“Consultation on Potential Changes to the Lending Framework for Credit Unions (CP125)”

January 2019

Core Credit Union Limited

Registered Number: 225CU

Overview

The report of the Commission on Credit Unions published in March 2012 categorised the Irish Credit Union sector as nascent. Despite being the most successful Credit Union movement in the World by member participation, it was generally accepted by Credit Unions that there was a failure to move to a more sophisticated or mature model.

The sector accepted the recommendations of the commission. At 31 December 2011, there were 403 credit unions in Ireland. Per issue 4 of the Financial Conditions, the number of Credit Unions now stands at 252, a reduction of 37% in a very short period of time.

It is disappointing that yet again, despite the sectors best efforts, the regulatory environment is failing to support us in a meaningful way. Unfortunately, the proposals outlined in CP125 is another missed opportunity to ensure the wellbeing of the sector.

The following pages outlines our formal response to the consultation paper.

4.1 Removal of 5 and 10 Year Lending Maturity Limits

1. *Do you have any comments on the proposal to remove the 5 year and 10-year lending maturity limits contained in Regulation 14 of the 2016 Regulations (taking account of the other changes to the lending framework)?*

We agree with the removal of arbitrary time-based maturity limits that do not enhance a risk-based approach to managing our loan portfolio.

4.2 Maximum loan maturity for unsecured loans

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

We oppose the introduction of an arbitrary time limit and instead suggest that the limit is not introduced at present but is reviewed as part of the post-implementation review to assess and analyse the impact that the regulations have had as proposed on page 6 of CP125.

Our reasons for opposing the limit of 10 years are as follows:

- It is contrary to the proposals in Section 4.1 whereby the consultation paper argues that the removal of time-based limits and the introduction of concentration limits ***will in effect allow for the management of loan book maturities*** and ***provision of scope to gain exposure to specific categories of lending and specific maturity profiles, within the stated risk appetite.***

- Section 4.2 does not set out a clear definition of secured lending and unsecured lending. It offers a proposed definition for a secured loan which as follows:

  A secured loan is any loan which is secured by way of:

  I. a first legal charge on property;
  II. a pledge of shares; or
  III. an assignment of a deposit.

  And

  An ***unsecured loan*** is any loan which is not a secured loan.

  Based on a simple interpretation of the above every loan in our Credit Union would meet the definition of a secured loan. For example, under this definition, we could issue a loan of €50,000 with an 11-year duration against a nominal number of pledged shares.

  If it is the CBI intention of requiring a minimum of say, 10% of the value of the loan, to be pledged or assigned then this has not been communicated in the consultation paper, and further consultation on question 2 is required before finalising any new regulations.

- Page 14 of CP125 states:

"c.50% of personal loans have a maturity of between 3 and 5 years with only ***1% of*** *personal loans having a maturity of > 10 years.*

Clearly, if only 1% of personal loans currently have a maturity of > 10 years, even with an increase in longer-term lending limits, there is no historical evidence to support the assumption that there may be an increase in the risk profile.

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

As discussed in our response to question 2 we do not believe there is any clarity with the proposed definition of secured lending. All Credit Union loans currently have a pledge of shares held as security. Based on the proposed definition all Credit Union loans would be defined as secure. We do not believe that this is the intention of the proposed regulations. Therefore, more clarity is required as to whether it is proposal to set an arbitrary percentage of security to be held against a loan. Is it to be 10% or 100%? The implications of the latter have a significant impact on the answer to question 2.

4.3 Concentration Limit for House and Commercial Loans on a Tiered Basis

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

We have no objection that all commercial loans exposure utilises the concentration limit for commercial lending. We object to the proposed concentration limit.

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

The boards of credit unions must be in a position to make informed decisions and set the strategy. The Credit Union and Cooperation with Overseas Regulators Act 2012 (CUCORA) set out an obvious demarcation between the governance (non-executive) function of a board and the operational (executive) function of the CEO.

Reporting to the board on such matters should be on a risk basis. The level of operational items that are reported to the board contradicts the as aspiration of CUCORA to separate the responsibilities between governance and operations.

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?

Yes. The risk profile of house loans is entirely different to the risk profile of commercial loans. Tying these impedes a Credit Union's ability to risk manage its loan portfolio.

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?

The proposals are regressive.

We question as to why no financial modelling has been included in the Regulatory Impact Assessment (RIA). Our modelling demonstrates that the proposals are more restrictive than the current regulations. We call on the Central Bank to publish your detailed financial models for the proposals outlined in CP125.

The table below is based on tables 10 and 11 of the Regulatory Impact Analysis on Potential Changes to the Lending Framework for Credit Unions, October 2018.

Review of impact of proposed changes to lending framework	**CBI Regulatory Impact Analysis**		**Core Credit Union**	
	Lending > 5 years	RIA	Lending > 5 years	
Capacity per current regulations	€1.43bn	Table 10	€14.01m	**Loan Book €46.7m**
Capacity per proposed regulations	€1.29bn	Table 11	€10.44m	**Total Assets €139.17m**
Reduction in capacity	€(0.14bn)		€(3.57m)	
Percentage reduction in capacity			(25.5%)	

Using the basic approach as per the RIA demonstrates that the proposed new regulations will negatively impact Core Credit Unions ability to undertake longer-term lending by 25% which will result in a reduction of income of approximately €178,500 per annum. This, in our opinion, is a serious regressive step that negatively impacts our business model and undermines the financial well-being of the sector generally.

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?

The limits are wholly inadequate. Per the Report of the Commission on Credit Unions, March 2012[1] credit unions in the US Loan profile constituted 59% of housing related loans. Proposing a maximum limit of 15% prevents Irish credit union from maturing.

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

[1] https://www.finance.gov.ie/wp-content/uploads/2017/05/Report-of-the-Commission-on-Credit-Unions.pdf

Core Credit Union considers the following necessary to support increased lending in house loans:

- Robust risk assessment, together with a cost/benefit analysis of this loan category;
- Separate Mortgage lending policy
- A clearly defined credit control & provisioning policy, with specific reference to house loans and arrears management & support unit for distressed cases.
- All supported by an IT system, which is robust & able to produce accurate & timely credit risk management reports for onward reporting to the Board on a monthly basis.
- Staff qualified and fully trained on all aspects in relation to house & commercial lending & arrears collection.

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

As per point 8 above, 15% limit will not allow credit unions develop.

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

We would agree with the level of complexity in the proposed application process if the increased limits were meaningful.

4.4 Re-name and Re-define Commercial Loans Loan Category

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

Yes. However, we do not agree with the exclusion of buy-to-let residential or commercial. All loans should be assessed based on the risk appetite of the credit union.

13. Do you have any comments on the proposed definition for a small business loan?

No

4.5 Large Exposures

14. 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?

We agree with the principle of having a large exposure limit however we believe that a limit of 2.5% is too conservative and could potentially have significant impact on rural based and small credit unions.

4.6 Transitional Arrangements

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

Due to the long-term nature of these loans and the restrictive nature of the proposals, it is likely that transitional arrangements will pose a significant burden for credit unions that are currently maximising the current limits.

5. Liquidity and Asset and Liability Management

16. 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?

The maximum long-term lending under the increased proposals is 15% of assets. As credit unions carry 10% regulatory reserves and the average total reserve ratio is in excess of 16%, the requirement for ALM is negligible. Liquidity is always an important consideration. Based on the proposal we believe a liquidity ratio of 20% to be prudent.