CLAREMORRIS CREDIT UNION BALLINROBE

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Registry of Credit Unions,
The Central Bank of Ireland,
PO Box 559,
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9 January 2019

Re: Consultation on Potential Changes to the Lending Framework for Credit Unions (CP125)

Dear Sirs,

We refer to the above document issued in October 2018 and set out our submissions hereunder for your perusal.

Removal of 5 and 10 Year Lending Maturity Limits:

1. This credit union has highlighted its misgivings on a number of occasions with respect to the present regulations which govern lending maturity limits and consider the proposal to amend and reflect as a percentage of assets to be a progressive one.

However, the proposed concentration limit of 7.5% of total assets with respect to House and Commercial Loans, designed in part to replace the present regulation, is deeply conservative with the proposed concentration intended for each individual classification even more conservative.

It would appear the proposal is designed to permit credit unions to tinker marginally at the edges of Commercial and Homeloan lending without ever allowing for any genuine loan book growth opportunity.

For many credit unions, including this one, the new proposed concentration limits will actually render a situation where we have less funds to satisfy Commercial facility seeking members that present capacity levels.

The paper informs on the increased combined concentration limits for house and commercial loans for approved credit unions to 15% of total assets. The paper is silent however on whether the 5% concentration level for house and commercial loans would be doubled to 10%, where a credit union is approved for the higher concentration limits.

The paper also appears silent on whether another application process would be required for credit unions which have received approval for the current longer term higher limits of 40% & 15% with respect to seeking the increased concentration of up to 15% of total assets.

Maximum Loan Maturity for Unsecured Loans:

2. This credit union has no difficulty with the proposed maximum term of 10 years for unsecured lending. This proposal makes perfect sense and is in line with requirements in other financial institutions.

3. The proposed definition of a secured loan as set out in CP125 is unsatisfactory. The pledged shares option and assignment of deposit require additional information and some 'fleshing out'. Do the pledged shares and/or assignment of deposit need to be of the same level as the loan being advanced for instance?

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We would also contend and as an aside, that the issue of attaching/pledged shares hinders the discipline of lending rather than assists. A loan should be judged on its own merits rather than the consideration of a lesser exposure when attaching shares are considered. It is our opinion lending decisions would be of higher quality if attaching shares were removed from the equation completely.

Concentration Limits for House and Commercial Loans:

4. This credit union would contend that the 2016 Regulations in respect of Commercial facilities issued for less than €25,000 not utilising the concentration limit is quite satisfactory and should not be amended and for the following reasons;

- Commercial facilities issued for less than €25,000 are hardly worthy of consideration as Commercial facilities in the first instance and which more than likely informed the reasoning behind the 2016 Regulations.
- Should facilities such as these present repayment difficulties, these can still be managed with relative ease to conclusion, given the scale.
- Capturing these relatively small facilities under the concentration limits proposed, only serves to restrict the credit union's capacity to serve such members even further.
- Though not requested by question 4, the requirement for business plans and detailed financial projections for any facility not less than €25,000 is simply not appropriate in many instances and should be reconsidered as part of this process. We have no issue with those requirements for larger facilities but requesting such information for a €26,000 facility and depending on the loan purpose, is heavy touch regulation without much being gained in the process and mitigating unfairly against the credit union sector to the benefit of the Banking world.

5. We have no issue with the proposed Board reporting on House Loans, have undertaken since the 2016 Regulations from a best practices viewpoint and consider this proposal to be quite good sense.

6. We have commented on this issue also at point 1, please see above, but in summary;

- The proposed base combined concentration limit for house and commercial facilities of 7.5% of total assets is far too conservative for those credit unions which wish to offer these facilities to their members.
- The proposed intention will actually render some credit unions with less capacity than present to serve member needs. The existing regulation and legislation regime as conservative as it is, would in fact be preferable to that proposed, though on the face of it and on initial reading, appears more progressive.
- The only conclusion one can ascertain from that proposed, is a firm Central Bank intention to limit credit unions almost solely to the personal loan market, by which it is virtually impossible to build a quality book, increase loan to asset ratio, increase this income stream and furthermore actually threaten the sector's continued viability.
- We appreciate the Regulators responsibility is to the entire sector, however many credit unions do not have an appetite for commercial facilities. Those that do and can demonstrate the skills, underwriting ability and satisfactory risk management procedures should not be restricted because this classification is not utilised by the entire sector.

7. As with question 6, the proposed concentration limit is far too restrictive and conservative. There are only 4 other more conservative option CBI could have opted for, namely 4, 3, 2 & 1. There appears no rationale why 5% has been chosen rather than for example 12.5%, which is still a relatively low concentration.

- Given CBI have finally issued CP125 and are of the mind to genuinely if belatedly bring some logic to the lending maturity side of things, it would seem a terrible shame to see the process mired in abject conservatism from the very start.

- Proposing such a restrictive figure would suggest tokenism for the credit union sector which is extremely well reserved and cost the state virtually nothing when compared to the esteemed Banking world.

8. We are fully in support of this proposal with respect to increased combined concentration limits for house and commercial facilities for credit unions who can demonstrate capability to undertake such lending.

We would add however that the individual limits with respect to house and commercial in both the 7.5% & 15% of total assets scenarios should not be less than the overall limit, which simply adds an unnecessary monitoring requirement in an seemingly illogical manner.

Credit Unions in urban areas may have higher demand for house loans while those in more rural areas may have more demand for commercial/Agri facilities. A broad and crude 5% (or10% if applying to the higher concentration level of 15%) seeks to remove the satisfaction of local demand from each individual credit union. Applying the overall 7.5% or 15% concentration limit is satisfactory in its own right rather than having additional and lower individual concentration limits for house and commercial facilities.

9. There are many various skills, expertise and capabilities needed to undertake lending in the first instance, whether for the present regulatory backdrop or indeed for 'increased lending' as set out in the question, which would include and not necessarily limited to;

- **Governance** – Any institution engaged in the business of lending should be well run at all levels with clear concise polices, standard operating procedures and processes to guide all aspects of lending, from inception to drawdown and beyond.
- **Strategic** – The risk appetite for each credit union and the appetite for credit related risk should be clearly outlined in addition to regular monitoring and reporting to Board. All Officers involved in strategic planning and thinking should clearly understand and be content with the chosen levels of risk.
- **Underwriting** – Officers should be suitably qualified and experienced, that almost goes without the need to state. Credit Officers should also be skilled and experienced in the art of understanding, taking and perfecting of any related loan security.
- **Arrears Management** – Arrears and loan distress are an inevitable consequence once the discipline of lending is engaged with. Officers concerned with this discipline also should be suitably qualified and experienced and guided by well informed policies and procedures. Arrears should be proactively managed and supported by timely and accurate reporting.
- **Provisioning** – Clear and concise policy should guide in line with Regulatory requirements.
- **IT Software** – A fit for purpose mainframe IT system should be retained in addition to supporting software which assists the underwriting process. The latter in early 2019, is most likely a standalone software and currently not satisfactorily comprised within the systems of the main IT providers to the credit union sector.
- **Risk Management** – Encompassing all of the above policies in addition to regular testing, monitoring and reporting. Regular loan reviews should be contacted both in-house in line with best practise together with occasional external independent reviews.

10. See comments in sections above which fully reflect our submitted points in respect of this question. A 15% of total assets concentration limit is certainly better than the base limit of 7.5% which is extremely conservative and restrictive.

11. It is somewhat difficult to make a submission with respect to this question, however, please see as set out below some of the concerns we would have in this respect;

- Credit Unions with total assets of less than €100m very possibly have invested in skills and resources in order to be in a position to offer commercial and house loan facilities. It would seem manifestly unfair to exclude

such credit unions from an application simply on the grounds of asset size, which does not reward initiative, skills, good governance and competent risk management.

- The application process would, following assimilation of that expressed in the CP125 document, appear to be quite arduous when the various capabilities of most credit unions are well known to the Central Bank after some years of PRISM engagements etc.

- We trust the application process will enjoy relatively quick turnaround times which may not have been the case with applications to date.

- The phased approach to the utilisation of increased capacity over the economic cycle as logical as that sounds may not always be in the best interest of the credit union sector or individual companies within the sector. While the country is a relatively small one, regional disparities do exist, what applies in the Capital or larger urban areas may not be that applying in more rural areas.

Definition of Commercial Loans:

12. The Central Bank would appear adamant in its belief that credit unions should continually be positioned in the '**small**' market. While credit unions continue to focus on the primary and core market of smaller consumer lending, it is our opinion that those which have the appetite for, and the skills to manage higher value lending should be accommodated to do so. Continually pidgeon-holing the sector as being the sector which can accommodate '**smaller**' facilities is manifestly unfair and discriminatory, particularly for the credit unions which have substantially invested in all aspects of their business to undertake and underwrite Commercial facilities.

We cannot think of any good reason to re-name nor why this might be included in the CP125 document in the first instance, nor indeed what will be accomplished by re-naming the classification at all, other than the reinforcement of the sector only being fit to undertake '**small**' facilities.

Therefore, we see no good reason why there should be any re-naming of this loan classification and would be very passionately opposed to the proposed re-naming.

We have set out above, our reasons why smaller facilities of less than €25,000 should not utilise the proposed concentration limits. The present 2016 Regulatory regime is more than fit for purpose in this respect, has not presented any undue problems and most certainly should be retained.

13. Though and as set out in (12) above, we are opposed to the proposed re-naming of this loan classification, the accompanying proposed definition would appear reasonable.

However, the terse two lines ''*As outlined above, the Central Bank intends to state in the regulations that buy to let residential and buy to let commercial property lending is prohibited under the lending framework*'' is staggering to put it mildly.

- The Central Bank has not seen fit to explain its logic (if any) with respect to the prohibition.
- Lending of this nature can perhaps be seen to carry more risk compared to House Loan lending. Loans issued for this purpose presented problems at an earlier stage and of higher proportion in the recent financial crisis. However, it is our unshakeable belief that these problems were caused fully by extremely poor lending practises in the Banking sector, which ignored proper underwriting and good governance factors and potentially have given lending of this nature a bad name.
- Lending of this nature is an important niche area and can be an excellent loan product for the right candidate, when properly underwritten and stress tested, where security has been properly perfected and where property prices and rent yields are at a historical proper norm, unlike the credit boom fuelled prices of a number of years ago.

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- [redacted]
- Excluding lending for quality cases within this classification is to ignore logic itself, is to apply extremely heavy touch regulation and simply mystifying, in the absence of any logic being expressed by the Central Bank.
- Enforcement of security taken for this loan classification is far more straightforward than enforcement of House loan related security, should this action be required.
- This credit union does not actively market such product but it is reassuring to believe it can be offered for the right candidate and certainly as good as any other lending classification, once properly underwritten and managed.

We sincerely urge the Central Bank to reconsider this proposed course of action with respect to buy to let properties.

Large Exposures:

14. We are supportive of the proposals with respect to large exposures.

Transitional Arrangements:

15. We have no issue with proposals in this respect and are supportive.

Liquidity and ALM Considerations:

16. Without question, ALM issues and considerations have been exacerbated in the credit union sector, given the trend towards longer term investments with respect to worthwhile yield in the past number of years and the growth in member savings for a variety of reasons.

The above has naturally lengthened the asset side of the balance sheet while higher savings have increased the short-term nature of the liability side, thus further highlighting the potential mismatch. Increased longer-term lending may well further exacerbate the present situation.

Some very obvious management mechanisms which could be introduced to mitigate the risk are substantially hampered by the present and ever-lasting 'super-low' interest rate backdrop, one we may add not caused in any manner by the credit union sector.

While additional longer-term lending may further highlight the mismatch, it is important to note that it has taken this credit union almost two (2) years to increase the percentage of lending > 5 years by a mere 7% and we have been hugely successful to date building a commercial book.

As noted by the Central Bank, liquidity ratios and asset quality in the credit union sector are high. Loan churn rates despite the trend towards increased longer-term lending remain high, further underpinning the liquidity of the sector.

Conclusion

That the Central Bank has finally chosen to review this strategically vital area for the sector is to be welcomed. Many of the proposed changes however are rooted in overarching conservatism which will be very much to the detriment of the credit union sector and indeed adds to the very challenges faced by the sector. There are simple amendments which can be implemented to ensure the credit union sector enjoys somewhat of a more level playing field when compared to our competitors. It should also be remembered that one of the main core lending products enjoyed by the sector encounters direct competition from a completely unregulated product i.e. PCP Finance.