Introduction of a Tiered Regulatory Approach for Credit Unions CP76

Submission by Enniscorthy Credit Union Limited

4.8 The Central Bank is seeking views on the following:
(i) Do you agree with the proposed tiered regulatory approach for credit unions? If you have other suggestions please provide them along with the supporting rationale.

Is it envisaged that all credit unions with assets in excess of €100m will be **obliged** to apply to be Category 2?

A tiered regulatory approach is acceptable but the need for existing Type 3 credit unions to apply to become Category 2 credit unions seems wasteful of credit union and Central Bank time. Current regulation and control by the Central Bank surely means that existing Type 3 credit unions which are in difficulty regarding the requirements outlined above can be specifically excluded by the Central Bank without the majority of Type 3 credit unions, who are known by the Central Bank to be capable of meeting the requirements, having to apply and go through a process the outcome of which is already known.

If a current Type 3 credit union is having difficulties with RMP's and PRISM visits, the Central Bank is aware of this and can exclude them from Category 2 until such time as they meet the necessary requirements.

All other Type 3 credit unions should be classified into Category 2 automatically.

5.12 The Central Bank is seeking views on the following:
(i) Do you agree with the proposals for the operation of the two category approach for credit unions set out in sections 5.1 – 5.11? If you have other suggestions, please provide them along with the 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.

The concentration limit on Commercial Loans seems very high at 100% of Regulatory Reserve.

Savings

5.4.2 Deposits up to 75% of shares. Presumably the logic here is about Asset/Liability matching with term deposits over specific periods to match loan durations over similar periods.

The onus on Category 2 credit unions to publish deposit rates for various deposit products could put the savings of members at risk if the deposit rates declared do not match rates achieved for investments and loans. This matching process is a complex issue for credit unions - many of which have no experience in this area.

This restriction could discourage credit unions from Category 2.

The limit of savings to €100,000 in Category 2 credit unions is extremely restrictive and will cause problems for many credit unions.

'The aggregate liabilities of a Category 2 credit union in respect of deposits can be up to a maximum of 75% of aggregate liabilities in respect of shares issued to members.'

This could restrict growth in Category 2 credit unions where a variety of deposit products might be used to attract member investors.

5.2.5 Large Exposure Limits
Large exposure is exceeding 5% of Regulatory Reserves. Exposure to a borrower or connected borrowers is €39,000 or 10% of Regulatory Reserves.
Total large exposures can be up to 500% of Regulatory Reserves.

The % for total large exposures including Contingent liabilities seems very high at up to 500% of Regulatory Reserves.

The proposal to introduce regulation of classes of lending, concentration limits, maturity limits, restricted person limits, large exposure limits and lending practices & policies should lead to a lifting of lending restrictions currently in place for many credit unions.

5.3 Investments
Category 2 credit unions

Investments in senior unsecured bonds issued by credit institutions can have a maximum maturity of seven years.
The maturity maximum should be the same at up to 10 years for both Category 1 & Category 2 credit unions to allow all credit unions to avail of structured returns on longer term investments.

Total investments in bank bonds can be up to 50% of a credit union's Regulatory Reserves.

Investments in a single counterparty can be up to 100% of a category 2 credit union's Regulatory Reserves.

Given the size of the Investment portfolio in some credit unions this would appear very low. Single counterparty risk for many credit unions is 25%. This would equate to closer to 15%.

With the limited number of counterparties in Ireland, this will be difficult to achieve. Most credit unions use investment advisors to assist with investment decisions. These advisors may hold some investments on behalf of the credit union thus increasing the counterparty holding of the investment advisor.

The only investments which are allowed to have maturity up to 10 years are Irish & other EEA state securities. Remainder is up to 7 years and must have 50% under 5 years.

The inclusion of corporate bonds is a positive move in terms of enabling the credit union to have greater diversification within its portfolio particularly given all that has happened over the past 6 years in the banking sector.

There is no mention in the document of collective investment schemes. Collective investment schemes can be an efficient means of bringing diversification and liquidity to an investment portfolio, and it would be unfortunate if they were excluded.

5.7 Governance
External evaluation of the performance of the board of directors will be required every three years.

Why is this proposed given the Fitness & Probity regime and governance requirements in the Act?

Is this required of other financial institutions such as banks?

5.9 Reserves
Operational Risk Reserve proposed for Category 2 credit unions at a specified % of assets, e.g. 2%.

Regulatory Reserves in credit unions are already very high. With the increased functions of Internal Audit, Risk & Compliance why is there a need for an additional Operational Risk Reserve? These functions will surely be tasked with keeping Operational Risk to a minimum thus obviating the need for additional reserves.

How long will be allowed to build up this reserve?

What % of assets would it be if Basel Basic Indicator approach was used?

Why not propose an increased Regulatory Reserve instead of introducing another reserve which will probably have the same rules applied to it as the Regulatory Reserve?

5.12 The Central Bank is seeking views on the following:

(ii) Are there any areas where credit unions could provide new additional services to their members? Should these be available to category 1 and category 2 credit unions or only category 2 credit unions? If you have suggestions please provide them along with the supporting rationale and the associated additional requirements.

6.3 The Central Bank is seeking views on the following:

(i) Do you agree that a provisioning framework should be developed for credit unions as proposed in section 6.2? If you have additional proposals please provide them along with the supporting rationale.

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.

Without further detail it is not possible to comment on this statement which could put onerous provisioning requirements across all credit unions as a result of a small few credit unions' financial positions.
Applying Res49 and quarterly Loan Book Reviews seems a fair indicator of provisioning adequacy.

7.2 The Central Bank is seeking views on the following:

(i) Do you agree that the tiered regulatory approach should be introduced at this time? If you consider that alternative timing is more appropriate, please provide suggestions, along with the supporting rationale.
(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 between the publication and commencement of the regulations? If you have other suggestions please provide them, along with the supporting rationale.

A 6 month Transitional period including applications to become Category 2 credit union seems very short.
Refer to previous comment (re 4.8) regarding existing Tier 3 (Assets greater than €100m) not having to apply to become Category 2. This could speed up the process as there would be fewer applications to deal with.