# RESPONSE TO CONSULTATION PAPER 125

# CONSULTATION ON POTENTIAL CHANGES TO THE LENDING FRAMEWORK FOR CREDIT UNIONS

## Overview:

Link Credit Union (LCU) Ltd welcomes the opportunity to make a submission on "CP125 Consultation on Potential Changes to the Lending Framework for Credit Unions".

LCU is a community Credit Union based across two counties, namely Cavan and Meath. We currently serve over 17,000 members and have assets in excess of €97m, with a loan book circa €19m. The provision of loans to our members is a core function of our credit union.

In summary, the changes proposed by the central bank are as follows:

i. Removal of the 5 year & 10 year maturity limits contained in Regulation 14 of the 2016 Regulations;
ii. Introduction of a maximum loan term of 10 years for unsecured lending;
iii. Introduction of a combined concentration limit (expressed as a percentage of total assets) for house and commercial lending for all credit unions on a tiered basis;
iv. Re-name and re-define the commercial loan category; and
v. Introduction of a prescribed large exposures amount for credit union lending.

Whilst we welcome the opportunity to provide our feedback, we are extremely disappointed by the content of the consultation paper, particularly the area of setting a maximum maturity limit for personal lending of 10 years.

We would also like to state that we felt the timing of the consultation paper was unfortunate, being issued late in October 2018 when credit unions were going through year-end and AGM, with a submission date of 9th January 2019, given the importance of the paper and the critical function that lending plays in the credit union movement.

## Impact on Link Credit Union

In order to assess the impact of the proposals, analysis was carried out using year figures at 30th September 2018.

LCU's loan portfolio is likely to be impacted in a number of ways if the proposals outlined in CP 125 are implemented.

1. **Removal of maturity limits**

We note that the CUAC Implementation Group in their Final Report proposed "that consideration be given to increasing the greater than 10 year limit to 25-30% of the loan book or 10-15% of assets, whichever is higher, with an expectation that these limits could be reviewed as the long-term loan book matures and the credit union sector demonstrates its capability".

2. **Concentration Limits**

Under current legislation:

- Concentration limits for commercial loans cannot exceed 50% of regulatory reserves.
- There is no concentration limit contained in the regulatory framework for house loans.

Proposals included in CP125 in relation to concentration limits for house loans and commercial loans would be as follows:-

| |
|---|
| Commercial – no more than 5% of Total Assets |
| House – no more than 5% of Total Assets |
| Combined limit of 7.5% |

So under the proposals in CP125, LCU's concentration limit for commercial loans reduces by over 10% and a concentration limit in relation to house loans is now introduced.

In relation to the combined concentration limit, LCU does not agree with the proposal to combine concentration limits for two very distinctive and very different loan categories.

In relation to house loans, a limit of no more than 5% of total assets corresponds to a relatively small number of loans, which we would only be able to offer to less than 0.5% of our membership.

If we were to aim to issue only [redacted] or the monetary equivalent in smaller value loans, we would have utilised this concentration limit between years 5 & 6, as can be seen in the table below:

| Year | Individual Loan Value | Number of Loans per Annum | Opening Balance | Value of Loans Issued | Home Loan Repayments | Closing Balance |
|---|---|---|---|---|---|---|
| [redacted] | | | | | | |

**Assumptions:**

All loans issued for 20 years. Only capital numbers included below.

Given that we have over 17,000 members, this does not allow us to consider going into this market in any meaningful way, as we would not be able to market and offer this service to all members.

We would suggest that it is more appropriate to introduce a separate concentration limit for house loans, and be set at a minimum of 10% of Total Assets. This would allow LCU to issue approximately [redacted] in a phased approach over a 10 year period, and allow us to grow this loan category over time in a prudent manner.

| Year | Individual Loan Value | Number of Loans per Annum | Opening Balance | Value of Loans Issued | Home Loan Repayments | Closing Balance |
|---|---|---|---|---|---|---|
| [redacted] | | | | | | |

**Assumptions:**

All loans issued for 20 years. Only capital numbers included below.

We view the option of providing house loans to our members, as an additional product line to complement our existing suite of products.

## Responses to the Central Bank's Questions

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)?**

LCU welcomes the removal of the maturity limits contained in the 2016 Regulations, (which restrict the maximum amount of loans which may be outstanding for periods of greater than 5 years and greater than 10 years at 30% and 10% of gross loans for 5 and 10 year maturities respectively, with increased up to 40% and 15% respectively where CB approves), when considered in isolation from the other proposed changes included in the consultation paper. However, consideration should be given to the responses below on other areas, which will be addressed separately.

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

LCU does not agree with this change. Currently, the maximum maturity limit contained in the 2016 Regulations for all lending is 25 years. This proposed change would severely limit credit unions business, specifically in relation to large home improvement loans, where first legal charge rests with another financial institution. In relation to the 25 year maturity limit and specifically with regard to house loans, this does not leave the credit union on a level playing field with banks, who are able to offer house loans for longer periods.

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

LCU consider that the definition of a "Secured Loan", specifically with regard to a first legal charge on a property, thereby excludes the potential for a second legal charge where there is sufficient equity available in relation to large home improvement loans.

In relation to a pledge of shares or an assignment of a deposit, will the proposed regulation stipulate the level of shares, i.e. total loan balance covered by shares or a percentage of the value of the loan (i.e.to ensure that there is clarity as to the treatment of a loan partly covered by shares)

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

LCU does not agree with this change and would recommend that the provision contained in the 2016 Regulation remain in place.

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

LCU agree with the Central Bank's intention to introduce board appropriate reporting requirements for house loans.

### 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?

LCU do not agree with the Central Bank's proposal to introduce a base combined concentration limit for house and commercial loans of 7.5% of Total Assets and doesn't understand the logic for combining these two categories.

### 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?

LCU agrees with the proposal to limit the maximum amount of **commercial lending** which a credit union may undertake to 5% of Total Assets on the assumption that commercial loans for less than €25,000 do not utilise this concentration limit, but suggests that a review be undertaken on this limit within a three year timeframe to ensure its appropriateness.

LCU do not agree with the proposal to limit the maximum amount of **house loans** which a credit union may undertake to 5% of Total Assets and feel this is totally inadequate to allow credit unions to properly and meaningfully provide this as a product line which they can market to their members.

LCU also note that included in the consultation paper is reference to the fact that "the Central Bank's intention to state in the regulations that buy to let residential lending and buy to let commercial lending is prohibited under the lending framework for credit unions. Please note that LCU do not agree with this prohibition on lending for buy to let properties and consider that the credit union should be able to decide if this is a loan category that they feel would be appropriate.

### 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?

LCU agrees in principle with the proposal to permit an increased 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.

However, LCU believes that applications should not be based on the size of the credit union, but rather on the credit unions ability to demonstrate the necessary financial strength, skills, expertise, operations and risk management capability to undertake increased lending in these loan categories, regardless of asset size.

However, as previously stated, LCU do not agree with the combined concentration limit for house and commercial loans.

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

LCU considers the following necessary to support increased lending in house and commercial loans:

- Robust risk assessment, together with a cost/benefit analysis of this loan category;
- A clearly defined credit policy, which covers the key lending criteria and best practice in relation to longer term lending; and supported by clear procedure notes on credit assessment.
- A clearly defined asset/liability management policy, covering the impact that longer term lending may have on liquidity;
- 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 previously stated, LCU do not agree with the combined concentration limit for house and commercial loans in the first instance.

However, LCU feel it may be appropriate to have a proposed increased limit for house lending, 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. (This is considered to be separate from a proposed limit for commercial lending)

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

LCU agrees in principal with the process mentioned in CP125. However, it would be useful to have a more in depth understanding and knowledge of the process before further comment could be made.

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

LCU agrees with the proposed re-naming of the commercial loan category to small business loan.  However, as previously mentioned, LCU do not agree with the proposed change that all small business loans (as they would be referred to) would utilise the proposed concentration limit for commercial lending, and would recommend that the provision contained in the 2016 Regulation, whereby loans of less than €25,000 do not utilise the concentration limit for commercial (small business) lending remain.

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

The proposed definition for small business loan "a loan made for the purpose of financing the working capital or capital investment needs of owner managed small business enterprise" is appropriate for loans in excess of €25,000. However, LCU feel that this is unsuitable and somewhat excessive for smaller value loans. This also does not take into account where a member has a primary source of income from employment, and where the loan is for "business" purposes, such as part-time farmer.

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?**

LCU does not 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 reserve of the credit union. For community based credit unions, LCU do not believe this to be an appropriate level.

In relation to the appropriate board reporting element of large exposure, LCU agrees in this regard.

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

LCU agree with the proposed transitional arrangement which would allow for any loans which are not in compliance with the amended lending framework to be held to maturity.

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?**

LCU considers that credit unions currently have high levels of liquidity. Based on the current model, at 20% of unattached share, LCU considers this to be adequate presently. LCU are cognisant of the fact the longer term lending will undoubtedly impact ALM into the future and would consider options at this stage.