standards, continually seeking to innovate, stretch and develop ourselves and member Credit Unions.

5. CUDA is accessible and responsive. Striving for constant strong two way communication with its members and other stakeholders.

Our Success

CUDA's growth is ongoing, with 14 owner member Credit Unions and a wider membership of over 47 strong Credit Unions who collectively manage assets of almost €6 billion. Each owner member Credit Union is represented on CUDA's National Council, who meet every month to determine and make policy decisions. CUDA's Management Committee is comprised of directors and CEO's. The Management Committee is responsible for strategic development within CUDA.

CUDA's success and growth is driven by the vision of forward–looking Credit Unions who see their Credit Union as recognised by the community as the main source of personal financial services. This business model will lead to Credit Unions broadening and deepening their commercial relationship and touch points with their members and communities. The broadening means that Credit Unions will attract new members by providing high performance, attractively priced and comprehensive range of financial offerings/products and services.

In effect the ultimate objective is to have locally owned and managed Credit Unions who will be able to provide almost the full range of banking and bancassurance services to their local community.

In preparation for this Submission CUDA has consulted with many Credit Unions and other stakeholders, including many of the Credit Unions' outsource partners. Our Reponses to the 9 questions posed in CP113 as set out below.

Tailored Fitness and Probity Regime:

Question 1

Do you agree that a tailored Fitness and Probity regime for credit unions remains appropriate at this time?

Yes. Please see responses below, in particular response to Question 2.

Question 2

Do you feel that the Fitness and Probity regime for credit unions should be aligned to the Fitness and Probity regime applying to all other RFSPs at a later stage? If so, please indicate what timeline you feel is appropriate for this to occur.

CUDA does not feel that the Fitness and Probity regime for Credit Unions should be aligned to the Fitness and Probity regime applying to all other RFSPs. It is the structure of the Credit Union model that makes it unique and successful, this includes volunteers. We would have thought the most appropriate Fitness and Probity regime for Credit Unions is one designed for Credit Unions.

The general Fitness and Probity Regime has 41 designated PCFs. To apply this regime to the Credit Union sector could mean up to 16 additional roles would be subject to pre-approval. Added to this, all Board members, being non-executive directors, would be subject to pre-approval.

Additional Observations:

1. Under the Fitness and Probity regime applicable to other RFSPs, all directors would have to seek pre-approval. The Central Bank in CP113 has noted that it has seen evidence of "*effective governance through boards...displaying a good balance and mix of skills and experience on the board*" This finding is encouraging and emphasises the huge work undertaken by Boards, Nomination Committees and operations to ensure this outcome. There is no doubt that the introduction of a Fitness and Probity regime for Credit Unions has focused thinking prior to the appointment of new directors.

   We are not convinced however, that where volunteers know they will be subjected to the pre-approval process that a Credit Union will be left with the same competent and capable individuals that may otherwise have been available to the selection process by the Credit Union. Research would be prudent as to the impact of a Central Bank pre-approval process to volunteers, and whether it could act as a deterrent to an otherwise fit and proper individual.

2. Applying the Fitness and Probity regime as applicable to all other RFSPs would clearly have a disproportionate impact given the size and governance structure of a Credit Union. The impact could also be disproportionate to the risks associated with the Credit Union model (taking into account its banking counterparts). We would follow the thinking of the Central Bank in CP83 in this regard. A disproportionate approach of this nature is unjustified.

3. The operation of a Credit Union would be subjected to considerable pressure and challenges should the general Fitness and Probity regime apply - from the appointment of directors and committee Chairs subject to the PCF process, to the recruitment of personnel. One could count a handful of individuals or roles not subject to the PCF requirements. The practicalities of this does not make sense and at the very least would give rise to an excessive and disproportionate volume of paperwork. Regulatory intervention should complement good governance.

4. Additional CF roles under the Credit Union Fitness and Probity regime are expected in due course. Our owner member Credit Unions have no difficulty with customer facing staff being included in CF roles, albeit with appropriate transitional arrangements. Considerable work is required under the Minimum Competency Code by the Central Bank to ensure the competency requirements are aligned with the nature of the Credit Union model and the associated risks.

5. Credit Unions are categorised as medium – low risk by the Central Bank. The Fitness and Probity regime should reflect this. CP113 highlights financial fraud as a concern, as well as identifying other "*weaknesses*". The instances are low. The Fitness and Probity regime should reflect this.

Controlled Functions:

Question 3

Are there any additional roles within credit unions which you consider should be prescribed CFs under the Fitness and Probity regime for credit unions? If so, please specify them along with a supporting rationale.

As stated above, we have no difficulty with customer facing staff falling under the regime once the minimum competency and Fitness and Probity requirements are aligned taking into account the Credit Union model. Aside from customer facing staff, Credit Unions themselves are determining if an individual has significant influence on the conduct of the affairs of the Credit Union or is carrying out a compliance related function. As roles develop we have seen Credit Unions designate certain roles as CF which had previously not being categorised as falling within a controlled function.

Furthermore, given the nature of Credit Unions, there is still considerable oversight internally. For example, the statutory role of the Credit Committee and the Board providing an approval and/or oversight role in the loan process.

Pre-approval Controlled Functions:

Question 4

Do you have any comment on these proposed PCF roles?

Observations:

1. CUDA has no difficulty with the proposed PCF roles and we have no difficulty with a tailored Fitness and Probity regime for Credit Unions. However, we note the concerns the Central Bank has identified as weaknesses at operational level, including *"failure to adequately segregate duties and responsibilities; deficiencies in procedures, systems and controls; and inadequate financial accounting systems...instances of financial fraud and losses as well as uncertainty over the completeness and accuracy of the books and records of the credit union and the overall financial position of the credit union".* Our experience across CUDA owner member Credit Unions is that the calibre of individuals fulfilling the three roles in question is very high and we are not convinced that converting these roles to PCF roles is the correct response to some of the concerns as identified by the Central Bank.

   From the commencement of the 2012 Act CUDA facilitated, through the shared service initiative, the recruitment of both risk and compliance functions of experienced individuals from the banking, finance and accountancy background to advance these new roles in Credit Unions. A service that proved highly successful in establishing and reinforcing highly competent and capable individuals within Credit Unions. Individuals of this calibre will have no concern with the additional pre-approval requirements, and perhaps a different impetus on these roles through the Fitness and Probity Regime will help alleviate the weaknesses and concerns documented by the Central Bank. We hope this is the case and doesn't merely act as an additional administrative process for the Credit Union.

   We would expect to see a proportionate approach being adopted to the pre-approval process taking into account the risk categorisation of the Credit Union sector, especially in comparison to some other RFSPs. CUDA would view some of the granularity expected by supervisors arising from PRISM inspections as irrational, and not seen in other regulated entities. Not all risks are high risks. We would like to see more proportionality applied to risk as part of the supervisory process.

2. Some Credit Unions are experiencing difficulty in the recruitment of individuals for management positions, such as RMOs, compliance officers, etc. The availability of experienced people in the market especially in more rural areas is becoming problematic. The traditional salaries-to-income ratio of 15% is coming under considerable pressure, especially with the additional regulatory positions now required. Outsourcing is becoming more prevalent in order to fill these vacancies, firstly, it fills the skill shortage in the market and secondly, it helps Credit Unions keep in line with traditional metrics as outsourcing impacts cost-to-income ratios. The impact of the outsourced approach is not clear. It has the added benefit of bringing expertise into the sector that may not otherwise have been affordable or available. However, it remains to be seen if it could give rise to a less cohesive management team.

3. As stated, we have no difficulty with the introduction of the pre-approval process for the three roles. It is important to ensure it is being done for the right and valid reasons. In the RIA the Central Bank states that the introduction of the PCFs *"will assist in maintaining and building members' confidence in the credit union sector".* Firstly, CUDA would like to draw the Central Bank's attention to the survey published by the Customer Experience Insights (CXi) for the years 2017, 2016 and 2015. Credit Unions are the strongest organisations for "customer experience" in Ireland. It is appropriate that Credit Unions themselves take the credit for these results, not the regulatory regime applicable to the sector. The sector is strong, as are many individual Credit Unions. CP113 speaks about reputational damage that may arise to individual Credit Unions "*which also have the potential to impact on the sector as a whole"* as a result of the ongoing weaknesses. This has not been evidenced to date.

Question 5

Have you any comment on the application of these proposed PCF roles on a tiered basis to credit unions with total assets of at least €100 million only at this time?

Monitoring of the application of the new PCF roles, from a practical perspective, to ensure the process is appropriate for the Credit Union model would be welcome, before the regime is rolled out further to Credit Unions below €100 million. Given the turnover as set out in the RIA, the impact is likely to be low.

However, given the risk categorisation for Credit Unions and in particular for Credit Union below €100 million the Central Bank may find it unnecessary to introduce the three proposed new PCF roles to all Credit Unions.

Question 6

Do you have any comment on the proposed commencement date for these roles being designated PCF roles?

We have no difficulty with this. Irrespective of the start date, the focus must be on practicalities of the roles requiring pre-approval going forward and that any prolonged vacancy does not have a negative impact on the Credit Union.

Question 7

Are there any other roles which you feel would benefit from being designated PCF roles at this time?

CUDA has addressed this above in the response to Question 2.

In summary:

1. We believe it could have a negative impact on obtaining the most appropriate persons to fill volunteer roles.
2. A disproporinate impact for Credit Unions should more of the executive be included as PCFs could ensue.
3. This would give rise to a disproporinate level of paper work and red tape.
4. With additional PCF roles designated, this could give rise to prolonged or longer periods of vacancies arising, and therefore the absence of a function being performed.

Transitional Arrangements:

Question 8

Do you have any comment on the proposed transitional arrangements for the designation of the proposed PCF roles?

We are satisfied that any new persons taking up one of the PCF roles post 1st April 2018 will be required to seek pre-approval from the Central Bank prior to appointment to the role.

Likewise, we have no difficulty with the 4-month duration in which Credit Unions will be required to submit to the Central Bank electronically a list of individuals holding these PCF roles in the credit union and confirm that the individuals are fit and proper according to the Standards of Fitness and Probity for credit unions issued under section 50 of the Act and that they have agreed to abide by the Standards.

Practical Considerations re Outsourcing:

Question 9

Do you have any comment on the requirements and obligations on the credit union where PCF roles are outsourced?

We have no difficulty with the principle that individuals of unregulated firms who are providing an outsourced role must be pre-approved. However, we would make the following comments on this:

1. Is a Credit Union entering into an outsourcing agreement required to receive prior approval from the Central Bank for an individual already pre-approved to provide that service (for example, an individual of an unregulated entity already pre-approved and providing the outsourced activity to one or more credit unions)? Whilst an RFSP providing an outsourced role to a Credit Union is excluded from the requirements to seek Central Bank's prior approval, so to should a pre-approved individual of unregulated firms already providing the service to other Credit Unions.

2. Some Credit Unions have identified that two individuals from the firm in which the role is outsourced to is performing the function. This is more prevalent in the internal audit function. Credit Unions have said this works well from a continuity perspective where one individual leaves. How will this approach be treated under the new regime which requires the naming and pre-approval of an individual?

Many thanks to the Central Bank for allowing us the opportunity to comment on the proposed introduction of additional PCF roles. As always, CUDA is happy to meet with the Central Bank to discuss any of the points raised in this Response.

credit union development association

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