RTÉ Credit Union - Submission CP 125

Consultation on Potential Changes to the Lending Framework for Credit Unions

RTÉ Credit Union believes the proposed changes to the lending framework for credit unions to be a progressive and positive step which modernises regulations. The proposed changes will assist credit unions to grow and develop a viable long-term business model. RTÉ Credit Union has also proposed some amendments to the proposed changes to the regulations under sections 3, 6 &7.

Significant growth in members savings continues which may pick up pace if interest rates increase in the medium term. Average LTA and Return on Assets ratios (based on personal loan books) are pressurised across the movement. Average loan sizes are low. Investment returns are also often low and virtually non- earning. The proposed changes will assist credit unions develop a sustainable business model incorporating an appropriate proportion of longer-term assets and income which will be diversified and balanced against robust capital.

Credit Unions have a strong track record managing liquidity and maturity transformation. Significant resources are available throughout the movement to manage risk effectively. Diversification strategies have been pursued in investment books in recent years since the financial crash. The proposed changes to the lending framework will allow credit unions to diversify lending appropriately over the longer term (at entry level in the house loan market) and compliment a growth strategy for personal loans.

From a growth perspective, the proposed changes will allow credit unions to engage and penetrate a "new" market for most credit unions i.e. borrowers at the house loan stage of the borrowing life cycle. This new and untapped market includes borrowers amongst key demographics and represents an opportunity to consolidate and grow in a safe manner.

The spare lending capacity and non- earning status of assets in credit unions nationally is of little benefit to society. The proposals for change to longer term lending limits are a positive step by the regulator and represent an opportunity to increase the relevance of credit unions as an Irish institution.

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)?**

   Removal of the 5 year and 10-year lending maturity limits contained in Regulation 14 of the 2016 Regulations is a good idea which will prove beneficial to credit unions once capacity under the new limits can be harnessed in an appropriate manner. The existing regime limited such lending regardless of assets and reserves. The existing regime was also overly restrictive and constraining and did not encourage diversification of cash flows. At the upper end the limits of 40% (loans over 5 years) and 15% (for loans over 10 years) was still too low and did not encourage viable investment and development in such longer-term assets. Under the existing regime and due to the restricted headroom unforeseen write offs (or number of write offs) of house loans could have a disproportionate impact on the financial position of credit unions (particularly small and medium) and may have caused significant issues.

The move to an assets basis is appropriate as limits are calculated based on a benchmark which considers size of credit union and considers loan and investment book. The assets basis also suggests and indicates access to resources and scale.

The scope, capacity and restrictive nature of the existing regulations could impede some credit unions develop a more appropriate business model as providing a small proportion of loans on a long-term basis, while absorbing accompanying costs, could not further secure the viability of the traditional credit union business model. As such it is crucial the existing regulations are replaced.

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

It does not make sense for unsecured loans to be offered over a period in excess of ten years as

- the risk associated with such loans and accompanying cash flows grows significantly once this period is exceeded
- extended loan terms in excess of 10 years could be open to abuse for the purpose of disguising loan arrears

The maximum maturity limit of 10 years for unsecured loans is prudent.

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

The proposed definition of a secured loan would include a loan that has a pledge of shares against it. This should state that the pledge of shares should cover a loan in full as has traditionally been the case for such a description, or a defined % of the members liability.

The max 25 yr. maximum loan term maturity should be extended to 30 yrs. Even though the maximum term remains the same and it has been prescribed with Tier 3 AHB investments in mind, no such investments have been yet made by credit unions. If the entitlement to make such an investment (i.e. Tier 3 AHB) was waived/ reduced by a credit union, we propose that the credit union could then be allowed to grant a percentage of its house loan book over a period up to 30 years. This would address any deterrent for members to take a home loan from their credit union and reduce any competitive disadvantage with the banking sector.

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

For transparency it's a good idea. An accumulation of loans under €25k could be quite significant and pose a significant credit risk. If the higher risk profile of such a basket of commercial loans lay undetected and was not factored into the management of such cases it could negatively impact collection and recoveries.

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

Board reporting requirements are essential to ensure effective governance and risk management (e.g. communication with regulators and management, early action on default

etc.) around house loans. Such reporting would also facilitate effective performance management of the business. Increased transparency around loans that will have a completely different risk profile to personal loans will be essential for the primary purpose of protecting members savings. As regards reporting, investment in training, professional staff and IT capabilities will be essential.

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 maturity profile may be similar, but the risk profile is not similar enough to suggest that combined limits are meaningful and appropriate. Ideally separate limits for house loans and commercial loans should be considered. If separate limits for those type of loans were not to be considered, please refer to our proposal in section 7.

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 new measurement basis is a positive development and moves away from the direct link to maturity of loans of a different class/ type.
If a credit union was willing to waive its rights to commercial lending, we propose that the amount that could then be lent on home loans be increased from 5% to 6% of total assets without moving through the application process for increased concentration.

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 proposals make sense for those credit unions who have the necessary financial strength, resources and skillsets (internally or through outsourced partners) to avail of the increased limits safely and effectively. The increased combined limit again further diversifies cash flows and develops the business model for credit unions of appropriate scale and ability to undertake such increased lending in a safe manner.

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

To support increased lending in house and commercial loans a credit union should have (inter alia):

- a professionally qualified and experienced senior management team.
- professionally qualified staff in specific areas such as risk, compliance, investments etc.
- experienced and accredited individuals in credit.
- properly resourced individual & dedicated departments e.g. risk management, compliance, investments, lending and finance.
- robust understanding of risk appetite framework at Board level.
- IT system changes accompanied by robust reporting capabilities.

- proven capability in preparing forecasts (revenue and cost models incorporating long term maturities).
- legal and compliance acumen (e.g. security, foreclosure etc.) for assessing, monitoring and treating risk associated with home loans.
- robust management of outsourced relationships

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

The percentage split of loans in the 15% of total assets included for home commercial lending is not express. This may require clarification.

The increased combined limit again is a good idea for those credit unions with the appropriate resources and ability to undertake such increased lending in a safe manner.

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

The application process for material new products/ services/ consolidation activities is reasonably standardised. Credit Unions who wish to make an application for increased concentration limits will be of a scale where they have experience in preparing such applications.

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

Yes, we agree with the proposal to rename the commercial loan category to small business loan.

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

The new title brings more clarity to the loans of this type which credit unions will be allowed to provide. The new term of “small business loan” provides guidance in itself and is an improvement on “commercial loan”.

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?

The introduction of a prescribed large exposures amount for credit union lending is a good idea as it increases transparency and reduces risk effectively by tracking large exposures in a prudent manner. The new metric is appropriate, and it is a positive that it is linked to regulatory reserves.

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

The transitional arrangements are appropriate.

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?**

    On liquidity and broader ALM considerations:

- Robust capital reserves and liquidity must be in evidence where credit unions express such an interest.
- Finance, operational and risk & compliance professionals will have to be available/ employed by credit unions.
- Robust liquidity management must already be in evidence. As the Basel requirements are already met by all credit unions, we agree that the current liquidity framework for credit unions is fit for purpose. The impact on liquidity management of locking funds away over the longer term and short-term cash inflows/ outflows (e.g. and how they interact with a growth strategy for personal loans) will require expertise.
- Risk management resources and appropriate specialisation must be in evidence. Risk management must be embedded to the extent that it interacts with credit, investments and finance effectively. Significant changes to financial risk, credit risk, liquidity risk, operational risk and compliance risk (e.g. EU directives and regulations, Central Bank mortgage measures) levels associated with the provision of home loans must be assessed and mitigated effectively.
- In relation to risk appetite, Boards must be aware and conscious of risk they are taking on and resources required for effective ALM in relation to commercial and house loans.
- The impact and consequences of enhanced ALM (e.g. investment in necessary skillsets, funds being tied up on a long-term basis, foreclosures etc.) must be considered in the Strategic Plan.
- Enhanced reporting and IT capabilities will be essential for effective ALM. Investment will be required. IT partners must deliver.
- A broad understanding at Board and senior management level of legal risk and the management of "new" assets (such as property in the context of enforcement of security and subsequent sale) and any associated reputational risk.
- Internal skillsets to manage balance sheet transformation will be a necessity. Boards must be willing to acknowledge and resource expertise in appropriate areas where balance sheet transformation is pursued, and the traditional savings and personal loan model is departed.
- The scale achievable, asset growth, cash flows and demand must be capable of being reliably forecasted. Expertise in producing revenue and cost models incorporating the provision of home and commercial loans with long term maturities will have to be employed or acquired.
- A proven track record in regulatory compliance must be in evidence.
- Controls around outsourcing arrangements must be robust where OSPs are used to assist to in delivering such compliance.

An appetite exists from members of credit unions across the Republic of Ireland to use credit unions for their core financial business. New business opportunities and markets for credit unions are also difficult to access. The proposed changes to the lending framework are an opportunity to develop credit unions further for the benefit of members while addressing both challenges.