Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

T +353 (0)1 224 6000

Bosca PO 559
Baile Átha Cliath 1

PO Box 559
Dublin 1

www.centralbank.ie

Mr Paschal Donohoe
Minister for Finance
Department of Finance
Government Buildings
Upper Merrion Street
Dublin 2

25 October 2019

Re: Consultation under section 84A of the Credit Union Act, 1997 on proposed changes to the Credit Union Act 1997 (Regulatory Requirements) Regulations 2016 (the 2016 Regulations)

Dear Minister

I refer to our statutory consultation with you on the proposed changes to the lending framework for credit unions.

In undertaking our statutory mandate and responsibilities towards credit unions, we recognise the important financial and social role they play in Ireland. In this regard, I very much welcome your views that the proposed changes are a positive step forward for the sector, particularly regarding an increase in credit union house lending capacity. I also welcome your view that the changes to limits as a percentage of assets and the simplification of maturity limits generally are welcome. You have also raised a number of issues with us and asked us to consider these further. Indeed, there has been further subsequent engagement on some of those points between the Registry of Credit Unions and Department of Finance officials, where your officials emphasised the need for:

- The lending framework to be fit for purpose in terms of capacity over a ten year timeframe;
- Additional capacity to be provided for commercial lending in particular, given the combined concentration limit proposed for house and commercial lending; and
- Simplification of the revised lending framework.

In addressing these issues, we believe it is useful to provide you with further context on our approach to credit union capacity for house and commercial lending. We will also outline the potential that the overall revised framework will have in terms of adapting to any future evolution of the sector and address the issue you raised on the complexity of the framework. We have set out more detailed responses to the issues you have raised with us in Appendix 1, and also include updated amending regulations to amend the 2016 Regulations in Appendix 2. You might please note that we may make some technical drafting changes before the draft amending regulations are finalised.

Separately, as you may be aware, we communicated with all credit unions last week in relation to investments held in UK credit institutions. This relates to a potential issue with credit unions' investments in UK credit institutions which may, in certain Brexit scenarios, become non-compliant with the investment requirements on eligible counterparties which are set out in Regulation 25 of the 2016 Regulations. We have informed credit unions that we do not expect individual credit unions to take action on these investments now and that we propose to put a transitional arrangement in place for such investments, if required, once we have clarity on the terms of a UK exit from the European Union. Should such a transitional arrangement be necessary, we will formally consult with you under section 84A of the Credit Union Act, 1997 on any resulting proposed amendment to the 2016 Regulations.

A. Our approach to capacity for house and commercial lending

As sector regulator, we view changes to the lending framework from the perspective of our statutory mandate, in terms of the protection by each credit union of members' funds and the maintenance of the financial stability and well-being of credit unions generally. With that in mind, the starting point in reframing house and commercial lending capacity for credit unions must necessarily take account of:

- The current position of credit unions in terms of their own strategic and business planning goals, bearing in mind existing low capacity utilisation (both in house and commercial lending)[1], individual credit union risk appetites, member loan demand, common bond dynamics and competitive factors. Our April 2018 lending questionnaire provided a credit union outlook in this regard; an evidence basis to support the capacity proposed;

[1] While there is currently no specific concentration limit in relation to house lending, at a sectoral level credit unions can currently lend up to €1.63 billion over 5 years and, of this, €566 million can be lent over 10 years. Total utilisation of this capacity is €997 million and €210 million respectively (as at 30 June 2019). In terms of commercial lending, at a sectoral level credit unions can lend up to €991 million; total utilisation of this capacity is currently €113 million (as at 30 June 2019 - capacity utilised is taken to include all commercial loans).

- The existing risk profile of credit unions, summarised in our recent Supervisory Commentary paper[2], which evidences material risk vulnerabilities, including in credit underwriting;
- The need to align house and commercial lending capacity with competence and capability. Generally credit unions provide a basic savings and loans offering, with some more recently engaging in house lending to a greater extent.[3] We believe it is prudent to ensure a safe and sound transition of business models, particularly where this is towards a more complex offering;
- Availability of key supports to credit unions through shared service type structures, which are under-developed in an Irish context. This contrasts to established international peer movements, where credit unions rely on highly developed centralised supports; and
- The macro environment - the outlook for Ireland's open economy is uncertain given factors such as Brexit, global trade tensions, international tax changes and domestic capacity constraints. Against this backdrop, a prudent approach to facilitating increased house and commercial lending capacity is essential, particularly in light of the already cyclically advanced stage of the economy, and the fact that the materialisation of certain downside risks could disproportionately impact specific regions and sectors (bearing in mind credit union common bonds).

These areas have informed our proposed capacity calibration in terms of the specific combined house and commercial base limit of 7.5%, the 10% conditional limit and the increased 15% limit. We recognise that for all credit unions, sustainable business models should include growth potential in short and long term lending based upon member needs. Our preference is to adopt a stepped phased approach, which will allow time for credit unions engaging in a newer activity to build the required competence and capability. The framework is being designed such that it can evolve to reflect the prevailing position of credit unions and the need to ensure safe and sound business model transition. Our approach will enable those wishing to evolve their long term lending offering to do so using a risk-based mind-set and in a manner that is cognisant of the risks involved. The Central Bank's '*Long Term Lending - Guidance for Credit Unions*' paper (December 2017)[4] provides a frame of reference on how to approach those risks to help ensure the protection of members' funds.

[2] https://www.centralbank.ie/docs/default-source/regulation/industry-market-sectors/credit-unions/communications/supervisory-commentary/prism-supervisory-commentary-april-2019.pdf?sfvrsn=5

[3] As set out in the Central Bank's latest *'Financial Conditions of Credit Unions'* publication – 5th Edition (August 2019), incremental changes in the overall lending profile continue to be reported by some credit unions, with early indications of an increase in credit risk appetite and an increase in the proportion of larger loans and loans of a longer duration.

[4] https://www.centralbank.ie/docs/default-source/Regulation/industry-market-sectors/credit-unions/applying-for-approvals/long-term-lending-guidance-for-credit-unions.pdf

Through tiered limits, we are seeking to provide meaningful capacity on a proportionate and effective basis to credit unions of all sizes (where this is aligned with strategy, competence and capability), in order to facilitate credit diversification while mitigating duration and concentration risks. Tied in with this, the capacity provided under the revised proposals reflects the Central Bank's desire to facilitate increased lending in these loan categories on a prudent basis. On the structure of the limit, which is a combined limit for house and commercial lending, there are several reasons for this approach. This approach will help to ensure that the maturity profile of credit unions' lending remains appropriate and there is not a disproportionate amount of credit union balance sheets being held in longer term assets. It will also aid asset and liability management (ALM), bearing in mind that most credit unions are new to these areas. Importantly, this approach provides credit unions with greater flexibility to determine how they wish to utilise the total headroom provided, whether this be in house lending, commercial lending or both. Two separate concentration limits for house and commercial lending would necessarily result in prescribing smaller concentration limits for each category of loan within the same capacity overall.

B. Potential of revised framework to adapt to future evolution of sector

The Central Bank's review under CP125 has been extensive and was informed by evidence gathered from credit unions, detailed analysis and engagement with relevant stakeholders. The amending regulations represent significant and fundamental structural framework changes, providing sufficient capacity and flexibility to enable safe and sound business model transformation. The refinements we have made to the proposed changes since consulting on them in CP125 provide additional flexibility, in particular, the inclusion of a conditional 10% limit (with no inner limit for house loans), the removal of an inner limit for house loans for the 7.5% limit and the extension of the maximum loan maturity limit from 25 years to 35 years.

The changes being made will facilitate a lending framework that is responsive to improved competence, capability and support structures available in the sector. The significant and fundamental structural changes being made to the framework will lay the groundwork for potential future changes. Where conditions in the sector are such that there is an evidence basis to adjust capacity in the future, this could be achieved by amending the level of the limits. In this regard, we remain committed to re-evaluating the capacity provided for house and commercial lending as the sector evolves and to making any necessary, appropriate and prudent adjustments. Indeed, as referenced in CP125, it is our intention to perform and publish an analysis on credit union sector

lending three years post-commencement of the changes, in order to assess and analyse the actual impact of the changes to the regulations.

If we consider any future changes to the framework to be warranted (including to the calibration of the limits) based on evidence and supporting analysis, we envisage that such future changes could be introduced within a reasonable timeframe, subject to the required consultations. Before any further significant recalibration of the lending limits would be considered necessary, and bearing in mind the areas already outlined that have informed our current calibration of the limits, we would expect to see the sector – through credit union ownership of business model transition - demonstrating the following:

- A clearly articulated strategy to support increased house and commercial lending reflective of proven underlying member demand (evidenced by utilisation of available capacity) and common bond dynamics;
- Delivery of a viable house and/or commercial lending business line that is providing a sustainable financial return;
- Demonstrated alignment of credit unions' risk appetites with business model strategies;
- Highly developed competence and capability in house and/or commercial lending;
- Fully embedded governance and risk management frameworks under a risk-based approach, capable of supporting both existing operations and new activities, as well as a track record of financial and operational resilience;
- Fully developed and operationalised shared service type structures (including centralised arrangements similar to those in established international movements). These should support credit unions to benefit from scale economies, technical resources and competence, that today are unavailable to individual credit unions; and
- Financial resilience at a credit union level to be able to manage potential challenges and risks posed by prevailing macro-economic conditions, including those that can impact more on credit unions given their specific common bonds.

C. Simplification of the revised lending framework

The Central Bank's overall approach to the lending framework changes has been informed by feedback received from sector representatives and individual credit unions and is an example of the application of our 'earned flexibility' approach. Further to your comments on simplifying the draft amending regulations to ensure they are easy to understand and implemented in practice, we have carried out a full review from a legal drafting perspective to simplify them, where possible. On

tiering specifically, it is inevitable that tiering adds to the complexity of the draft amending regulations; however, the 10% and 15% limits and associated requirements will only be relevant to the cohort of credit unions who wish to access this additional capacity. On the CUAC Implementation Group recommendation that credit unions of a certain asset size and risk profile would automatically qualify for elements of tiering within regulations (with such tiering still available for smaller credit unions to apply for), we are of the view that the provision of the additional 10% conditional limit goes some way to addressing this recommendation. We have also considered the level of demand from smaller credit unions for additional capacity and the potential these categories of lending have to generate credit concentration risks, particularly in the lending portfolios of such credit unions. Appendix 1 includes further details on simplification of the draft amending regulations and tiering, and sets out our response to your comments on liquidity requirements for credit unions.

Conclusion

We view changes to the lending framework from the perspective of our statutory mandate. The additional lending capacity proposed has been carefully calibrated having regard to the prevailing conditions and other considerations outlined above, as well as considering the feedback received to CP125 and through the statutory consultation process. We are of the view that the significant structural changes we are making to the credit union lending framework are prudent and can facilitate future changes, where necessary, taking account of business line viability and the development of competence, capability and support structures. Overall, we are of the view that the changes being made are proportionate and effective and, together with greater credit union ownership of business model transition, they will enable credit unions to evolve their business models to continue to fulfil their important role from a financial and social perspective.

Next Steps

Following completion of this statutory consultation, the Central Bank intends to publish a feedback statement on CP125 (including amending regulations) and all the submissions received on our website over the coming weeks, with the regulations expected to come into effect in January 2020.

Yours sincerely,

Patrick Casey

Registrar of Credit Unions

Appendix 1

Response to your feedback

The Central Bank has considered your specific feedback, as well as feedback received from other stakeholders, including the CUAC and credit union representative organisations. To address the feedback received, the Central Bank has made a number of refinements to the draft regulations to simplify them (and clarify certain aspects). We set out below the specific issues you have asked us to consider together with our responses under relevant headings.

The regulations should allow all credit unions to develop sustainable loan-to-asset ratios in a diversified loan book in the medium to long term to reduce the risk of a further consultation process, and to give the certainty to allow the sector plan and invest for the long-term. Ideally, the regulations will have sufficient flexibility to endure for the long-term and allow for sustainable business model transformation.

Sustainable loan to asset ratios

Within the existing lending framework, there is a wide range of loan to asset ratios (LTAs) across the sector with many credit unions not utilising the capacity that is already available to them. This confirms that for some credit unions, at least, it is commercial challenges rather than the regulatory framework that is impacting LTAs. The Central Bank has previously expressed concern at the sector's low LTAs and has cited it as one of the key sustainability challenges facing credit unions given the negative impact on return on assets. Discussion by a number of credit unions has turned to the provision of mortgages. The Central Bank is supportive of credit unions increasing lending on a prudent basis using a risk-based approach, including engaging in new areas of lending and increasing exposure to longer term lending as part of a balanced loan portfolio. The Central Bank is of the view that a balanced loan portfolio, supported by strong risk management capability, can increase diversification in loan books and help to manage credit concentration risks to which credit unions may be exposed. Nonetheless, we would caution that all lending should be prudently undertaken, well-managed and in line with the credit union's strategy, capabilities and risk appetite. While credit unions have called for increased capacity to engage in longer term lending, the Central Bank remains of the view that this is not the sole solution to the low LTA ratio and associated sustainability challenges facing the sector.

Longer term lending presents specific credit risks given its nature and characteristics. In addition, house loans and commercial loans are generally higher value loans and cumulatively can assume material volume relatively quickly, and this must be reflected in the lending concentration limits put

in place. Commercial challenges aside, the Central Bank believes that the proposed calibration of the concentration limits will provide headroom for credit unions which will provide greater flexibility for credit unions in managing loan exposures and scope to gain exposure to specific categories of lending and specific maturity profiles which may help to address low LTAs.

Sufficient flexibility to endure for the long term

As referred to above, the significant and fundamental structural changes being made to the framework will lay the groundwork for potential future changes. In this regard, the timeframe for the current review process should not be taken as a benchmark for the timeframe for future reviews. If we consider future changes to the framework to be warranted (including to the calibration of the limits) based on evidence and supporting analysis, we envisage that such changes could be introduced within a reasonable timeframe in consultation with stakeholders. We believe that establishing the concept of an upper lending concentration limit with an associated clear and transparent application process, can potentially provide for an increase to the limit where we see evidence of developed competence and capability and a need to provide additional capacity.

The regulations should ensure that the capacity for credit unions to lend is increased, not restricted, from what is currently available, and that capacity for business lending to meet Programme for a Partnership Government objectives is sufficient to allow for the investment required, and that such capacity isn't reduced and/or eliminated through concentration in house loans.

Capacity to lend is increased

As part of the Regulatory Impact Analysis undertaken during the development of the CP125 proposals[5], analysis was undertaken to assess the total capacity which the proposed base combined concentration limit would provide to credit unions of varying asset sizes for house and commercial lending.[6] Analysis was also undertaken to identify the potential impact for credit unions should these concentration limits be introduced relative to their current loan book portfolio and the amount of loans currently outstanding for house and commercial lending. This analysis indicated that all credit unions with the exception of two (out of a total 263 active credit unions) would have

[5] CP125 - https://www.centralbank.ie/docs/default-source/publications/consultation-papers/cp125/cp125---consultation-on-potential-changes-to-the-lending-framework-for-credit-unions.pdf

[6] Based on June 2019 Prudential Returns data, total capacity provided under the 7.5%, 10% and 15% limits is c.€2.27bn (assuming that all credit unions with assets of €50m->€100m avail of the conditional 10% limit and all credit unions with assets of at least €100m apply and are approved for the increased 15% limit).

additional scope for increasing their combined house and commercial lending within the 7.5% base concentration limit.[7]

The Central Bank has also undertaken analysis to assess the adequacy of the proposed concentration limits relative to the forecasted lending activity of credit unions based on the data provided by credit unions in their responses to the lending questionnaire issued in April 2018. Of the 172 questionnaire respondents included within the dataset for analysis, 63 indicated that a change in the existing maturity limits was necessary in order for them to meet lending demand out to 30 September 2022.[8] In other words, 109 of the 172 questionnaire respondents, based on their own strategic planning and risk appetites, did not require a change in the existing maturity limits in order for them to meet lending demand out to 30 September 2022.

Since consulting on the original proposals set out in CP125, we have updated our analysis to reflect data reported by credit unions in their June 2019 Prudential Returns. This analysis indicates that the 7.5% base limit would provide sufficient capacity for 43 of the 63 questionnaire respondents who indicated that a change in the existing maturity limits was necessary. Of the 20 credit unions for which the base limit is not sufficient for forecasted lending out to September 2022, 9 have assets of less than €50 million and 11 have assets of at least €100 million. Of the 11 credit unions with assets of at least €100 million for which the base limit is not sufficient for forecasted lending, the 10% concentration limit would provide sufficient capacity for 6 of these credit unions and the increased concentration limit of 15% of total assets would provide sufficient capacity for the forecasted lending activity of 4 of the remaining 5 credit unions. This would leave just one credit union with assets of at least €100 million, where the limits would not provide sufficient capacity for forecasted lending out to September 2022.

In relation to your comment on the elimination of the ability of a small or mid-size credit union to apply for regulatory approval for additional capacity, feedback received during the consultation process was broadly supportive, in principle, of the concept of an increased limit being available to those credit unions who demonstrate the necessary financial strength, skills, expertise, operational and risk management capability to undertake increased lending in house and commercial loans. While some submissions disagreed with the proposal that credit unions with total assets of at least €100 million would be indicative of those credit unions with the necessary scale, resources and

[7] This analysis took account of all commercial loans currently outstanding as it is proposed that all commercial loans issued and outstanding will now utilise the concentration limit for commercial lending contained in the lending framework.
[8] These 63 respondents also provided forecasted lending data.

capability to avail of an increased concentration limit, we believe, having considered the data provided by credit unions, that the introduction of the additional 10% conditional limit largely addresses this concern. In addition to this, the feedback we received via the 2018 lending questionnaire does not evidence significant demand for additional capacity for the majority of smaller credit unions. We have also considered the potential these categories of lending have to generate concentration risks in lending portfolios, which are particularly relevant in respect of smaller credit unions for whom any losses on larger scale loans could have a significant financial impact.

More generally, it is worth noting that capacity for credit unions to provide personal loans may be increased under the revised framework as the current limit on personal lending with maturity between 5 and 10 years will be removed.

Capacity for commercial lending

Specifically on headroom available for commercial lending, based on June 2019 Prudential Returns, our analysis suggests that just 2 credit unions out of 245 (at that time) had commercial loans outstanding of greater than 5% of total assets. The vast majority of credit unions (221) had commercial loans outstanding of 2% of total assets, or less. This suggests that significant headroom would still be available for credit unions to increase their commercial lending under the proposed 7.5% base concentration limit, if this is aligned with their strategy, capability and risk appetite. The addition of the proposed conditional 10% limit since consulting on proposals in CP125 should alleviate, to some extent, concerns that utilisation of the limits for house lending may eliminate capacity to engage in commercial lending. In short, there is ample commercial lending capacity proposed given existing and planned utilisation – over and above this, credit unions themselves acknowledge that they currently lack the competence to build a business model based upon commercial lending.

The regulations could be simplified to ensure they are easy to understand, and easily implemented by credit unions and the Regulator while being proportionate and effective. Such simplification would be of benefit to all parties, and assist in managing the cost and time burden of the regulations.

Tiering

We note your specific comments on the three tiers of capacity for total house and commercial loans. As set out above, this overall approach has been informed by feedback received from sector representatives and individual credit unions and is an example of the application of our 'earned

flexibility' approach. Tiering inevitably adds to the complexity of the regulations, but will only be relevant to the cohort of credit unions who wish to access this additional capacity. For example, it is only those credit unions seeking to avail of the 10% limit who must hold additional regulatory reserves. It is worth noting that the 7.5% base limit can be distinguished from the 10% and 15% tiers on the basis that it is made available to credit unions of all sizes with no qualifying criteria, notification or application requirements. Credit unions benefit from a tailored regulatory framework. Consistent with this, the proposed suite of changes to the lending framework, including the introduction of tiered combined concentration limits for house and commercial lending, is both tailored and proportionate in recognition of the specific characteristics of credit unions and the various considerations that have informed the calibration of the concentration limits.

We have again considered the recommendation of the CUAC Implementation Group that *"credit unions of a certain asset size and risk profile automatically qualify for elements of tiering within regulations (with such tiering still available for smaller credit unions to apply for)"*. We are of the view that the provision of the additional 10% conditional limit goes some way to addressing this recommendation. Again, for smaller credit unions, the 2018 lending questionnaire does not evidence significant demand for additional capacity for the majority of these credit unions and the potential to generate concentration risks in lending portfolios are particularly relevant in respect of smaller credit unions.

The manner in which we have formulated the 15% tier recognises the potential for larger credit unions to move into commercial and house lending in a more meaningful way given their scale. As set out above, we believe that establishing the concept of an upper tier with an associated clear and transparent application process can potentially provide for an increase to the limit where we see evidence in the future of a developed competence and capability and a need to provide additional capacity.

Liquidity

You have raised a number of questions relating to liquidity requirements. In accordance with the 2016 Regulations, credit unions are currently required to hold 20% of their unattached savings in relevant liquid assets. The Section 35 Regulatory Requirements for Credit Unions published in 2013 set out additional requirements for credit unions that increase lending over 5 years above

20% of total gross loans outstanding.[9] CP125 outlined the Central Bank's intention to move the liquidity requirements set out in the Section 35 Regulatory Requirements for Credit Unions into Part 3 of the 2016 Regulations for clarity and ease of access. We did not receive feedback on this proposal. While transferring the requirements to regulations has resulted in different wording, the requirements to be included in the 2016 Regulations do not represent any change to those currently contained in the Section 35 Regulatory Requirements for Credit Unions. We will ensure that this is clear to all credit unions through the provision of a Frequently Asked Questions (FAQs) document on the implementation of the amending regulations.

As part of the review of the lending framework for credit unions, the Central Bank undertook high level analysis to consider liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) in a credit union context. In summary, the analysis indicated that all credit unions would meet the LCR requirements that apply to credit institutions reflecting the sector's low LTA ratio, profile of investments and the high proportion of funding drawn from retail deposits covered by a deposit guarantee scheme, which are subject to lower outflow rates under the LCR. Similarly, all credit unions would meet the NSFR requirements, reflecting the sector's level and source of stable funding relative to the sector's LTA. The Central Bank indicated in CP125 that it does not consider that these alternative liquidity requirements are suitable in a credit union context given the relative complexity of these requirements and fundamental differences between credit unions and credit institutions, including the comparative difference in LTA ratios and available sources of funding.

Taking account of the changes introduced to the definition of relevant liquid assets for credit unions from 1 March 2018, the capacity of credit unions to grow their LTAs, the permitted classes of investment for credit unions under the investment framework which supports the availability of high quality liquid assets and the scope for longer term lending being provided under our proposed changes for all credit unions, the existing liquidity framework is deemed appropriate for credit unions seeking to undertake commercial and house lending up to 7.5% of total assets. Those credit unions who wish to undertake additional longer term lending and/or additional longer term investments will be required to have more advanced ALM frameworks, liquidity contingency plans and will be required to monitor and report on asset and liability mismatches regularly to the Central

[9] Credit unions with lending over five years above 20 per cent of total gross loans outstanding must hold additional liquidity as set out below.

Lending Over Five Years	Minimum Liquidity Ratio
>20% and <25%	at least 25%
≥25% and <29%	over 25%
≥29%	at least 30%

Bank. In addition, credit unions will be required to demonstrate their understanding of ALM and provide an overview of their ALM frameworks in any application submitted to avail of the increased concentration limit for house and commercial lending.

Simplification and proportionate & effective requirements

As mentioned earlier in this letter, in finalising our drafting of the amending regulations, we have carried out a full review from a legal drafting perspective to simplify, where possible, the regulations. We have also had good engagement with sector representative organisations who have made some drafting suggestions to enhance the clarity of the regulations. For example, changes have been made to the definition of 'secured loans' and the definition of 'business loan' has been clarified in respect of lending to approved housing bodies. We are of the view that the changes being made to the lending framework are proportionate and effective. We intend to support the implementation of the regulations with the publication of an FAQs document, which will accompany the publication of the draft regulations, and update our guidance in the Credit Union Handbook.

House and business lending have differing characteristics, risks and maturity profiles. I am unclear as to the rationale for a combined lending limit. I am not convinced that the combined limit will achieve the objectives stated and could inhibit increased diversification, particularly in the area of business lending.

Rationale for combined concentration limits

An integral element of the suite of changes proposed to the lending framework under CP125 is the removal of the existing 5 and 10 year maturity limits (based on a percentage of a credit union's loan book). Our analysis, including an assessment of the forecasts provided by individual credit unions via the 2018 lending questionnaire, demonstrates that it is house loans and commercial loans that primarily have maturities of over 5 and 10 years. Combining the concentration limits for house and commercial lending will help to ensure that ALM impacts can be mitigated, the maturity profile of credit union lending remains appropriate and that there is not a disproportionate amount of credit union balance sheets being held in longer term assets.

Importantly, and as outlined above, the combined nature of the limits also affords maximum flexibility to the sector in utilising the capacity available. Adopting an approach of two distinct concentration limits for house and commercial lending would necessarily result in separate smaller concentration limits for each category of loan. Noting the inner limit for the 7.5% base concentration limit (and the proposed 10% limit) for commercial lending, if credit unions should

wish to do so, they may lend up to 5% of total assets in commercial loans within these concentration limits. In addition, subject to an application and approval process, for those credit unions meeting the asset size criteria for the increased 15% limit, considerable additional capacity may be available for house and/or commercial lending, if desired.

In summary, combining the concentration limits for house and commercial lending:

- Helps to ensure that the maturity profile of credit union lending remains appropriate and there is not a disproportionate amount of credit union balance sheets being held in longer term assets;
- Helps to ensure that the ALM impacts of engaging in increased longer term lending can be mitigated; and
- Importantly, affords maximum flexibility to the sector in utilising the capacity available.

Growth in sources for SME lending is a Programme for Government commitment

The calibration of the proposed lending limits, including limits for commercial lending, reflects feedback from the sector including information provided by the April 2018 lending questionnaire and our assessment of competence and capability across the sector. In this regard, it is worth noting that, at a sectoral level, credit unions can currently lend up to €991 million in commercial loans and total utilisation of this capacity is currently €113 million.[10] In addition, our analysis of the forecasted split between categories of lending up to September 2022 indicated that across all asset size categories, credit unions forecasted that a higher proportion of their loan books would be in house loans compared to commercial loans. This reflects credit unions' risk appetites for house and commercial lending in existing loan portfolios and on a forecasted basis.

Our revision in removing the inner limit for house lending for the 7.5% base limit was informed by feedback from the sector and is also supported by the fact that the sector has started focusing on building shared services for house lending.[11]

The regulations could be reviewed in areas where they could restrict product development to ensure these are appropriate and that they aid rather than hinder a level playing field, particularly in the context of the wider banking sector.

Generally speaking, we agree that the lending framework for credit unions should aid rather than restrict product development. This is evident from the changes to the lending framework being

[10] As at 30 June 2019 – capacity utilised is taken to include all commercial loans, i.e., commercial loans above and below €25,000.
[11] The ILCU and CUDA have developed shared service structures to support credit unions in the provision of house loans.

proposed. Further still, the refinements made to the suite of proposals since we consulted under CP125 reflect our desire to facilitate those credit unions wishing to increase their house and commercial lending to ensure that they are not disadvantaged. For example, our proposal to extend the current loan maturity limit from the existing 25 year limit to 35 years recognises that credit unions could be disadvantaged in the first time buyer lending market, in particular, if the existing 25 year maturity limit was left in place.

BTL Lending

We note your comments on the restriction from all forms of buy to let (BTL) lending. The Central Bank remains of the view that it is not currently appropriate for credit unions to undertake such lending given the specific risk characteristics of BTL lending. However, with regard to lending to approved housing bodies, as referenced above, the definition of 'business loan' has been refined to clarify that credit unions may lend to approved housing bodies.

European Investment Bank backed scheme for young farmers

We recognise that the European Investment Bank (EIB) funding initiative for young farmers may be a scheme that certain credit unions would like to participate in, in order to meet the needs of their members. Following a review of the joint initiative for improving access to funding for European Union Young Farmers, we note that the purpose of the initiative is to improve access to funding for European Young Farmers and that the initiative outlines a number of possible EIB financing arrangements that can be made available to young farmers via financial intermediaries in member states including Group Risk Sharing Instruments and Guarantees. It does not appear that the intention of the initiative is to encourage longer term unsecured lending to young farmers. Rather, the initiative seeks to reduce the risk for the financial intermediaries the benefit of which can be passed on to young farmers via a reduced level of required collateral. The Central Bank's proposed amending regulations do not prescribe the level of security a credit union must take for loans over 10 years as we are of the view that the amount of security required for a loan must be assessed on a case by case basis taking account of the risk characteristics of the loan. Therefore, if there are formal risk mitigation mechanisms in place such as those outlined in the EIB and EU Commission joint initiative, a credit union should take these into consideration when calculating how much security to require.

Requirement for a comprehensive business plan

The requirement for a comprehensive business plan and detailed financial projections, appropriate for the scale and complexity of the loan, to be provided by a borrower before a commercial loan can

be granted is an existing requirement which was introduced in January 2016. It is important to note that this requirement does not apply to commercial loans of less than €25,000. The Central Bank's expectation is that this is applied by credit unions by requiring more comprehensive business plans and detailed financial projections for more complex and larger scale loans. We will consider further communication on our expectations through our engagements with the sector and guidance.

Appendix 2

Updated draft amending regulations

STATUTORY INSTRUMENTS.

S.I. No. of 2020

CREDIT UNION ACT 1997 (REGULATORY REQUIREMENTS) (AMENDMENT) REGULATIONS 2020

S.I. No. of 2020

CREDIT UNION ACT 1997 (REGULATORY REQUIREMENTS) (AMENDMENT) REGULATIONS 2020

In exercise of the powers conferred on the Central Bank of Ireland (the "Bank") by section 182A of the Credit Union Act 1997 (No. 15 of 1997) (the "Act"), the Bank, having consulted the Minister for Finance, the Credit Union Advisory Committee and other bodies that appear to the Bank to have expertise or knowledge of credit unions generally and that the Bank considers appropriate to consult in the circumstances, hereby makes the following regulations:

1. (1) These Regulations may be cited as the Credit Union Act 1997 (Regulatory Requirements) (Amendment) Regulations 2020.

   (2) These Regulations come into operation on [Insert].

2. In these Regulations "Principal Regulations" means the Credit Union Act 1997 (Regulatory Requirements) Regulations 2016 (S.I. No. 1 of 2016).

3. Regulation 2(1) of the Principal Regulations is amended –

   (a) by deleting the definition of "commercial loan",

   (b) by replacing the definition of "house" with the following:

   "'house' means any building or part of a building that does not have a commercial use as its primary purpose and is used or suitable for use as a dwelling and any outhouse, yard, garden or other land appurtenant thereto or usually enjoyed therewith;", and

   (c) by inserting the following definitions:

   "'business loan' means a loan other than a community loan, that is made to:

   (a) A member of the credit union that is an approved housing body; or

(b) A member, or where there is more than one member, at least one of those members, that satisfies the following conditions:

(i) the loan is made for purposes of the person's trade, business or profession;

(ii) the person is a micro, small or medium-sized enterprise within the meaning of Commission Recommendation 2003/361/EC;

(iii) the loan is not made for the purpose of financing, in whole or in part, the purchase, construction or refinancing of buildings or the purchase or refinancing of land that the person intends to rent to a third party in order to generate income;

'Commission Recommendation 2003/361/EC' means the Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises[12];

'secured loan' means a loan that is secured by a mortgage, charge, assignment, pledge, lien, or other encumbrance in or over any asset or property, but shall not include unsecured guarantees by third parties;

'unsecured loan' means a loan that is not a secured loan;".

4. Regulation 7(2) of the Principal Regulations is amended by substituting "Regulation 8" for "Regulation 8(1)".

5. The Principal Regulations are amended by substituting for Regulation 8 the following -

"*Liquidity Requirements*

8. (1) Subject to paragraph (2), a credit union shall establish and maintain a liquidity ratio of at least 20 per cent.

(2) A credit union shall establish and maintain a liquidity ratio of -

[12] OJ No. L124, 20.5.2003, p.36.

(a) at least 25 per cent, where the total gross loan amount outstanding to that credit union with more than 5 years to the final repayment date exceeds 20 per cent but is less than 25 per cent of the total gross amount outstanding in relation to all loans,

(b) greater than 25 per cent, where the total gross loan amount outstanding to that credit union with more than 5 years to the final repayment date is equal to or exceeds 25 per cent but is less than 29 per cent of the total gross amount outstanding in relation to all loans,

(c) at least 30 per cent, where the total gross loan amount outstanding to that credit union with more than 5 years to the final repayment date is equal to or exceeds 29 per cent of the total gross amount outstanding in relation to all loans.

(3) Where a credit union fails to comply with paragraph (2), it shall not make any new loan with more than 5 years to the final repayment date unless it has obtained the Bank's prior approval in writing to make such a loan.

(4) A credit union shall ensure that relevant liquid assets held in compliance with this Regulation shall have the following composition:

(a) at least 2.5 per cent of unattached savings shall comprise cash and investments with a maturity of less than 8 days;

(b) no more than 10 per cent of unattached savings shall comprise the relevant liquid assets specified in Regulation 7(1)(c), after application of the applicable discounts specified in Regulation 7(2).

(5) In this Regulation, 'liquidity ratio' means relevant liquid assets as a percentage of unattached savings."

6. The Principal Regulations are amended by substituting for Regulation 11 the following:

"*Categories of Lending*

11. A credit union shall only make loans that fall within the following categories:

(a) personal loans;
(b) business loans;
(c) community loans;
(d) house loans;
(e) loans to other credit unions."

7. The Principal Regulations are amended by -

(a) substituting for Regulation 12 the following:

"Concentration Limits

12. (1) A credit union shall not make –

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

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

(2) Subject to paragraph (3), a credit union shall not make a house loan or a business loan where such loan would cause the combined total gross amount outstanding in relation to house loans and business loans to exceed 7.5 per cent of the total assets of the credit union.

(3) A credit union that satisfies all of the requirements in paragraph (4) can increase its combined total gross amount outstanding in relation to house loans and business loans to 10 per cent of the total assets of the credit union.

(4) The requirements referred to in paragraph (3) are the following:

(a) the credit union has maintained, for 2 or more consecutive quarters immediately preceding the date on which notification referred to in subparagraph (b) is made -

(i) a minimum total asset size of €50,000,000, and

(ii) a regulatory reserve, calculated in accordance with Regulation 3, of greater than or equal to 12.5 per cent;

(b) the credit union provides the Bank with at least one month's prior notification in writing that –

(i) immediately prior to making the notification, the credit union has satisfied itself that it is compliant with the criteria in paragraph (a), and

(ii) the credit union intends to increase lending in respect of house loans and business loans but only to the extent that the credit union's combined total gross amount outstanding in relation to house loans and business loans would not exceed 10 per cent of the total assets of the credit union.

(5) A credit union to whom this Regulation applies shall not make a business loan where such a loan would cause the total gross amount outstanding in relation to business loans to exceed 5 per cent of the total assets of the credit union.

(6) A credit union that has made a notification to the Bank under paragraph (4)(b) but no longer complies with the criteria in paragraph (4)(a), shall –

(a) notify the Bank in writing without delay, and

(b) cease making new house loans or new business loans in breach of paragraph (2) except where the credit union

has already entered into a legally binding loan agreement with a member to advance a new house loan or a new business loan."

(b) inserting the following Regulation after Regulation 12:

"*Approval for increasing Combined Lending Capacity to 15 per cent*

12A. (1) A credit union may apply to the Bank for approval to increase its combined total gross amount outstanding in relation to house loans and business loans to 15 per cent of the total assets of the credit union.

(2) The Bank may grant an approval referred to paragraph (1) where it is satisfied that –

(a) the credit union has a minimum total asset size of €100,000,000 for 2 or more consecutive quarters immediately preceding the date on which the application is submitted under paragraph (1), and

(b) the credit union has demonstrated that the approval is -

(i) consistent with the adequate protection of the savings of members, and

(ii) effective and proportionate, having regard to the nature, scale and complexity of the credit union.

(3) For the purpose of paragraph (2)(b), the Bank shall consider the following:

(a) the total realised reserve position of the credit union;

(b) such other matters that the Bank may specify from time to time.

(4) Where the Bank grants an approval under paragraph (2), it may, at that time or at any other time, make the approval subject to conditions with which the credit union shall comply.

(5) A credit union that is approved by the Bank pursuant to paragraph (2) shall notify the Bank in writing without delay where it no longer complies with the minimum total assets set out in paragraph (2)(a), or any condition imposed on the approval under paragraph (4).

(6) Subject to paragraph (7), a credit union that has made a notification pursuant to paragraph (5) shall -

(a) cease making new house loans or new business loans that would cause the combined total gross amount outstanding in relation to house loans and business loans to exceed -

(i) 10 per cent of the total assets of the credit union provided that the credit union complies with Regulation 12(4)(a), or

(ii) 7.5 per cent of the total assets of the credit union in all other cases,

and

(b) cease making new business loans in breach of Regulation 12(5).

(7) Where, prior to the date on which a credit union identifies that it no longer complies with paragraph (2), or a condition imposed under paragraph (4), the credit union has already entered into a legally binding loan agreement with a member to advance a new house loan or a new business loan, it can provide that loan to that member."

8. The Principal Regulations are amended by substituting for Regulation 14 the following:

"*Maximum Loan Terms*

14. (1) Subject to paragraph (2), a credit union shall not make -

(a) an unsecured loan to a member where the period from the date on which the loan is made until the final repayment date exceeds 10 years, or

(b) a secured loan to a member where the period from the date on which the loan is made to the final repayment date exceeds 35 years.

(2) With respect to a loan made to a member, a credit union may with the consent of the member, or a person acting under the member's written authority, alter the repayment conditions of a loan in order to extend the term of the loan to exceed the loan terms in paragraph (1) in either of the following circumstances:

(a) the loan was in arrears at the time of the repayment conditions being altered;

(b) the loan would have fallen into arrears if the repayment conditions were not altered because the terms of the original loan agreement would no longer be met."

9. The Principal Regulations are amended by substituting for Regulation 15 the following:

"*Requirement for House Loans*

15A. credit union shall only make:

(a) a loan referred to in subparagraph (a) or (c) of the definition of 'house loan', or

(b) a loan to refinance a loan previously provided for one or more of the purposes specified in subparagraph (a) or (c) of the definition of 'house loan',

where that loan will be secured as a first legal charge on the property."

10. The Principal Regulations are amended by substituting for Regulation 16 the following:

"*Lending Practices for Specific Categories of Lending*

16. (1) A credit union shall only grant a business loan, community loan or loan to another credit union where a comprehensive business plan and detailed financial projections (supported by evidence based assumptions), appropriate for the scale and complexity of the loan, are provided and in place before granting the relevant loan.

(2) A credit union shall report on the performance of loans, in writing, to the board of directors of the credit union on a monthly basis. Such report shall include details on the performance of business loans, community loans, house loans and loans to other credit unions.

(3) This Regulation does not apply to a business loan granted by a credit union, where the total amount of business loans granted to a borrower, or group of borrowers who are connected, is less than €25,000."

11. Regulation 17(2) of the Principal Regulations is amended by substituting "business lending" for "commercial lending".

12. The Principal Regulations are amended by substituting for Regulation 23 the following:

"*Lending Policies*

23. (1) A credit union shall, at a minimum, establish and maintain the following written lending policies:

(a) credit policy;
(b) credit control policy;
(c) provisioning policy.

(2) A credit union shall assess the adequacy of the credit union's provisioning for bad and doubtful debts, having regard to its provisioning policy on a quarterly basis.

(3) A credit union shall make any necessary adjustments to provisioning for bad or doubtful debts arising from the review referred to in paragraph (2) without delay."

13. Regulation 24 of the Principal Regulations are amended by substituting for paragraph (1) the following paragraph:

"(1) Nothing in these Regulations shall render unlawful any loan made or restructured in accordance with legislative requirements applicable at the time the loan was made or restructured, and the credit union may continue to hold such loan until it has been paid or discharged in full."

14. Schedule 2 to the Principal Regulations is amended by substituting "European Union (Insurance Distribution) Regulations 2018" for "European Communities (Insurance Mediation) Regulations 2005" in each place where it occurs.

15. (1) A credit union that has satisfied the criteria in Regulation 12(4)(a) of the Principal Regulations for at least 2 consecutive quarters immediately prior to the commencement of these Regulations shall be taken to comply with the criteria in that Regulation as at the date of commencement of these Regulations.

    (2) A credit union that has minimum total assets of at least €100,000,000 for at least 2 consecutive quarters immediately prior to the commencement of these Regulations shall be taken to satisfy the minimum total assets requirement under Regulation 12A(2)(a) of the Principal Regulations as at the date of commencement of these Regulations.]

16. The revocation, amendment or substitution of any enactment, or part of enactment, by these Regulations –

    (a) shall not affect any direction given by the Bank, any investigation undertaken, or disciplinary, sanctioning or enforcement action undertaken by the Bank or any other person, in respect of any matter in existence at, or before, the time of the revocation, amendment or substitution; and

    (b) shall not preclude the taking of any legal proceedings, or the undertaking of any investigation, or disciplinary, sanctioning or enforcement action by the Bank or any other person, in respect of

any contravention of an enactment (including anything revoked, amended or substituted by these Regulations) or any misconduct which may have been committed before the time of the revocation, amendment or substitution.

Signed for and on behalf of the CENTRAL BANK OF IRELAND

on [insert date]

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PATRICK CASEY,
Registrar of Credit Unions

EXPLANATORY NOTE

(This note does not form part of the Instrument and does not purport to be a legal interpretation)

The purpose of these Regulations is to amend the Credit Union Act 1997 (Regulatory Requirements) Regulations 2016 (S.I. No. 1 of 2016).