

# CP 76 – Consultation on the Introduction of a Tiered Regulatory Approach for Credit Unions

Response to CP 76 – Ballinasloe Credit  
Union (Our Lady of Lourdes) Limited

March 2014

## **Section 1**

### ***Introduction***

Ballinasloe credit Union is pleased to have the opportunity to comment on the Consultation on the Introduction of a Tiered Regulatory Approach for Credit Unions and responds as below.

Every effort has been made to follow the format of the CBI's original document for ease of reference.

In consequence of the methodology employed in the Consultation Paper the Bank seeks answers only to questions pertaining to the Bank's views as contained within the document. However this response will attempt to answer the questions raised and highlight other areas of concern to the credit union.

BCU is concerned that the entire document seeks to constrain and / or restrain the development of the credit union movement. In particular BCU refers to the lending limit, savings limits, limits on investments etc. as outlined in Section 5.

Also a noted feature of the document is the absence of any rationale for the proposals as outlined within CP76 even though the Bank requests a rationale for any suggested changes to the bank's approach herein..

## **Section 2**

### ***Background***

The Board notes that the CBI's reference point is the Commission on Credit Unions' Recommendation and Proposals on a Tiered Regulatory Approach. The Commission's Report, agreed by the participants / stakeholders, sets out a particular 3 Tiered scenario. The Board regrets that the CBI does not seek to implement same, but rather proposes its own tiered structure – presumably the CBI also suggested this at the Commission and it was not accepted. It is regrettable therefore that the CBI now seeks to implement its own preference as against that of the Commission Report.

In referencing the Commission Report relative to tiered regulation one could have an expectation that a less intrusive regulatory model would have been indicated within the Consultation on a Tiered Regulatory approach particularly in respect of smaller credit unions. Instead what is proposed does not differentiate between a credit union of €1m in size versus a credit union of €100m – and we end up with a one size fits all regulation for 360 (approx) credit unions. This is particularly evident when one considers that credit unions of the Tier 2 variety number approx 20 of the total number of credit unions in the Republic of Ireland. CP76 also indicates that initially every credit union will be considered as Category 1 Credit unions

The Board also notes (at 2.3) that across the globe the tiered structured is favoured by only two credit union systems (out of 101) – the UK and Ontario, Canada – both of which are very diverse vis a vis one another in that the UK system is relatively underdeveloped and the Ontario one is one of the most advanced in the world.

### **Section 3**

#### ***Purpose of this Consultation***

BCU notes that “The tiered regulatory approach will also take account of the Commissions on Credit Union recommendations and proposals”. However it appears that whilst the Commission report was agreed by the participants the Bank now seeks to implement the areas it agrees with and to substitute others wherever it disagrees as in Section 2 above – tiered regulation. Credit unions have a right to expect that the tiered regulation proposals would not seek to usurp or rewrite the Commission report.

## Section 4

### ***Overview of Proposed Tiered Regulatory Approach for Credit Unions***

At 4.1 of the consultation it states that “The nature, scale and complexity of a credit union is determined by the individual characteristics ... etc”. The paper then goes on to propose a two tiered approach only – furthermore the paper goes on to state that (4.4) “initially all credit unions will be designated as category 1 credit unions”. One wonders how the application of a single category reflects an approach that is “proportionate to the nature, scale and complexity of the business undertaken” (4.3). It seems completely contradictory and has little or no regard “to the nature, scale and complexity of the business undertaken” for the purposes of regulation. BCU notes that credit unions in category 1 can decide to “operate a more limited business model...” and the governance arrangements and prudential requirements that take account of the nature, scale and complexity will automatically apply in a manner proportionate to the business undertaken” (4.4). Why is this not elaborated upon in the document? It appears to be a lesser category than category 1 yet no real detail of what a credit union can expect by way of regulation is given and yet *proportionate regulation will automatically* apply – what does this mean?

**Response to 4.8(1) BCU does not agree with the tiered regulatory approach as outlined. Instead BCU would ask that the Bank follows the approach as outlined within the Commission Report and in particular ease the regulatory requirements on smaller credit unions (i.e. up to €25m /€30m). There is no supporting rationale for the Tiered Regulatory structure within the proposal as outlined in the document from the Central Bank.**

## **Section 5**

### ***Lending***

Within the overview of categories in section 5 the Bank has outlined significant regulation which will pertain to categories of credit unions i.e. 5.1.1 “Lending limits will apply ... and a maximum loan maturity of 15 years”. The rationale for lending limits and maturities is difficult to comprehend – given that no rationale is included in the document. Apart from general concerns expressed by the Registry there appears to be no factual basis that curtailing lending – by lending limits and or loan maturity time limits – benefits the credit union. It is noted that at 5.1.2 “... a specific category of home loan *may* be considered” (and this for category 2 credit unions only) - again limiting the credit unions potential to develop. Section 35 (2) of the CUA states”... The ability of the loan applicant to repay shall be the primary consideration in the underwriting process of the credit union”. The proposals as outlined seem to undermine the act and to require additional primary considerations.

The core business of credit unions is savings and loans. Curtailing its business activities will prevent credit unions from achieving their potential. Is this what tiered regulation should do? Is this what the Bank seeks to achieve by tiered regulation?

Section 5.2.4 deals with a proposed “Restricted Person Limits”. BCU notes that there is no reference to restricted persons within the CU Act 1997 (as amended). Directors, Members of the Board Oversight Committee and employees should be treated in the same manner as any other credit union member – their individual right, as members, should be sacrosanct and not be interfered with. The proposal to identify an additional restricted group is representative of the Bank overstepping its authority (and perhaps unlawful?). The extension of the restrictions (proposed) to family members is particularly obnoxious and unnecessary. The Bank should confine itself to the regulation of “officer” as defined by Section 2.2 of the CUA 1997 (as amended) and not seek to install an additional category of restrictions.

### ***Investments***

In general the changes as proposed to the investments of the credit union will lead to a significant loss of income given the limits proposed on investments in any single institution. The relationship between an investment and the credit unions reserves needs rational explanation from the Bank. The availability of sufficient counterparties will pose difficulties if the proposals proceed as outlined. The imposition of the proposed regulation will oblige credit unions to seek new counterparties and this will occur

simultaneously across the credit union movement thus handing a significant advantage to financial institutions seeking credit union deposits. The absence of any reference to investment by credit union in social finance projects (i.e. specific bonds, social housing etc) is noted with regret.

The depletion of the current holdings (max 25% of overall investment portfolio in any one institution) requires explanation – and again the rationale for same is absent from the document.

There is no mention of Collective Investment Schemes as currently allowed – will they be excluded?

A review of the BCU investment portfolio shows that BCU will have to reallocate substantial investments across a wide counterparty group with immediate effect. This will make a significant impact on the credit unions earnings from investments – and this at a time when investment income is already under pressure. BCU asks that the RIA be used to interrogate the effects of the investment proposals as outlined.

See additional commentary below under *Liquidity*.

### ***Savings***

Similarly with savings – the CP76 states that category 1 credit unions “will be able to offer savings up to the lower of €100,000 or 1% of the credit unions assets”. Such a restriction will compel credit unions to *remain always as only the secondary provider of savings and loan services to members* and not the members ***primary provider of financial services*** – which is the aim of the BCU strategic plan. One suspects that if the Deposit Guarantee Scheme maximum guaranteed amount was less than €100,000 (i.e. €20,000) that this would be the maximum restriction. Again this begs the question why only allow €100,000, - what is the rationale behind such a figure? Such regulation (currently in force in BCU) has compelled members in good standing to open bank accounts – something which they were loath to do as they regard their credit union as their sole provider of financial services. Regulation by the CB should not determine individual choice or compel a member to choose another financial institution for their savings.

### ***Additional Services***

The absence of any reference to debit card services and credit card services within this document (at 5.1.1 and 5.1.3) leaves a lot to be desired. Section 5.1.3 states “The provision of further additional services by credit unions will depend on the nature and complexity of services proposed” – absent from

this section is the time frame that credit unions may expect to see such applications being concluded within. (The recent application for the CUSOP licence can only leave credit unions in dismay at the delay in granting the licence at the Central Bank). Consequently, at a minimum, a timeline relative to new service applications needs to be displayed at this stage of the consultation process.

### ***Governance and Fitness and Probity***

BCU believes that it is not unreasonable to indicate within this consultation paper that the F&P regime recently instituted will be reviewed, assessed and revised in due course. In addition the “external review of the Board every three years” (Sn 5.1.4) is completely unnecessary. This job has already been given to the Board Oversight Committee. Where else within the financial services providers is there such a requirement? This additional onerous requirement on Boards will make it increasingly difficult to attract suitable volunteers as Directors.

### ***Liquidity***

The present liquidity requirements are stated to remain in place with some additional short term liquidity requirements being required in certain circumstances. The liquidity requirements of 20% (minimum) of unattached shares being in liquid form, has had severe repercussion on the investment return to the credit union. Again one questions the 20% as being a reasonable liquidity requirement – in the absence of any rational explanation as to the need for such a high percentage requirement – except that it is set out in S.I. 515 of 2010. In movement terms based on a savings pool of say €10 billion a liquidity requirement across the movement stands at a minimum of €2,000,000,000. It appears an extraordinary sum to have available in liquid form and there is no evidence to date of any such need or requirement<sup>1</sup>. (The liquidity constraints will also severely impact the credit unions ability to source good returns on its investments portfolio – in particular if up to 45%<sup>2</sup> of available funds are

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<sup>1</sup> Even the resolution of Newbridge Credit Union did not impact unduly on the movements’ liquidity – and this was arguably the movements’ greatest test to date).

<sup>2</sup> Minimum liquidity 20% plus additional short term liquidity requirements of 10% up to seven days and 15% available within one month (Ref 5.10 CP76)..



tied up in a liquidity requirement. Again a rationale for such a liquidity requirement is not clear within the document.

That this paper suggests an additional liquidity requirement as being necessary is ludicrous.

### ***Reserves***

The current minimum reserve requirement is 10% of assets. The movement as a whole has far greater reserves and a requirement to hold additional reserves for operational risk is unnecessary. BCU notes the power of the Bank to impose reserve requirements on a credit union (or in general on all credit unions) as outlined in the CUA 1997 (as amended) Section 45. Again no rationale has been provided for the current requirement and no indication or example is given as to the volume of any additional reserve.

**Response to 5.12(i)** Given that the differences between Category 1 and Category 2 are relatively immaterial BCU does not agree with the Two Category approach. But a lesser regime should be put in place for smaller (€25/€30m) credit unions.

**Response to 5.12(ii)** Credit Unions should be allowed to provide card services to members. The regulation of the credit union movement should be such that an application from a central provider (i.e. CUSOP) should be capable of being assessed centrally, in a timely manner, on behalf of the movement generally. The requirement for each unit to apply for permission to supply a new service (i.e. debit cards) will slow down the process of the delivery of the new service considerably – especially given that the consultation paper gives no indication at all of any timeframe for an application to be considered and finalised.. The applicant credit union will be at the mercy of the Bank with little say or control over the process.

## **Section 6**

### ***Provisioning***

It is instructive to note that the only objective assessment of delinquency in the loan book is as laid out by the ILCU Res 49 provisioning requirement. That this has been discounted as being of little benefit by the RCU is evident by the many loan book reviews undertaken on behalf of the Bank by auditing firms in the last number of years. That the bank now proposes a methodology is worthwhile in that it should clarify for all credit unions the Banks requirements. The use of the Roll Rate Methodology in the recent past coupled with the Incurred but Not Reported exposures in the more recent past and its replacement with the Banks own requirement will bring necessary clarity to this important area of the credit unions business. However at 6.2 in the “Proposed Provisioning Framework” it is noted that “The Central Bank is also considering setting a requirement for credit unions to provide in full for a loan that has been delinquent for a specified period of time”. The setting of this yardstick is crucial to the whole movement and BCU looks forward to a full consultation with stakeholders before this critical time period is issued as a regulation by the Bank.

**Response to 6.3(i)** BCU welcomes the proposal to develop a provisioning framework – provided that a consultation with stakeholders is used to enlighten and inform same. This provisioning framework should be agreed by all stakeholders – or their representative bodies.

## **Section 7**

### ***Timelines***

BCU notes that the original timeline for the consultation has been extended and it welcomes same. BCU has a concern however that the Regulatory Impact Analyses (RIA) may require a further extension in time especially when the responses to the consultation paper are considered – in particular in respect of the impact of the regulation as proposed on investment portfolios. There is little indication within the consultation paper on how the RIA may be conducted and BCU questions if this will also be a consultative process? The transitional period as outlined seems tight and credit unions will require a broader timeframe. The publication of the regulation at the beginning of the credit union year (as propose) when credit unions are busily engaged in finalising the previous years accounts and preparing an annual report for the AGM is particularly unhelpful. Early / mid 2015 would seem like a more appropriate timeframe.

**Response to 7.2(i)** The introduction of a tiered regulatory approach at this time, on top of the many other changes in credit union operations, is not helpful.

**Response to 7.2(ii)** The proposed timelines are tight and need to be reviewed. The introduction of a tiered regulatory structure should be delayed until 2015. The extension of the Banks original timelines would indicate that the introduction of a tiered regulatory structure will take more time than has been indicated in the document @ 7.1

## ***Conclusion***

BCU having considered the proposals as outlined in CP76 finds that the tiered regulatory regime as proposed is actually a one size fits all scheme. The discussion document allows for the larger credit unions to apply for Tier 2 designation - which allows for a slightly differentiated regulatory regime. However it is the reverse that is required – an ability by smaller credit unions in particular to seek a derogation from the requirements of the single proposed structure.

The level of direction and restriction within the proposals will inhibit the development of credit union into the future. There is a complete absence of any strategic thinking within the document about the future of credit unions and the credit unions ability to service its members in any meaningful way with financial services. Any additional services a credit union wishes to offer must be firstly approved by the Central Bank – yet it is the same institution which took 33 months to decide on a Payments Institution Licence for the ILCU’s CUSOP. Will a similar timeframe be applied to individual credit unions – and will each one have to make the same case for providing similar services?

The development of credit union in the past half century was a magnificent achievement in the servicing of the unbanked with financial services. The banking crisis of this decade has had little impact on credit unions – thereby indicating their resilience – based on their rootedness in local communities. The Bank should regulate for the future development of credit unions and not seek to constrain their potential as outlined in the proposals within this Consultation Paper.