BALLINA CREDIT UNION

SUBMISSION DOCUMENT ON

CONSULTATION ON THE INTRODUCTION OF A TIERED REGULATORY APPROACH FOR CREDIT UNIONS

Section 4.8 – (i)

Do you agree with the proposed tiered regulatory approach for credit unions? If you have other suggestions please provide them along with supporting rationale.

Ballina Credit Union Ltd. does not agree with the proposed tiered regulatory approach for credit unions. The reason for opposing this decision is due to the parameters being suggested for categorisation of credit unions. The proposal suggests a two category approach as opposed to the initial three tier recommendation. Category 1 credit unions will be allowed to offer services similar to those currently in place with category 2 credit unions having the potential to offer a wider range of services. Alongside the level of services allowed to be offered restrictions in place in the areas of lending, savings and investments will be in place. The restrictions in place for category 1 credit unions in these areas are negative and do not encourage growth. It is not acceptable that a credit union with €60m in assets must adhere to that of a credit union with €10m in assets. Lending and investment restrictions may be prudent for a credit union of a smaller scale but in terms of a credit union with €60m these restrictions are restrictive for growth potential. For one credit union that is six times the size of another to be restricted by the same rules is not acceptable. The rules applied to both will have the impact of contracting the larger credit union rather than offering opportunity for growth.

While the initial categorisation will be completed on a phased basis if a credit union is to apply for category two status at a future point applications can only be made annually. This means that a credit union will be waiting for a period of up to one year to progress into category 2 which again will damage the organisations ability for growth in this period.

The tiered approach suggested seems to be heavily based on asset value and does not factor in other aspects. An example of this is Ballina Credit Union, currently with an asset value of €60m, the credit union is currently lent out at 16.36%. As the credit union is €60m under the proposal it will be classified as a category 1 credit union. Currently the credit union needs to rebuild its business model and concentrate on increasing its loans to improve its lent out percentage. However being categorised in level 1 we must agree to the same restrictive lending rules as a credit union with €10m. Ballina Credit Union has money to lend and grow but due to the restrictive rules contained in the proposal it will be limited to whom and for how long it can lend. This results in the credit union being less able to explore new lending opportunities and lengths of lending.

With the rules of category 1 being forced on Ballina Credit Union the ability for growth on the loan book will be hampered. This means that the credit union falls dependent on its investment and deposit income but again the credit union wants to enforce restrictions on these investments. Restrictions that would apply for a €10m Credit Union the same as a €60m credit union. Due to the restricted investment rules Ballina Credit Union will not be able to generate the same level of return. Overall the proposals do not offer opportunity for growth in terms of lending or investments.

Suggestions;

The categorisation of credit unions needs to be further analysed with the potential of extra categories being introduced. A fairer more scaled categorisation process should be put forward, one that will not classify a credit union with assets of €90m similar to that of one with €10m. The proposed category approach only offers to restrict the growth of the credit union with assets of €90m. The concept of categorisation is one that could potentially work within the sector but the parameters attaching to it need to be changed and the governing rules within these parameters more dynamic and flexible for credit unions with larger asset portfolios.

Both the categories and rules governing categorisation need to be expanded. Recognising a €10m credit union similar to a €60m credit union is not acceptable. Further categories need to be added on the classification between categories not just dependent on asset size but consider other factors such as percentage lent out, percentage provisioning, percentage reserves and the ability of the credit union in question to meet the increased regulation in category 2.

For example in the case of Ballina Credit Union that has €60m assets and loans of €9.8m it should be categorised in a more growth optimistic fashion. Stricter lending limits and lengths should not be enforced on it and thus give potential for growing its loan book.

Section 5.12 – (i) & (ii)

Do you agree with the proposals for the operation of the two category approach for credit unions set out in section 5.1 – 5.11? if you have other suggestions, please provide them along with supporting rationale. It should be noted that tiering is possible where regulation making powers are available to the Central Bank. Where requirements are set out in the 1997 Act they apply to all credit unions and cannot be tiered.

Section 5 of the consultation paper sets out the proposals on various categories including lending, investments, savings etc. Ballina Credit Union wish to express the view of disappointment with the proposals. The proposals are not so much geared towards regulation but are instead geared heavily towards manipulating the operation of credit unions. Ballina Credit Union agrees with the concept of regulation and that tiered regulation can be effective but the proposals laid out while they could be argued are regulatory also verge on a form of external management being enforced on credit unions. The new proposed regulations leave little room for individual credit unions to develop their own evolving business model but instead would be basically told in detail exactly what can and can't be done with little room to evolve or grow.

5.2 Lending

Again Ballina Credit Union would recommend that the classification of a category 2 credit union is less based on asset size and instead based on a wider consideration of asset size, reserves, ability to meet increased regulation etc.

The Central Bank states that the vast amount of lending within the credit union sector is for personal loans. This may in fact be the case but with continual dropping loan books it may be time to expand areas of lending and concentrate in areas such as community and business lending. Because the vast majority at present is personal loans the Central Bank propose to limit credit unions in the area of commercial lending. This is an example of external management from the Central Bank rather than regulation. Once prudent lending regulations are in place then there is no argument as to why commercial loans could not form a larger part of the credit unions business model.

In the proposal both Category 1 & Category 2 credit unions can partake in community lending up to a value of 25% of regulatory reserves. This for Ballina Credit Union would equate to a value of €1.675m. The new proposal also suggests category 1 credit unions could also take the same percentage in terms of commercial lending. Again this equates to €1.675m for Ballina Credit Union. In total from these lending types the maximum available to lend in these areas for Ballina Credit Union would be €3.35m. This is based on Ballina Credit Union being classified as a category 1 credit union due to its asset size of €59.8m. Currently holding a loan book value of €9.8m Ballina Credit Union is lent out at circa 16.40%. If the credit union was to reach its maximum community and commercial lending it's lent out percentage would increase to 21.98%. This level is far too low. The proposed limits prove too restrictive and seem more a deterrent for credit unions to enter new lending markets. It is evident in today's economy that commercial loans are in demand and thus this is an opportunity for credit unions if the limits were not so restrictive. Restricting lending limits for commercial loans while imposing increased regulation in issuing these loans seems counterproductive. Surely with increased regulation on commercial lending the limits in fact would be increased. It could be argued that the Central Bank simply do not want credit unions entering this market.

The proposal is also restrictive in terms of lending time limits. With category 1 credit unions only allowed to lend 30% of its loan book in excess of 5 years and 10% in excess of 10 years. This again forces credit unions to continue to operate in the personal loan market as many commercial loans may be in excess of 5 years.

The lending proposal seems to be loosely worded. While it states that for large exposure limits the maximum amount is the greater of €39,000 or 1.5% of total assets it does not state if the Central bank will enforce individual ad hoc limits on credit unions. An example of this is the current lending limit enforced on Ballina Credit Union at €25,000. If the proposal was to go ahead does this mean the new limit of €39,000 will be automatically applied to us or will the individual limit still remain? This is not clearly stated and we would request that a clearer definition of the rules be given.

Overall the new proposal seems heavily geared on pigeon holing credit unions into the personal lending market in a time when statistics show that personal lending and demand is diminishing. Credit unions are in an era of evolving and part of this may require increased community and commercial lending as income sources but this will not happen under the new proposal. Ballina Credit Union suggests that a more dynamic form of regulation is argued by the Central Bank, one that can help the credit union movement evolve into new markets.

In terms of issuing loans to directors and the management team Ballina Credit Union support the proposal of having controls. This is already in place with all officer loans in the credit union being approved by a committee. However Ballina Credit Union strongly opposes the area of restricted person lending. The paper states that a restricted person is one who is a member of the board, management team and family members of the same. In total the Central bank wish to impose an aggregate lending value of €200,000 on all such persons. To break this down, Ballina Credit Union currently has 11 board directors and 4 members of the management team. This is 15 individual excluding other staff, board oversight committee and volunteers. The term family member could incorporate their spouse, brother/sister, children, uncles, aunts etc. Within a small community each individual person will have a large number of family connections. Let's say each of the 15 people in question had 10 connected persons this accumulates to a total of 150 connected persons who can in total have borrowings of €200,000. This is on average €1,333 per individual. This is absolutely unacceptable and only exists to punish volunteers and active members of a local community. The proposal acts to punish those who volunteer their time and treat them as a second class member of the credit union for no legitimate reason.

5.3 Investments

Ballina Credit Union wishes to fully oppose the proposed conditions attaching to the investments. The proposals only offer to restrict current credit unions investments further with no acknowledgement or proposals for alternative investments to be made available to credit unions. Such investments could be in the form of a collective investment scheme for state projects etc.

Currently Ballina Credit Union is highly dependent on investment income as are many credit unions. In times of diminishing demand for personal loans credit unions have fallen reliant on investment income to create surplus and cover additional regulatory costs.

The proposal for category 1 credit unions (off which based on the €100m guideline Ballina will be category 1) are geared at lowering credit unions dependence on investment/deposit income. The removal of the collective investment scheme will be detrimental. Currently Ballina Credit Union must maintain 30% liquidity, due to step up accounts being no longer available then more reliance will be placed on collective investment schemes for liquidity. Currently Ballina Credit union invest in DAVYS collective scheme which pays circa 1%, if funds are forced out of this scheme and high levels of liquidity are to be maintained then the use of call accounts will increase. Such accounts currently only pay between 0.2% and 0.4%, this will have a detrimental effect on our investment/deposit income.

Under the new proposal the Central Bank wishes to limit the amount to be invested in one institution to 100% level of the regulatory reserves. This means that instead of investing in average in the top 4 institutions Ballina Credit Union will be forced to invest in up to 7/8 institutions. Due to this the credit union will be forced to invest in lower yielding foreign banks which again will have a detrimental effect on income.

The proposal wishes to limit category 1 credit unions to an investment time limit of 5 years. With the limits proposed on the amount to be invested the option of state securities becomes appealing to credit unions. However with the proposal laid out Ballina Credit Union would only be able to invest in 5 year government securities yielding 1.93% as opposed to 10 year ones yielding 3.26%. Combining this with the limits of 50% of all investments to be for a maximum period of 3 years the proposals only appear to be set out in a form to restrict credit unions from earning investment income. With falling deposit rates the proposal to make unavailable investments in bank bonds also prohibits credit unions from earning investment income.

Currently under the proposal Ballina Credit Union would have to find alternative investments and institutions for circa €19m of its investment portfolio while keeping €13.3m liquid in 3 month access accounts. Of the €13.3m, €6.67m would have to be liquid in deposits within 30 days. This basically is a recommendation from the Central Bank to have €13.3m liquid in non-earning investments held within the credit union. One can only query the logic behind this proposal, does the Central Bank feel that credit unions are not able to manage their investment portfolios and if so what evidence is there to suggest the same. Again regulation is about setting principles within which an institution operates, but this regulation sets strict and limited rules more so than principles.

An example of the detrimental impact of the proposed regulation is the case of two bank bonds held by Ballina Credit Union. The two bonds accumulate to €4m and earn interest of 3.25% and 2.75%. In total the annual income drawn from these bonds will accumulate to €114,972. Under the proposed regulations category 1 credit unions are prohibited from investing in bank bonds. These bonds would need to be reinvested in deposits with a financial institute that may only offer 1%. This 1% earns income of €40,000 per annum. This is a drop in income for the credit union of €74,972 euro on two single investments totalling €4m. €4m currently accounts for 8% of the investment portfolio. If we increase the 8% to represent a conservative 50% of the portfolio this accumulates to circa €25m. Under the proposals effectively 50% of the credit unions investments will yield rates of circa 1% when currently on average our investments are yielding in excess of 2%. This would be detrimental to the operation of the credit union.

Ballina Credit Union suggest that the rules pertaining to investments for both category 1 & 2 credit unions is widened and set in a more encouraging fashion so as to enable credit unions to integrate investments and income derived from the same into their business models. Ballina Credit Union does encourage regulation in the area of investments but it should be geared more on prudence when investing rather than set out to just restrict investment income for credit unions.

5.4 Savings

The proposal sets out to limit savings held in a credit union to €100,000 or 1% of the total assets of the credit union, whichever is the lower. This seems to be in line with the current government security on savings of €100,000.

While Ballina Credit Union does not fully disagree with this limit and in fact has the same limit currently enforced it wonders as to why the central bank propose such a limit? There is no such limit imposed on other financial institutions that again are only covered by the €100,000 governmental guarantee. Recent results show that saving and share balances are increasing in credit unions and the proposed limit seems geared on stopping this trend rather than being for any regulatory manner.

Surely if a limit is placed on one financial institution it should be place on all. Ballina Credit Union would seek further information as to why the proposal is in place and only for credit unions?

5.5 Borrowings

This is an area that is not of concern to Ballina Credit Union. As laid out in the proposal credit unions are traditionally funded by their members and do not engage in borrowing to any significant extent. The proposal seems to one of a giving nature but is not needed for the majority of credit unions. Perhaps relaxation of other areas of the paper would be a more giving approach.

5.6 Additional Services

Ballina Credit Union feels that the level of services available for offer by credit unions should be increased and as broad as possible. Both categories 1 & 2 credit unions should be allowed to offer full online banking, debit cards, credit cards, mobile banking and full automated phone banking. Such services should be allowed to facilitate the full needs of a member of a credit union from simple EFT transactions to membership set up and loan applications.

5.7 Governance

Ballina Credit Union encourages the area of increased governance. However one area of question with the new proposal relates to Category 2 credit unions in which it states that a board appraisal on performance is carried out every three years. This is worded loosely and does not allude to answering who carries out the review, the implications of such a review and who the review is to be submitted to for review? Currently the board of directors are appraised through the Board Oversight Committee and another undefined review seems somewhat over rigorous. Further clarity on this point should be given.

5.9 Reserves

Section 5.9.2 deals with the proposal for a category 2 credit union to maintain an operational risk reserve. This is assessed and based on the nature, scale and complexity of the credit union. While the proposal wants to cater for different credit unions it seems that ultimately it will apply a one size fits all approach. Placing an additional 2% of assets as a reserve without any full explanation as to how it is calculated it not transparent. Ballina Credit Union would seek that the Central Bank gives greater clarity on the area of reserves including that of regulatory reserves. Credit union reserves and their operation and function need to become more transparent overall. The proposal does not set out the position of a credit union entering category 2 but not offering the full services allowed to it in this category, is this credit union to be hit with a risk reserve although it is technically at that time similar to a category 1 credit union. The proposal seems more based on category than the actual individual credit union.

Ballina Credit Union also suggest that if a new reserve is to be placed on credit union as this is calculated on a risk assessment basis then so to should the regulatory reserve. Can the Central Bank put forward an argument for one reserve to be just set at a percentage and another based on risk assessment? This does not make sense. Central Bank should also clarify the rules surrounding the regulatory reserve and what the reasoning behind a current 10% minimum reserve is? A final point of clarity should be drawn on why if a credit union tries to increase its reserves over 10% it cannot access the excess again in the future. Surely any access of excess regulatory reserves should be carried out on a risk basis and not just a no access basis irrespective of the actual performance of a credit union.

5.10 Liquidity

The area of the extension of what is deemed a liquid asset is applauded and encouraged. However overall the restrictive liquidity percentages combined with the lack of step up investments and inability to invest in collective investment schemes will be detrimental to credit unions. The proposal does not mention about individual credit union restrictions on liquidity. Is the category 1 & 2 percentage levels to apply to all credit unions within those categories or will ad hoc individual percentage levels on top of the proposed ones be place on credit unions. This areas needs to be clarified.

Currently Ballina Credit Unions liquidity is in the region of 40% and as a prudent measure it is held over the required amount of 30%. However with no step up deposits available to the credit union it has to reconsider how it invests in terms of liquidity to maximise interest income. With the new proposals the credit union will be completely restricted on its ability to maximise interest return. Ballina Credit Union have a 30% liquidity requirement enforced on it, with the new proposal will rate be dropped to 20% automatically? This needs to be clarified.

If Ballina Credit Union is forced to maintain liquidity level of 30% this means that a total of €13.34m would need to be kept liquid. Removing the option of step ups and collective investment schemes will basically mean that €13.3m of funds within Ballina Credit Union will be non-income generating.

Ballina Credit Union suggests that further explanation and emphasis is placed on the area of liquidity. Any proposals relating to liquidity need to be examined in line with investment restrictions. Currently combing the both included in the proposal it seems the Central Bank have taken a negative approach and wish to restrict credit unions in the area of earning investment/deposit income.

Section 6.3 – (i)

Do you agree that a provision framework should be developed for credit unions as proposed in section 6.2?

Ballina Credit Union would request further detailed explanation to be given in the area of provisioning. Section 6.2 states that the central bank is considering setting out requirement for credit unions to provide in full for a loan that has been delinquent for a specified period. The term 'specified period' needs to be defined by the central bank. Currently credit unions provide in full for loans in arrears by 52 weeks. If the specified period referred to in the proposal is less than 52 weeks then this will have a significant impact on Ballina credit union and all credit unions. Currently Ballina Credit Union currently has a provisioning percentage of 16.98% from resolution 49 and with an additional provision held the total percentage is 23.11%. If attached/committed shares are brought into the equation then Ballina Credit Union currently has an even higher level of provisioning. These levels currently in place are very prudent and any extra levels of provisioning could be seen as over the top regulation. Ballina Credit Union is continually reducing its resolution 49 provision through prudent lending and credit control practices. In a time of declining provisions the proposal only acts to increase these provisions without giving proper explanation as to why. Any such extra provisions required will be a direct hit on operating income and combined with lending and investment restrictions would be detrimental to Ballina Credit Union.

Section 7.2 - (i)

Do you agree that the tiered regulatory approach should be introduced at this time?

Ballina Credit Union does not agree that the tiered regulatory approach should be introduced at this time. The proposed timelines seem to be quite soon and must be dependent on the position of feedback from the initial proposal. Dependent on the feedback and adjustments made to the initial proposal can a valid opinion of time lines be able to be given. The timelines should also incorporate the enforcement of the act and should incorporate the fact that credit unions are currently in a phase of sever movement from a governance perspective. While stating that the timelines are dependent on feedback form the consultation ultimately Ballina Credit Union feel that the timelines are both to rigid and soon.

Section 7.2 - (ii)

If it is considered that the tiered regulatory approach should be introduced at this time, do you agree with the proposed timelines for the introduction of the tiered regulatory approach set out in section 7.1, in particular the transitional period proposed?

Ballina Credit Union does not agree with the proposed timelines or transitional arrangement dates. Again as stated above only after further clarification of the areas of the initial proposal can this question be answered. Ballina Credit Union does not feel that the transitional arrangement dates from October 2014 to March 2015 are fair. The proposal contained in the document if implemented would mean a large scale reorganisation for credit unions including reassessing their strategic plans, business models, assessing potential mergers etc. The timescale offered is very limited in trying to achieve this and ultimately will verge on impossible for many.

Section 8 – Summary

(i)

Ballina Credit Union does not agree with the tiered regulatory approach as laid out by the Central Bank. This proposal outlined is not an actual tiered regulatory approach for credit unions but more an invasive form of external management.

(ii)

Ballina Credit Union does not agree with the proposal laid out in sections 5.1 – 5.11. They do not act as a form of tiered regulation but a form of restrictive management. Tiered regulation should set out to develop realistic principles in which a financial institute can operate its business model. The proposals put forward are mere rules than principles and more define the exact operation of a credit union rather than credit unions having input into their own business models and how they evolve within a system of sound and prudent controls. The only proposal that could be applauded to some extent is that of recognition of deposits longer than three months with a certain level of access as liquid. Recognising the mount of access on a deposit over three months as liquid can be seen as prudent and an act of forward thinking on the Central Banks behalf.

(iii)

Ballina Credit Union does not feel that services on offer to member should be defined in detail at this point. The question of whether such services should apply to category 1 or 2 is irrelevant at this point as at present only 20 credit unions affiliated to the ILCU would be eligible for category 2. With changing strategic plans and business models it is unfair to request a list of exact services that should be offered by credit unions. A potential service to be offered by a credit union should be dealt with on an individual basis and the offering of such as service should be based on ability and capability of the credit union to offer such a service rather than based on category 1 and 2.

(iv)

Ballina Credit Union does not agree with the provision requirements as laid out in the proposal. The lack of clarity and reasoning behind the proposals is somewhat baffling and verges on insulting to credit unions. To suggest extra provisions to be put in place without giving in depth explanation as to the operation of those provisions is not acceptable. Currently Ballina Credit Union is heavily provisioned and any extra requirement would act as a constraint and limitation for growth. The provisions would merely act as an over the top form of regulation. To request an opinion on a loosely worded proposal is not satisfactory and there is no mention of how current regulatory provisions will function with the new proposals.

(v)

Ballina Credit Union does not agree that tiered regulation should be implemented at this time. The movement as a whole is undergoing major change. The business model on which credit unions operate is evolving and changing continuously. This has the effect of requiring fast and effective management of the same and continual development of strategies. Combining this with current parts of the act already enforced the timing of introducing tiered regulation is unfair and not realistic.

Ballina Credit Union does not agree with the period proposed. For one it is largely pointless as only 20 credit unions at present could apply for category 2. For any other credit union to apply they would have to build their balance sheets and this may involve mergers. A mere six months for application to category 2 is unrealistic and could be envisaged as a statement from the Central Bank that they do not want credit unions operating within category 2.

The whole question of the timelines is somewhat pointless to a degree as the overall proposals of the consultation paper are so damning for Credit Unions. To request an opinion on timelines on proposals that effectively mean the Central Bank manages each individual credit union is insulting to all involved in the movement. Surely such an answer should only be requested in light of a more favourable, realistic and more regulatory geared consultation paper.