Comhar Linn
INTO CREDIT UNION

33 Parnell Square,
Dublin 1. D01 W563
Tel: 1850 277 377 – Fax: (01) 873 3253
Email: info@intocreditunion.ie
Web: www.comharlinnintocu.ie

Submission on Consultation Paper 125

On behalf of Comhar Linn INTO Credit Union Limited

9th January 2019

Introduction

Comhar Linn INTO Credit Union ("CL INTO") welcomes the proposed removal of restrictions on Credit Union ("CU") lending. CL INTO supports the development of a successful CU sector where progressive, professional and well-run CUs are enabled to provide a broader range of services to members. We feel that these CUs must demonstrate the necessary resources and expertise to provide a sustainable business case.

(Sibley, 2018) recently commented on the Irish market *"The housing stock in Ireland was just over two million homes in 2016, increasing by just 8,800 since 2011 (less than a half of one per cent of the stock). Over the same period, the Irish population grew by over 170,000 (by 3.8%) to 4.7m. Added to this, with the welcome economic recovery, Ireland is experiencing:*

- *increasing income;*
- *increasing employment;*
- *a longer-term trend in a reduction in the size of households;*
- *the increasing presence of foreign private equity firms and real estate investment trusts (REITs), which tend to operate mainly in urban markets; and*
- *evidence of a trend to increasing use of short-term lets in urban areas.*

Project Ireland 2040 estimates that by 2040 the population of Ireland will reach almost six million. This will result in a need for 550,000 more homes with current estimated housing demand of 30,000-35,000 per annum to overcome the current shortfall, and then this will reduce to 25,000 new homes per year. In this context, Central Bank research points to house completions of approximately 23,500 units in 2018 and 28,500 in 2019."

It is clear that there is an opportunity for CUs and a synergy between demand, members' expectations and mortgage lending.

CL INTO recognises the difficulty in developing new regulation given the scale and disintegration of CUs in Ireland. The proposals outlined in the consultation paper provide additional flexibility to CUs, but we are concerned to note that the basis for the new regulations appears limited to the current business model. CL INTO is further concerned that the proposed changes may not provide sufficient scale or flexibility to allow CUs launch a commercially viable mortgage proposition.

Removal of 5 and 10 Year Lending Maturity Limits:

1. Do you have any comments on the proposal to remove the five years and 10-year lending maturity limits contained in Regulation 14 of the 2016 Regulations (taking account of the other changes to the lending framework)?

The removal of five- and ten-year maturity limits for secured loans benefit the business model, and CL INTO welcomes the opportunity to diversify its balance sheet into longer-term lending.

Internationally, CU mortgage lending developed where an adequate business case existed that supported the expertise, resources and systems required to sustain and grow the % of assets lent for secured loan purposes.

The recognition in the consultation paper that current limits do not allow the generation of a profitable mortgage business case across the business cycles is acknowledged. CL INTO espouse that the new regulatory framework must, therefore, provide sufficient scope to develop a business case that enables CUs to meaningfully, over time, enter the secured lending market, thus ensuring the sustainability to support the skillset, expertise, and risk management required. In CL INTO's opinion, while the proposals increase the capacity for mortgage lending, it does not provide sufficient scale to achieve this outcome.

CL INTO would welcome the Central Bank having the authority to adjust regulation for specific business cases instead of proposing limits that are reflective of the current environment and risks. Thus producing enabling regulation that provides CUs with the opportunity to develop mortgage propositions that serve their market. Examples include the MPCAS model which demonstrates a framework for how collaboration with the sector yielded a regulatory framework that enabled CUs to develop their business model.

CL INTO is of the opinion that the existing maturity limits could remain for unsecured loans.

Maximum Loan Maturity Limit for Unsecured Loans:

2. Do you have any comments on the proposal to introduce a maximum maturity limit of 10 years for unsecured loans?

In Banking legislation, no duration limit is prescribed for unsecured lending. The introduction of a maximum maturity for unsecured loans is unnecessarily restrictive on the CU business model. It restricts a CU's ability to set its risk tolerance levels and undermines our unique strategic asset "responding to a member's circumstances" in turn damaging the trust and loyalty of members.

The consultation paper does not articulate a rationale for the proposed introduction of a maturity prohibition on unsecured loans. CL INTO recognises the risk of longer-term unsecured lending. A large percentage of CU loans do not currently exceed ten years. However, a portion does for the following reasons:

- Rescheduled loans
- Loans where it is not necessary to take security due to the credit risk profile
- Where the purpose of the loan is to enhance a personal asset
- Member considering a career break

Members who find themselves in challenging financial circumstances could be impacted by the duration limit when restructuring their financial commitments.

Also, the duration limit excludes CUs from a significant portion of the current lending where members are completing home renovations, a recent driver of lending growth.

The consultation paper does not identify the risk posed by the current regulatory requirements that require the introduction of a prohibition on loans > 10 years. In CL INTO's opinion, the current tiered maturity limits are adequate to manage the risk within the unsecured personal lending portfolio.

Additionally, the proposed twenty-five years limit on mortgage lending limits the business case further. The (Ireland, 2018, p. 22) highlights that a new buyer typically takes out a 29-year mortgage in Ireland and second-hand buyers have an average 24-year term. The average mortgage duration demonstrates that the proposed limits exclude CUs from a large percentage of the mortgage market and restrict the potential business case.

CL INTO members are teachers with state salaries. A teacher's ability to afford a mortgage over twenty-five years is healthy. Incomes increase with defined salary increments and the (Department of Public Expenditure and Reform, 2012) suggest an average teaching career now spans 44 – 49 years.

CL INTO wishes to highlight that a twenty-five-year limit constrains the business model, excludes the business case from a large portion of the mortgage market and limits risk diversification of the portfolio.

3. Do you have any comments on the proposed definition of a secured loan?

CL INTO is supportive of clear and simple definitions for each loan type.

CL INTO request clarity on the interpretation of the proposed definition. Are all loans with a pledge of shares to be considered "secured" under the definition? The consultation paper does not prescribe a "Loan to Value ratio" for a loan to be considered secured.

Concentration Limits for House and Commercial Loans:

4. Do you have any comments on the proposal to require that all commercial loan exposures utilise the concentration limit for commercial lending?

The proposed requirement classifying commercial loans does not present a challenge for CL INTO.

CL INTO disagree with the proposed prohibition on Buy to Let mortgages. Prudent and conservative CUs with the appropriate skillset can underwrite and adequately mitigate the risk profile of these loans. Buy to Let mortgages may present an increased risk profile. However, CUs should not be prohibited from this type of lending en bloc.

CUs are currently disallowed to lend for holiday homes under the current CU handbook (as it is not their principal residence), we recommend this is clarified and removed under the new proposals.

5. Do you have any comments on the Central Bank's intention to introduce board reporting requirements for house loans?

CL INTO acknowledge the requirement to ensure adequate and robust reporting requirements recognising the need to balance governance and operational matters. The Board agenda must provide for the identification of risk within the strategic framework.

6. Do you have any comments on the proposal to introduce a base combined concentration limit for house and commercial loans of 7.5% of Total Assets?

The concept of combining concentration limits does not present a challenge for CL INTO.

7. Do you have any comments on the proposal to limit the maximum amount of house or commercial lending which a credit union may undertake to 5% of Total Assets within the base combined concentration limit?

CL INTO welcomes the opportunity to develop a business case for secured lending but is concerned that the concentration limits proposed are too low. The limits suggested match the current extended limits for loans greater than ten years. CL INTO concurs with the (Central Bank of Ireland, 2017) that mortgage lending is a *"High volume, low margin business activity".* However CL INTO believes mortgage lending to be an attractive proposition for CUs at scale.

The Central Bank recognises that the current restriction on longer-term lending impacts the development of the current business model in the consultation paper, highlighting the challenge of developing a profitable business model. Recognising that CUs must invest in additional resources, IT, risk management and ALM structures to adequately enter the space. The maximum lending increase under the proposals may not provide sufficient headroom to invest in the business case.

International comparisons identify significantly higher concentration limits operate for mature CU business models. In the US, CUs hold approx. 50% secured with an additional 33% in secured car lending; Canadian CUs holds 61% secured plus 34% commercial secured lending, in Australia secured loans represent 91% of the balance sheet. The international comparisons indicate that the proposed limits may not go far enough while acknowledging that the international model has become more sophisticated over time.

CL INTO proposes that the consultation process considers the ability for the Central Bank to regulate for the introduction of a CU led shared services model, similar to the PAYAC model for current accounts. Providing for a CU owned shared services entity, adequately resourced to access materially increased long-term lending limits thereby offers a sustainable business model to CUs. This would match international experience.

8. Do you have any comments on the proposal to permit an increased combined concentration limit for house and commercial loans for those credit unions who can demonstrate the necessary financial strength, skills, expertise, operations and risk management capability to undertake increased lending in these loan categories?

CL INTO welcomes the opportunity for CUs with the necessary attributes to access increased scale.

There is a need for clarity on the % split between commercial and house loans in the proposed extended limits.

9. What skills, expertise, operational and risk management capabilities do you consider necessary to support increased lending in-house and commercial loans?

CL INTO believes that CU's who have demonstrated a strong track record, prudence and professionalism in their business model be permitted to engage in mortgage lending.

These CUs will have a solid lending framework, possibly supported by credit scoring with the CU demonstrating quality results through their arrears profile over time. CL INTO believe it is essential to ensure that all staff are appropriately trained and qualified to manage the process. A professional member services function that is supported by competent legal and administration functions is required.

The evolution of the balance sheet should be supported by a well-managed ALM function in the CU.

10. Do you have any comments on the proposed increased combined concentration limit for house and commercial lending of 15% of Total Assets?

CL INTO reiterate the answers provided in section 7 and support a higher limit to enable CUs to engage the necessary recourse to develop this business model.

11. Do you have any comments on the application process referred to above?

The application process prescribed in the consultation paper would benefit from increased clarity of requirements, timelines and conditions for approval. Increased transparency would benefit the Central Bank and CUs.

Definition of Commercial Loans:

12. Do you agree with the proposal to re-name the commercial loan lending category to small business loan?

CL INTO does not have a strong view on the definition of small business loans. Do you have any comments on the proposed definition for a small business loan?

CL INTO does not have a strong view on the definition of small business loans, other than to reiterate, that Buy to Let mortgages should not be defined as commercial loans (as arises in section 4.3 of the CU Handbook) or prohibited.

Large Exposures:

13. Do you agree with a large exposure being prescribed as an exposure to a borrower or group of borrowers who are connected of 2.5% or greater of the regulatory reserves of the credit union?

CL INTO are encouraged by the progressive limits proposed to manage large exposures.

Transitional Arrangements

14. Do you have any comments on the proposed transitional arrangements?

The proposed transitional arrangements provide adequate opportunity to migrate to any new requirements.

Liquidity and ALM Considerations

15. Do you have any comments on liquidity and broader ALM considerations for credit unions wishing to increase the proportion of their loan books held in house and commercial loans particularly where those loans have longer maturities?

Comhar Linn INTO CU welcomes enhanced ALM requirements for all CUs. The balance sheet and financial performance should be analysed from many perspectives (critical business trends, budget variances, key ratios, liquidity gap analysis and stressed liquidity scenario analyses, interest rate re-pricing risk, and asset and liability interest rate sensitivity).

The consultation paper does not consider the funding profile of CUs. Member deposits may be classified under (European Banking Authority, 2018) framework. Enhanced ALM conditions will improve the position and support a more ambitious long-term lending business case.

Summary:

1. CL INTO is very supportive and welcomes the removal of restrictions to the CU business model promoting long term sustainability by evolving the CU balance sheet.
2. Increased ALM requirements are to be encouraged. The funding profile of CUs – deposits are sticky, with enhanced ALM requirements may support a more ambitious long-term lending business case.
3. CL INTO consider the proposed twenty-five and ten-year maximum duration for loans as restrictive, uncompetitive and may be strategically damaging to well-run CUs:
    a. The average first-time buyer mortgage is 29 years, and 24 years for the second mortgage. The limits exclude CUs from a significant % of the market, increasing risk and limits the development of a profitable business case.
    b. Limiting unsecured loans to 10 years presents unnecessary restrictions on the CU business model which limit flexibility to respond to member needs, a differentiating strategic asset.
4. Concentration limits are well below international comparisons.
5. All loans are by definition secured by "pledged shares", the guideline makes no reference to loan to value of the security held.

References

Central Bank of Ireland. (2017). *Long Term Lending - Guidance for Credit Unions.* Dublin.

Department of Public Expenditure and Reform. (2012). *Circular 19/2012: Commencement of the Single Public Service Pension Scheme.* Dublin.

European Banking Authority. (2018, December 12). *Interactive Single Rulebook.* Retrieved from Capital Requirements Regulation > PART SIX > TITLE III > Article 427 : https://eba.europa.eu/regulation-and-policy/single-rulebook/interactive-single-rulebook/-/interactive-single-rulebook/toc/504/article-id/979;jsessionid=97A96F6BDCC404D672AD33CEF09199FB

Ireland, C. B. (2018). *Household Credit Market Report.* Dublin: Central Bank of Ireland.

Sibley, E. (2018). The Irish Mortgage Market – 2018 and beyond - Speech by Deputy Governor Ed Sibley. Dublin: Central Bank of Ireland. Retrieved from https://www.centralbank.ie/news/article/irish-mortgage-market-2018-and-beyond-ed-sibley