

# **Introduction of a Tiered Regulatory Approach for Credit Unions**

## **Consultation Paper CP76**

### **Submission from Bantry Credit Union Limited**

**31 March 2014**

Bantry Credit Union ('BCU') welcomes the opportunity to respond to the Central Bank's Consultation Paper on the Introduction of a Tiered Regulatory Approach ('TRA') for Credit Unions. The submission follows the structure of the Consultation Paper rather than the six questions listed in Section 8.

#### **General**

BCU does not object in principle to the introduction of a TRA. However, we would make the following points:

- Per CP76, Section 2.3, only two jurisdictions (the UK and Ontario, Canada) operate a TRA. Therefore, the regulatory regimes that supervise all the other advanced credit union movements in the world do not currently regard a TRA as necessary or appropriate.
- The objections BCU has to many of the proposals contained in CP76 relate not to the principle of a TRA but to the micro-managing and 'straight-jacketing' of credit unions that these proposals entail.
- Some of the proposals set out in CP76, if implemented, will have far-reaching and, we believe, disastrous consequences for Irish credit unions. Yet there is no evidence in CP76 of a rigorous analysis of the potential impact (financial and social; macro and micro) of these proposals. In CP76, credit unions are asked to give their supporting rationale for alternative suggestions, but CP76 itself is devoid of even the most rudimentary business case or rationale to support its proposals.
- To answer the foregoing point by referring to the commitment to produce a second consultation paper including a Regulatory Impact Analysis is inadequate, because by then it will in all likelihood be too late. CP76 states that the second consultation paper will also include the draft regulations that will give effect to the TRA. In other words, by then all the main proposals will be set in stone and all that will remain open to consultation will be a bit of fine-tuning.

#### **Section 1: Introduction**

- CP76 p. 5 states: 'The timing of the introduction of the tiered regulatory approach will need to be considered in light of the significant changes required in credit unions to implement the strengthened regulatory framework and the voluntary restructuring of the sector that is currently underway.'
- BCU agrees with this statement and concludes that now is not the time to consider introducing such sweeping and potentially damaging changes as are outlined in CP76. Credit unions in Ireland are facing the most challenging environment in their history, challenges which are well-documented elsewhere and are well-familiar to everyone involved in the movement. In this context, BCU agrees with Davy:

- ‘We are concerned that the proposals, if implemented, may act as further headwind to the sustainability of a number of credit unions and we struggle to understand the rationale for introducing the proposed measures at this time.’<sup>1</sup>
- ‘The timing is not right to introduce the scale of the changes proposed in the Consultation Paper (CP76): If implemented as outlined the commercial viability of the credit union sector may be compromised. Therefore Davy highly recommends that the status quo be maintained, with certain modifications, or alternatively that consideration is given to an extended consultation period to allow for further stress testing of the model.’<sup>2</sup>

## **Section 5: Overview of Categories**

### **5.2.1: Classes of Lending**

- BCU believes that the definition of commercial lending (and by extension the definition of personal lending) should be revised to reflect the distinction between typically small-scale lending to individuals who are in business and typically larger-scale lending to business entities. Failure to make this distinction will result in credit unions being prohibited from serving the perfectly legitimate borrowing needs of large numbers of members.
- In rural Ireland, farmers, fishermen and self-employed tradesmen constitute a large proportion of the working population. Under the existing definition of commercial lending, relatively small loans to these members for purposes related to their livelihood will be classed as commercial lending, in the same way as a six-figure loan to a large-scale commercial enterprise.

### **5.2.2: Concentration Limits**

- BCU believes that the limit of 25% of Regulatory Reserves in relation to commercial lending (for category 1 credit unions) is too restrictive, bearing in mind our comments above regarding the definition of commercial lending. Take, for example, a rural credit union with, say, €50m in assets, Regulatory Reserves of €5m (10%) and a loan book of €25m. This concentration limit would mean that this credit union could lend only €1.25m (5% of its existing loan book) for business-related purposes to all its farmers, fishermen and self-employed members (as well, of course, as all other commercial purposes).

### **5.2.3: Maturity Limits**

- BCU agrees with all the maturity limits set out in CP76.
- BCU agrees in principle with the proposals regarding home loans set out in CP76.

### **5.2.4: Restricted Persons Limit**

- BCU vehemently and fundamentally disagrees with the proposals regarding ‘restricted persons’. This disagreement is based on principle as well as practical implications.
- We fully acknowledge and agree with the necessity of appropriate safeguards and controls in relation to the issuing of loans to credit union officers and members of their families. However, we believe that this can and should be achieved through different means, such as

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<sup>1</sup> Davy, ‘The Central Bank of Ireland’s Consultation on the Introduction of a Tiered Regulatory Approach for Credit Unions (CP76): Assessing the Impact on Credit Union Investments’, March 2014, p. 8.

<sup>2</sup> Davy, ‘Proposed Alternative Approach to Tiered Regulatory Framework for Credit Union Investments (CP76): A Follow-up to our Assessment of the Impact on Credit Union Investments’, 20 March 2014, p. 1.

the internal audit and compliance functions, the statutory auditor, and regular reporting to the regulatory authorities (through Prudential and Annual Returns).

- The setting of regulatory limits on the aggregate borrowings of a category of members such as ‘restricted persons’ is inherently discriminatory. It means quite simply and brutally that, from the day this measure is introduced, in some (or maybe most?) credit unions no ‘restricted person’ or a member of their family will be able to apply to their credit union for a loan for the foreseeable future (until such time as the aggregate borrowings fall below 5% of Regulatory Reserves).
- And, when it is below 5%, what happens then? A waiting list? First come, first served? Preferential treatment for small loan applications?
- The implications of this ill-conceived proposal for organisations that are governed by a volunteer Board of Directors are far-reaching and highly undesirable.
  - Who would become a director of a credit union, knowing that he/she and his/her (very extended) family may be prohibited from borrowing from that credit union as a direct consequence of his/her directorship?
  - Will there be an exodus of good and experienced directors from credit unions, at this most challenging moment in their history? If a director stays onboard, he/she and all family members are prohibited from borrowing from the credit union (because it exceeds the 5% Regulatory Reserves rule); if the director retires, he/she and all family members are able to borrow from the credit union in accordance with normal lending criteria.
  - Will it skew the composition of Boards of Directors, with an inherent – and unrepresentative – bias towards non-borrowing members?
  - Will suitable candidates be inhibited or precluded from applying for a position on the management team, depending on the aggregate borrowings of themselves and members of their family?
- The inclusion of the wide-ranging definition of ‘member of the family’ from the Credit Union Act 1997 (which includes nephews, nieces and first cousins) makes this proposal all the more undesirable.
- The contrast between the treatment of restricted members and the treatment of large exposures in CP76 is noteworthy. The aggregate lending to restricted persons is limited to 5% of Regulatory Reserves. To take the earlier sample credit union (€5m in Regulatory Reserves), this would amount to a limit of €250,000 aggregate lending to restricted members, who could number well in excess of 100 people. In contrast, a single non-restricted person can borrow up to 10% of Regulatory Reserves, or €500,000.
- BCU regards the proposals regarding ‘restricted persons’ as inherently discriminatory and calls for their removal rather than revision, because of this inherent unfairness.

### **5.2.5: Large Exposure Limits**

- BCU believes that, at 500% of Regulatory Reserves, the proposed limit on total large exposures is too high. This means that a credit union with Regulatory Reserves of 15% could have 75% of its total assets out on loan to large exposures, the smallest of which would be 5% of Regulatory Reserves. Again to take the example of a €50m credit union, this would equate to potentially €37.5m being out on loan to large exposures, the smallest of which would be €375,000.

### **5.3: Investments**

- BCU has considered the CP76 proposals regarding investments and liquidity in the light of the two research papers produced by Davy in response to CP76 in March 2014 (see footnotes 1 and 2 above). BCU fully endorses the views, concerns and proposals set out in these two papers. In particular, we echo Davy's concerns and proposals regarding:
  - Counterparty limits and concentration limits
  - Range of authorised classes of investments, particularly collective investment schemes
  - Increasing reliance on call deposits
  - Maximum maturity limits
- BCU believes that these proposals, particularly when considered in conjunction with the likely consequences of Basel III (especially the likelihood that access accounts will no longer be available), will have a severe negative impact on the investment income – and in some cases the viability – of credit unions.
- BCU wishes to publicly acknowledge the instructive and constructive contribution of Davy to this very important matter.
- BCU urges the Central Bank to reconsider all the CP76 proposals regarding investments in the light of the two Davy reports and to enter into constructive dialogue with Davy regarding all the issues raised in the two Davy reports.

### **5.4: Savings**

- BCU agrees with the proposals regarding savings set out in CP76.

### **5.5: Borrowing**

- BCU agrees with the proposals regarding borrowing set out in CP76.

### **5.7: Governance**

- BCU agrees with the proposals regarding governance set out in CP76.

### **5.10: Liquidity**

- See comments above on Section 5.3: Investments.

### **Section 6: Provisioning**

- BCU cannot comment on the proposed provisioning framework due to the lack of detail provided in CP76. This applies in particular to the first paragraph on p. 36 regarding guidance on assessing appropriate loan loss provisions and a requirement to provide in full for a loan that has been delinquent for a specified period.

### **Section 7: Timelines for the Introduction of the TRA**

- See comments above on Section 1: Introduction.