

Submission to the Central Bank of Ireland

**Re: Public Consultation on Enhanced
Governance, Accountability in Financial
Services
Consultation Paper 153**

Background

CUDA (the Credit Union Development Association) welcomes the opportunity to make a submission on behalf of its member credit unions to the public consultation by the Central Bank of Ireland in respect of the proposed application of the Individual Accountability Framework on the credit union sector.

As a representative body and development association for many of Ireland's largest and most progressive credit unions, CUDAs membership is supportive of a consumer-focused culture. Credit Unions operate under a culture and ethos of service to their membership. This ethos is enshrined in legislation that safeguards the economic, social and cultural well-being of its members as well as their communities¹. It is this ethos and culture, together with their cooperative business model that make credit unions naturally aligned with the principles of a people-first approach. The value that credit unions bring to Ireland is rooted in the co-operative model. This model operates by a set of principles that apply to all co-operatives whether the co-operative offers financial services or farming supplies. These principles have distinguished credit unions from the commercial banking system in Ireland.

Credit unions are professional organisations providing professional services, however we believe it is important to highlight these overarching principles of credit unions as they are at odds with the findings in 2018 Central Bank's Report on behaviour and culture in the Irish Retail Banks². The Report found that two important prerequisites for successful transformation towards a consumer-focused culture were not met in all instances. These were:

- A collective understanding of what consumer focus means and what behaviour it requires.
- An embedded consumer focus in structures, processes and systems.

Following the Report, the Central Bank noted:

“Culture is set from the top down. It is a matter for boards and senior management, in the first instance, to set an effective culture that places the best interests of their customers first. Banks still have a distance to go to live up to their slogans of putting customers first.

Effective organisational culture builds on shared purpose and standards such as professionalism, honesty, integrity and accountability to deliver fair outcomes that have the interests of consumers at heart. The Central Bank expects to see such standards and values embedded in all the firms we regulate”³.

The standards set out here as voiced by the Director General are already embedded in credit unions. Democratic control translates to governance that resides in the community and represents, as much as possible, each member's needs in the

¹ Credit Union Act 1997, Section 6(2)

² Behaviour and Culture of the Irish Retail Banks July 2018

³ Derville Rowland, Director General Financial Conduct commenting on the findings of the Report.

community or workplace serviced by their credit union. Member economic participation enables members to share in the surplus generated by the credit union. Since their inception, credit unions have paid millions of pounds, punts and now euro in patronage and/or dividends to members⁴. Section 6(2) of the Credit Union Act 1997 (as amended) determines the objects of a credit union, namely:

- 1) the promotion of thrift among its members by the accumulation of their savings;
- 2) the creation of sources of credit for the mutual benefit of its members at a fair and reasonable rate of interest;
- 3) the use and control of members' savings for their mutual benefit;
- 4) the training and education of its members in the wise use of money;

It is simply incorrect to suggest that credit unions do not already understand what consumer focus means.

We are aware of the deletion of Section 18(2), Central Bank Reform Act 2010⁵ and the Supreme Court ruling in *Zalewski v. An Adjudication Officer & Others* [2021] IESC 24, however CUDA would caution against the over-layering of regulation on a sector already understand about the importance of a consumer focused approach and are already meeting appropriate standards. In our response below, we set out our reasons for opposing: -

- the application of the Common Conduct Standards and the Additional Conduct Standards on the credit union sector,
- the certification process for volunteers working in the financial service sector, and
- the reporting of disciplinary actions to the Central Bank for individuals that do not fall within SEAR.

Finally, at this juncture, it is important to note that we agree that the application of SEAR does not extend to individuals in the credit union sector. We also note the recommendation of the Joint Committee on Finance, Public Expenditure and Reform and Taoiseach that the Central Bank report on the possible inclusion in SEAR of the entities proposed to be excluded (including credit unions) within one year of commencement of the IAF Act⁶. CUDA is opposed to the inclusion of credit unions in the application of SEAR for reasons set out above and we are happy to provide further observation of this should it be required.

⁴ Patronage refers to the payment from the surplus generated by a credit union by way of rebating of interest paid, non-charging of transaction and administrative fees or by way of community development contribution.

⁵ As per Section 7, Central Bank (Individual Accountability Framework) Act 2023

⁶ Joint Committee on Finance, Public Expenditure and Reform and Taoiseach Report on Pre-Legislative Scrutiny of the General Scheme of the Central Bank (Individual Accountability Framework) Bill 2021 33/F/7 April 2022 Recommendation 1

Submission

In our Submission, we respond to questions which are relevant to the credit union sector.

What are your views and comments regarding the guidance on the Common Conduct Standards and Additional Conduct Standards? (Q12)

Key points

- Credit Union should be exempt from the Conduct Standards.
- CUDA is not in favour of the one size fits all approach that does not take into account the size of organisations, their business model or the dependence on volunteers.

Detailed response

Credit unions are committed to ensuring they operate in a professional and compliant manner, with competent and trained staff and volunteers.

We appreciate the framework seeks to strengthen the pre-existing compliance regime through the imposition of a common conduct standard on individuals performing controlled functions for Regulated Financial Service Providers (“RFSPs”), alongside additional conduct standards for individuals in positions of authority (and more general business standards for RFSPs), however we do not agree with a one size fits all approach.

Credit unions comply with Fitness and Probity requirements. To prevent a disproportionate application of the regime, these requirements were specifically designed for credit unions taking into account both their business composition and low risk model⁷.

In 2013, two CFs were prescribed for credit unions⁸:

- a function in relation to the provision of a financial service which is likely to enable the person responsible for its performance to exercise a significant influence on the conduct of the affairs of a credit union (CUCF-1⁹);

⁷ The Central Bank of Ireland is responsible for the regulation and supervision of credit union. Under Section 84 of the Credit Union Act 1997, the functions of the Central Bank are to administer the system of regulation and supervision of credit unions with a view to the:

- Protection by each credit union of the funds of its members; and
- Maintenance of the financial stability and well-being of credit unions generally.

As part of this role the Central Bank has created a regulatory framework which sets limits on lending and investments, and specific requirements on liquidity and reserves.

⁸ S. I. No. 171 of 2013

⁹ Note: throughout the draft Guidance, it references CF roles as eg CF1. As per Regulation, each role in the credit union sector is CUCF (or CUPCF accordingly). There is not a one size fits all approach to Fitness and Probity.

- a function in relation to the provision of a financial service which is related to ensuring controlling or monitoring compliance by a credit union with its relevant obligations (CUCF-2).

Two PCFs were also prescribed under the same Regulations:

- the office of chair of the board of the credit union (CUPCF-1); and
- the office of manager of the credit union (CUPCF-2).

In 2015, an additional 9 CF positions were prescribed for credit unions that are also authorised as retail intermediaries¹⁰.

And, in 2018, 3 additional PCFs were included for credit unions that have total assets of at least €100 million¹¹, namely Risk Management Officer (CUPCF-3), Head of Internal Audit (CUPCF-4), and Head of Finance (CUPCF-5).

This staggered and proportionate approach is appropriate for the credit union sector when taking account of the unique nature of the business model. The Central Bank also issued sector specific Fitness and Probity Standards¹².

Bringing credit unions within scope of the proposed Common Conduct Standards and Additional Conduct Standards is disproportionate. The Central Bank has not taken into account their business composition and low risk model. The draft Guidance has also failed to differentiate between credit unions and other commercial banks. Whilst the draft Guidance talks about proportionality, it does not give any indication what this means or what the reasonable expectations are for any given sector. We address other concerns with regard to proportionality under the ensuing Question (Q13).

Unlike the 2018 Report on Irish Retail Banks (referenced above) we have not seen a report or any analysis carried out in the sector. Should it be deemed necessary to introduce Conduct Standards and an individual accountability framework for the credit unions sector it requires a sector specific approach similar to the introduction of fitness and probity.

The need for applicable standards of behaviour for large retail and investment institutions is well accepted by people who lived and worked through the financial crash. That said, by setting out a single set of applicable conduct standards of behaviour which will apply to relevant individuals in all RFSPs, irrespective of the financial sector in question, or the measure of conduct risk, or its application on volunteer led and community focused organisations will also present significant unintended challenges.

¹⁰ S. I. No. 97 of 2015

¹¹ S. I. No. 187 of 2018

¹² Fitness and Probity Standards for Credit Unions (Code issued under Section 50 of the Central Bank Reform Act 2010)

a) Board Room Retention

While we would not expect any officer to intentionally breach any of the standards, there may be a perception among some that it could happen unintentionally. The perception of even a potential impact (resulting in the application of an enhanced ASP and proposed mandatory reporting) on volunteer Board members may further hinder recruitment and retention of volunteer Directors, which is already highly challenging for credit unions. The role of the Chair – also a voluntary role, will be required to take on much of the supervision, administrative oversight and application of the Conduct Standards by Directors. A role that is already very prescriptive under Credit Union legislation¹³.

Further difficulties and legislative inconsistencies arise with respect to application of the certification process on volunteers and reporting of disciplinary actions against volunteers which we highlight below (in response to Q17). However, it is noteworthy that the Consultation Paper provides no information as to how the proposals may impact volunteers – including volunteer Directors and volunteer Board Oversight Committee members – both volunteer groups being mandatory in the credit union sector. A further concern is that by volunteering and participating in Committees within the credit union could further give rise to the perceived exposure for individuals – leaving credit unions with an additional challenge of finding appropriate Directors that are also willing to sit on Committees – again, a mandatory requirement that such Committees as staffed by volunteers¹⁴.

Volunteer Directors fall under CUCF1 and as a result will be obligated to demonstrate compliance with the higher standard – Additional Conduct Standard. This is also the case for many credit union committees that are deemed to exercise a significant influence over the affairs of the credit union (CUCF1). Volunteers will be required to demonstrate they have taken “reasonable steps” to achieve compliance with the Conduct Standards and meet the Central Bank’s expectations in relation to the Conduct Standards. Therefore, it is clear to us that the framework applies a one size fits all without taking into account the impact the Individual Accountability Framework will have on attracting and retaining volunteers and the dependence the credit union sector has on volunteers for its mere survival.

The draft Guidance purports that the “*Conduct Standards will...contribute to the ultimate goals of better outcomes for consumers and a more sustainable financial system*” – we are not so sure that this sentiment is a given in a sector that is reliant on volunteers to ensure the survival of the services to its customers and wider community.

b) Executive Roles Recruitment & Retention

The perceived personal impact may also increase the risk for retention and recruitment of senior and skilled governance personnel. Credit unions are competing with national and international institutions for skilled governance talent. In such institutions there is

13 Section 55, Credit Union Act 1997 as amended by Credit Union and Co-operation with Overseas Regulators Act, 2012.

14 Section 56B(3) and Section 56A Credit Union Act 1997 as amended by Credit Union and Co-operation with Overseas Regulators Act, 2012.

usually a significant remuneration premium attached to rolls with personal regulatory exposure.

The potential increase in perceived personal regulatory exposure as a result of the Individual Accountability Framework and the lack of financial compensation for same, could make an already challenging recruitment and retention situation significantly more so for these key governance roles.

Unfortunately, the cumulative impact of the ever increasing direct and indirect cost of complying with new regulations, which in our view was primarily designed for national retail banks and international institutions, is putting that which makes credit unions central to their communities at risk. As noted in our introduction, due to the nature of their socially responsible and community focused business models, credit unions are generally not in a financial position to match the remuneration packages available from the national retail banks, or other financial services firms, particularly for senior rolls impacted by the Individual Accountability Framework. This is most clearly evidenced in the average Cost to Income (CTI) ratios of retail banks (approx. 50% to 65%) to that of credit unions (approx. 90%+).

There is also a concern that some roles in credit unions such as chief executives, internal audit, risk and compliance, could opt to leave the financial service sector, especially where regulated entities must report disciplinary action.

For credit unions to align their business model to that of the retail banks, in order to cover these escalating regulatory costs, credit unions would need to follow the retail banks operating model of reducing branches, replacing personnel with automated processes and increasing fees. This, in itself, goes against the ethos of a credit union.

Whilst we agree with the draft Guidance that most individuals working in the financial services industry will likely consider the Conduct Standards reflective of the sound values to which they already hold themselves, the Central Bank fails to recognise or acknowledge the administrative application of the new regime on the sector, a breach of which is subject to the ASP. This includes the legal obligations on firms in relation to the Conduct Standards to notify and train staff and to report disciplinary actions arising from breaches of the Conduct Standards to the Central Bank.

We appreciate there may be a need to adopt a standard for firms to operate in compliance with standards of market conduct and trading venue rules. Each credit union's marketing and trading parameters are limited to a membership that is subject by geography or occupation/employment boundaries¹⁵. By generalising the application of the Conduct Standards it does not taken account that in the credit union sector there are already existing and appropriate measures in place that manage conduct risk – such as common bond¹⁶.

¹⁵ Section 6(3), Credit Union Act 1997

¹⁶ Section6(1), Credit Union Act 1997.

Finally, whilst not specifically asked in any of the questions posed in the Consultation Paper, the proposed roll out of the relevant parts of the Individual Accountability Framework on credit unions and the expected implementation timeline would be highly challenging for credit unions. Particularly given that the information is not yet finalised and the final months of the implementation window could clash with the sector's year end reporting and AGMs.

What are your views and comments on the guidance in relation to obligations on the firm in respect of Conduct Standards? (Q13)

Key points

- Whilst the draft Guidance talks of proportionality, there is no guidance on how this will be assessed.

Detailed response

The draft Guidance provides that an important concept in the IAF Act is the taking of reasonable steps by individuals to discharge their responsibilities and duties. The draft Guidance further provides that the concept of reasonable steps should be already embedded in CF role holders' day-to-day actions in managing their areas of responsibility. That said, demonstration of compliance with the new requirements under the Conduct Standards is a considerable body of work.

There is an obligation on RFSPs to establish, maintain and give effect to policies on how the Conduct Standards are integrated into the culture and conduct of the affairs of the firm. As set out in the Certification Regulations, RFSPs are also required to report disciplinary action arising from breaches of the Conduct Standards to the Central Bank. RFSPs will be required to maintain up to date records regarding the notification of the Conduct Standards to the relevant individuals and be ready for review upon Central Bank request. The draft Guidance requires that a RFSPs training programme in relation to Conduct Standards is subject to oversight and challenge by senior management to ensure that the training programme adheres to IAF legislative and regulatory requirements, is adequately embedded into the firm's day-to-day activities, including the performance review process, and identifies areas of enhancement where required.

Given the business composition of credit unions and low risk model (the sector is highly regulated from a prudential perspective and operates strictly within common bond) we are of the view that such requirements on credit unions are excessive and disproportionate. This is an unnecessary use of resources for credit unions. And whilst we fully support a professional and competent sector, the overlap with the already existing Fitness and Probity regime and MCC/MCR is not a balanced approach for the sector. The F&P regime and MCC/MCR ensures that appropriate standards are already in place (for example, the overlap with the new requirement under Section 53E (1) of the 2010 Act as amended by the IAF Act which provides (b) that the person acts with due skill, care and diligence, including (i) having appropriate knowledge of the business activities of the regulated financial service provider).

Furthermore, as set out in the 2010 Act as amended by the IAF Act, in the case of an individual who performs a PCF or a CF1 role, the standard to require credit union

personnel, including directors, to ensure that the business of the credit union is conducted in accordance with its obligations under financial services legislation in already an existing requirement under Credit Union legislation¹⁷.

Do you agree with our proposed approach to temporary appointments within scope of SEAR and the Conduct Standards? (Q14)

It is uncertain whether the approach to temporary appointments within the scope of the Conduct Standards are expected to apply to credit unions. At para 4.21¹⁸, temporary appointments are referenced in the context of Regulation 11 of the PCF Regulations - Central Bank Reform Act 2010 (Sections 20 and 22) Regulations 2011, as amended. These regulations are not applicable to credit unions.

Aside from this ambiguity, the office of chair of the board of the credit union is a PCF role and in a voluntary role. As noted above, any application of the Conduct Standards needs to be duly assessed in the context of volunteers.

What are your views and comments on the draft Certification Regulations and related guidance? (Q15)

Key Points

CUDA does not object to the Certification process for salaried staff, however the timelines fail to take into account the business model and nature of credit unions.

CUDA objects to the Certification process for volunteers – it does not offer a balanced approach for volunteers and is not consistent with existing legislation.

Detailed Response

In general, CUDA has no difficulty with the certification process, as it is aligned with Section 21 of the 2010 Act which prohibits a credit union from allowing an individual to perform a CF role unless the credit union is satisfied on reasonable grounds that the individual complies with the specific standards of fitness and probity issued by the Central Bank for Credit Unions.

However, we have other concerns, which are twofold:-

1) Timelines and Implementation

In meeting compliance within the proposed timelines, we are concerned with the additional requirements set out in regulation with respect to procedures, systems and controls which must be adopted and additional checks that would be required by credit unions. The Central Bank is failing to recognise the business model of credit unions – credit unions do not have the resources or the capacity to undertake the work within the timelines set out in the Regulations. The draft Guidance provides that for firms in scope of SEAR, an individual must be assigned PR3 '*Responsibility for embedding the conduct standards throughout the firm*'. Whilst the day-to-day operation and

¹⁷ Section 55(1)(m) Credit Union Act 1997 as amended by Credit Union and Co-operation with Overseas Regulators Act, 2012.

¹⁸ And also at 2.9.12 with respect to the application of SEAR

management may be delegated to the relevant department(s), one individual must be assigned PR 3. In a credit union this additional workload is likely to fall on the role for the CEO with respect to salaried employees and the role of the Chair with respect to volunteer directors. In order to ensure that the credit union can demonstrate compliance (such as record keeping, training and policies), a two month lead in time is not sufficient. For CF and PCF roles in scope of the certification process, CUDA proposes a lead in time of 6 months from the commencement of the Certification Regulations.

2) Directors and other Volunteers

The role of the Chair of the Board is a voluntary role. The functions of the Chair are set out in legislation¹⁹. It will fall on the role of the Chair to provide the Certificate for members of the Board. The Credit Union Act 1997 already imposes a statutory requirement on the Chair to complete a performance evaluation on an annual basis for each member of the Board and must ensure that the Director is fit and proper and that each Director is complying with its obligations under financial services legislation. The Chair keeps a record of the performance review for each individual. It is our view that this is sufficient without the need for the additional procedures, systems and controls that would have to be undertaken by the Chair under the proposed Regulations. If concerns with the existing legislative requirements have been identified with regard to evaluations of Board members, we would ask that the Central Bank address that concern rather than imposing unnecessary layering of regulations, that fails to reach a balance.

Furthermore, the definition of “Disciplinary action” as set out in the draft Guidance is not consistent with the role of a volunteer director as stipulated by law. Credit unions themselves cannot suspend or dismiss a director or member of the Board Oversight Committee and there is no “reduction or recovery of any of a person’s remuneration”.

Do you agree with our proposed approach to reporting of disciplinary actions? (Q17)
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Key points

- CUDA does not agree with the proposed approach to reporting of disciplinary actions.
- The approach proposed by the Central Bank fails to recognise the role of the volunteer.

Detailed Reply

Taking into account the example of “disciplinary action” in the draft Guidance, we believe it is a disproportionate response by the Central Bank to require the reporting of such disciplinary actions across all regulated financial service providers and across all CF roles.

¹⁹ Section 55A(3), Credit Union Act 1997 as amended by Credit Union and Co-operation with Overseas Regulators Act, 2012.

As noted above the regulatory exposure for individuals across all levels will impact retention of staff in the credit union sector and in the regulated financial service sector as a whole. Disciplinary actions are a matter of employment law with strict rules under GDPR.

We believe that reporting of disciplinary actions should be applicable to individuals subject to SEAR, where the consequences of conduct risk is the greatest and where remuneration already reflects the regulatory exposure.

Volunteer directors and other officers

Furthermore, the proposed approach is not aligned with the role of a volunteer and in this regard it should not apply to credit unions.

The examples in the draft Guidance as to what amounts to disciplinary action eg *“formal written warning, suspension or dismissal, reduction or recovery of remuneration”* is nonsensical where attributed to a volunteer. Furthermore, the suspension or dismissal of a Director is not directly within the remit of the credit union.

The removal of a Director is set out in legislation (Section 66, Credit Union Act 1997, as amended) and as part of the legislative process, the Central Bank must be notified of a suspension of a Director or the calling of an SGM in order to remove a Director. The legislation created the Nomination Committee who is tasked with identifying gaps on the Board with respect to expertise and seek to fill those gaps.

As the Central Bank are already notified under law, the reporting requirements set out under the IAF are an unnecessary and inconsistent layering of regulations and administrative duplication.

Credit unions cannot operate without volunteers, and as noted above under our response to the introduction of Conduct Standards, this framework has taken no account of the unique model of credit unions.

Many thanks for the opportunity of allowing CUDA to respond to CP153. We welcome the prompt and comprehensive approach adopted by the Central Bank following the enactment of the IAF Act. If you have any questions whatsoever, please do not hesitate to contact us.



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