Submission on behalf of Cathedral Credit Union Ltd to the Central Bank of Ireland on Consultation Paper CP76 on the introduction of a Tiered Regulatory Approach for Credit Unions

26th February 2014.

We enclose our submission on the Consultation Paper CP76 on the introduction of a Tiered Regulatory Approach for Credit Unions under the following headings :

Lending

We wish to make some observations and suggestions regarding the following proposed changes :

(A) Maximum loan repayment term of 15 years & possibility of limiting home loans to Category 2 credit unions.

Our credit union has successfully provided limited lending in relation to home loans over the past ten years. The major portion of this type of lending was to facilitate long term tenants to purchase their homes from the local city council. Strict lending criteria were set for our home loans including ;

- Value of loan not to exceed 75% of the value of the property
- The total of the home loan repayment and any other loans not to exceed 35% of Member's income
- First legal charge on the property to cover existing and future liabilities

In providing this type of loan to our Members, our credit union was creating an opportunity for Members, who would not otherwise have access to such credit, to purchase their own home as well as facilitating the retention of the financial benefits of the transaction within the local community.

We would have concerns with the proposed new lending limit of 15 years and the fact that as a Category 1 credit union, we may no longer be allowed to issue home loans to our Members. We would suggest that a more suitable maximum lending limit would be 20 years and to include our stricter lending criteria listed above. We would also suggest that certain Category 1 credit unions, which have a proven record of prudent lending in this area, should be allowed to retain the option to provide limited lending for home loans, perhaps up to an overall maximum of 75% of their Regulatory Reserve.

(B) Loans to Restricted Persons (i.e. credit union Directors & the management team and their families) cannot exceed a total of the greater of €200,000 **or** 5% of our Regulatory Reserve i.e. €169,100.

The Credit Union Act 2012 (Part 1-Preliminary & General) outlines that a

"member of the family', in relation to any person, means that person's father, mother, grandfather, grandmother, father-in-law, mother-in-law, spouse or civil partner, cohabitant, son, daughter, grandson, granddaughter, brother, sister, half-brother, halfsister, uncle, aunt, nephew, niece, first cousin, step-son, step-daughter, step-brother, step-sister, son-in-law, daughter-in-law, brother-in-law or sister-in-law;"

Management team' has the following meaning given by section 55(1)(*i*) of the Act;
" identifying, in consultation with the manager, other officer positions within the credit union that—
(i) are essential to the proper management of the credit union,
(ii) are likely to enable the person holding the position to exercise significant influence on the conduct of the affairs of the credit union, and which, together with the manager and risk management officer of the credit union are referred to in this Act as the 'management team';"

We are requesting that the proposal to limit lending to Restricted Persons as outlined above would be reviewed by the Central Bank and replaced with a more measured and practical approach. Given the community focus of credit unions, the inclusion of the families of Directors and the Management team in the calculation makes the existing proposal particularly restrictive on credit unions. We would suggest that the term "families" would be excluded from this calculation and that the limit would be extended to 10% of the Regulatory Reserve of the credit union as a lower limit may affect the sourcing and retention of Directors particularly in credit unions of our size who may wish to retain an eleven member Board of Directors. It will also facilitate a more realistic and practical solution to this issue and allow credit unions to retain the benefit of such lending within the local community. We also suggest that robust lending policies, a prudent approach to loan approvals and strict enforcement of the Code of Ethics/Conflicts of Interest Policy can alleviate and manage any concern regarding the extent of lending to families of Directors and the Management Team.

(C) Commercial Loans (loans to fund an activity whose purpose is to make a profit (*new description*)) up to a maximum of 25% of our Regulatory Reserve i.e. €845,500
Given the reduction in credit union loan books over the past few years and the stagnant demand for new loans in our traditional personal lending market, it may be an opportune time for credit unions to explore the possibility of a limited form of commercial lending. We would, therefore, like to suggest that a higher limit of 75% of a credit union's Regulatory Reserve may be more practical and beneficial for credit unions, particularly in light of the proposed additional guidelines put forward by the Central Bank for this type of lending.

Investments

We wish to make some observations and suggestions regarding the following proposed changes :

(A) Maximum maturity of 5 years and a maximum of 50% of total Investments can be investments with a maturity in excess of 3 years.
We are concerned that these proposed changes would have a negative affect on the investment income of our credit union at a time when our income from loan interest is also declining.
We would suggest that the current maximum maturity term of 10 years would be retained as the proposed lower limit of 5 years will severely restrict credit unions in the range of products they can invest in and the returns they can potentially achieve on their investments.
In relation to the proposals that a maximum of 50% of total Investments can be investments with a maturity in excess of 3 years, we would suggest that the existing limits would be retained, that is "**Not more that 50% of deposits shall be held in deposits maturing after 5 years and not more than 20% of deposits shall be held in deposits maturing after 7**

years" and **"Not more than 30% of a credit union's holding in Irish & EAA State Securities shall be held in Bonds maturing after 7 years and the total holding in such investments shall not exceed 70% of the total value of the credit union's investment portfolio".** We would contend that

1. This will enable credit unions to avail of new 10 year Government Bond issues as well as taking advantage of the higher yields available on bonds with a maturity date of between 5 and 7 years.
2. It will allow credit unions to place funds on deposits with a maturity of between 5 and 10 years with other financial institutions and avail of any higher rates of return for such deposits.
3. The consistent and predictable nature of a credit union's Annual Cash Flow requirements and the stability of the retention levels of Members Savings would justify retention of the existing maturity levels for our investments. History has clearly shown that, in the normal business requirements of a credit union, the placing of a large portion of excess funds in investments with a maturity of between 5 and 10 years doesn't have a destabilising affect on either the liquidity requirements of the credit union or the security of our Member's Savings.

<u>(B) Value of total investments in a single Bank or EEA State cannot exceed 100% of a credit union's Regulatory Reserve</u>

For our credit union, the introduction of this proposed change would mean that the maximum value of funds we could invest in any single Bank or EEA State would be €3,382,000. Currently this is €5,375,000 in any single Bank (i.e. 25% of our total investments) and €15,000,000 in Government Securities (i.e. 70% of our total investments). This will have many serious implications including :

1. Potential loss of investment income for our credit union as we will not be in a position to earn additional bases points available from financial institutions tied into the overall value of funds placed with that institution.
2. We will be required to source additional financial institutions in which to place investments and deposits in order to achieve the lower limits, thus increasing the possibility for lower returns and increasing the prospect for placing funds with non-Irish financial institutions.
3. Unnecessarily increasing the complexity of managing the investment portfolio of credit unions.

We suggest that the existing limits would be retained (i.e. 25% of our total investments in a single Bank and 70% of our total investments in Government Securities) as this has served the credit union well during the turbulence of recent years and provides adequate protection for our Members Savings, particularly in light of the enhanced regulatory oversight of financial institutions.

<u>(C) Investments to be limited to Bank Deposits, Irish & EEA State Securities (e.g. Government Bonds) and placing funds with other Credit Unions.</u>

We are requesting that the Central Bank would review this proposed amendment and include an option for credit unions to invest in Irish & EEA Senior Secured Bank Bonds and Senior Unsecured Bank Bonds up to a limit of 100% of our Regulatory Reserve. As Senior Secured Bank Bonds take precedence to Bank Deposits and Senior Unsecured Bank Bonds enjoy equal status to Bank Deposits in bank debt rankings, we believe that they represent a viable alternative for credit unions to diversify their investment portfolio and an opportunity to source a product that may represent a potential for higher yields without increased risk.

Liquidity

We wish to make some observations and suggestions regarding the following proposed changes :

While the existing minimum liquidity requirement of 20% of unattached shares will continue, it is proposed that 10% of unattached shares would be kept up to seven days and 15% up to one month.

Given the consistent and predictable nature of a credit union's Annual Cash Flow requirements and the stability of the retention levels of Members Savings, we would suggest that the proposals "that 10% of unattached shares would be kept up to seven days and 15% up to one month" are not necessary. We would, however, suggest that an additional liquidity buffer of 5% of unattached shares would be required for credit unions that have more than 50% of their total investments in Investments with a maturity in excess of 5 years

Provisioning

While there is an absence of specific detail in respect of some of the proposed changes to provisioning as outlined in the Central Bank Consultation Paper, we nonetheless would like to make the following observations and suggestions

1. Top-Up Loans have historically been the bedrock of credit union lending and have provided a much cheaper alternative to moneylenders for many Members. Our credit union employs a prudent approach to such lending. It is our policy to closely monitor Members Loan repayment terms when assessing Top-Up Loans to ensure that the total Loan balance is repayable within an appropriate period of time and that the repayment term doesn't continually increase after every Top-Up Loan. We also review the frequency of Top-Up Loans by a Member at every Loan application and impose conditions such as "a stay on future Loans" or "a cannot apply until the Member's outstanding Loan balance reduces to a certain value or until a particular period of time passes", as considered appropriate in order to prevent over-borrowing or over-extending of the repayment term.

2. Being conscious of the socio-economic group of the traditional credit union Member and our social responsibility to our Members and the local community, our credit union, as part of our lending practices, proactively educates Members on wise use of credit and assists them in financial budgeting.

3. In recognition of credit unions social responsibility in providing Loans at a reasonable rate of interest to Members who may have, through no fault of their own, experienced temporary financial difficulties, we would suggest that credit unions would set aside a general bad debts provision of 5% of their overall bad debts provision to guard against any unexpected non-performance of these Loans. This general provision would be in addition to any specific provision already allocated to such loans

4. We would suggest that the existing Resolution 49 Bad Debts Provision calculation would be retained as the basis of provisioning. In addition, credit unions would be required to review their levels of provisioning on individual loans on a monthly basis with a view to applying additional provisions as required. We would also suggest that credit unions would, on an annual basis (e.g. financial year end) undertake a "justification" exercise to determine the level of general provisioning required. This

will create a more accurate and realistic approach to provisioning, lead to closer monitoring of individual loans and avoid situations where credit unions are possibly maintaining unnecessary high levels of bad debts provision.

Epilogue

"A prudently and soundly managed credit union providing a quality service to our Members" is our mission statement. We are extremely concerned that some of the proposed changes outlined in the Consultation Paper may undermine our capacity to prioritise the protection of our Members savings and adversely affect our plans to maintain our credit union as a financially strong and well managed organisation at the heart of our local community.

The proposed amendments on lending, investments and liquidity will have a substantial negative impact on our potential income and severely restrict our capacity to provide credit facilities to our Members in a prudent manner and at a reasonable rate of interest. The absence of any recognition of a credit union's social responsibility in providing Loans to Members who may, through no fault of their own, have experienced temporary financial difficulties, will erode part of our traditional lending market and eliminate a cheap source of credit for Members who may have no option but to avail of the growing number of moneylenders and online pay-day loan providers.

In conclusion, we hope that the Central Bank will take on board the suggestions and proposals which we have outlined in this submission. We look forward to your follow-up Consultation Paper and Regulatory Impact Analysis and trust that our concerns will have been addressed at that time. If you require additional information or clarification, please contact our Manager, Eoin Newman.

Finbarr O'Sullivan
Chairman