# SUBMISSION BY

# Health Services Staffs Credit Union

# To the

# Central Bank of Ireland

# On Consultation Paper CP 76

# Tiered Regulatory Approach

# For Credit Unions

# March 2014

## Introduction

Health Services Staffs Credit union Limited (HSSCU) is an Industrial credit union serving 28,000 members. The credit union draws it membership from health service employees, and also holds membership from the common bonds of James Street, Texaco Employees and Law Library credit unions.

HSSCU appreciates the opportunity to make a submission to the Central Bank of Ireland on Consultation Paper 76 on the Tiered regulatory Approach for Credit Union

## Background

The report of the commission on credit unions proposed the introduction of a strengthened regulatory framework to be phased in over time. The report further proposed that there would not be a one size fits all regulatory framework. CP76 is the initial consultation document in this process.

HSSCU welcomes the fact that the Central Bank recognizes the need to consider the timing of the introduction of a tiered regulatory framework in light of the major regulatory changes and voluntary restructuring currently underway in the movement. HSSCU also welcomes the proposal to issue a further consultation paper which will include a Regulatory Impact analysis.

The Bank is proposing a two category approach, with category 1 credit unions offering services comparable to those currently provided while category 2 credit unions will offer enhanced services under additional regulation.

**Executive Summary**

HSSCU has a culture of compliance embedded in the processes and procedures of the organisation and have always been in favour of appropriate and proportionate regulation. However we find the proposals in CP 76 to be over regulatory, restrictive and directive. We believe that the intentions of the commission when it made recommendations on tiered regulation was that regulation should be proportionate to the scale, nature and complexity of a credit unions business model. In practice the proposals are an attempt by the office of the RCU to restrict and micro manage the business of credit unions.

**The objects of a credit union enshrined in law are as follows,**

(*a*) the promotion of thrift among its members by the accumulation of their savings;

(*b*) the creation of sources of credit for the mutual benefit of its members at a fair and reasonable rate of interest;

(*c*) the use and control of members' savings for their mutual benefit;

(*d*) the training and education of its members in the wise use of money;

(*e*) the education of its members in their economic, social and cultural well-being as members of the community;

(*f*) the improvement of the well-being and spirit of the members' community; and

(*g*) subject to *section 48*, the provision to its members of such additional services as are for their mutual benefit

It is noteworthy that CP76 lists the first three objects and ignores the social objects. HSSCU can find very little in CP 76 that supports these objects and that would facilitate credit unions to grow and prosper as our economy continues to recover. Credit Unions have in general weathered the recession quite well. We therefore find it hard to understand why credit unions appear to be the only sector regulated by the Central Bank of Ireland (CBI) to have such stringent limits, caps and restrictions placed on our business. The involvement of our regulators in the day to day management of our business is not appropriate.

## Overview of the Proposed Tiered Regulatory approach for Credit Unions

### Two Tired Regulatory Approach

The Bank is proposing a two category approach as opposed to the three tiers proposed by the Commission report. The commission proposed that regulatory requirements should be proportionate to the nature scale and complexity of the business. The proposal is that category 1 credit unions which covers the current Type 1 & type 2 credit unions (< € 100M) can offer services comparable to those currently offered. Category 2 credit unions will cover type 3 credit unions (> €100M). Initially all credit unions will be designated as category 1 with an application process to become a category 2 credit union. It is proposed that credit unions applying to be a category 2 credit union " will have assets close to or above €100M".

**HSSCU** would not be in favour of the two tired approach and would suggest that the use of categories based solely on size to determine the level of service a credit union provides is not appropriate.

The bank proposes to make regulations for categories of credit unions in the following areas,

**5.2 Lending**

- Category 1 credit unions would be allowed,
  - personal lending
  - Commercial lending – 25% of regulatory reserve
  - community commercial – 25% of regulatory reserves
  - credit union lending – 12.5% of regulatory reserves

- Maximum loan term 15 years

- Large exposure limits – (borrower € 39,000 or 10% of RR)
  Total exposure 500% of RR

- Restricted persons (member of board or management team and family members) – Aggregate of € 200,000 or 5% of RR.

- Category 2 credit unions will be allowed,
  - personal lending
  - Commercial lending – 100% of regulatory reserve
  - community commercial – 25% of regulatory reserves
  - credit union lending – 12.5% of regulatory reserves

- Existing section 35 limits will apply within which a specific class of home loan will be allowed.

- Large exposure and restricted persons limits as in category 1

- Home loan – LTV 80% term 25Years -

The proposals on lending are essentially around limiting the value of loans a credit union can issue based firstly on the category of credit union and then on classes of loans, concentration levels based on regulatory reserves, additional maturity limits and large exposure and restricted person limits.

HSSCU would suggest that the proposals are restrictive. Although HSSCU has traditionally loaned in the less than five year personal loan market, we would be aware that credit unions are already restricted by the section 35 limits. The restriction of loans to a 15 year term is not acceptable. The proposal for a home loan would allow HSSCU grant secured loans of € 15M which would mean we could grant 75 loans of € 200,000. HSSCU cannot understand why the proposals suggest that secured loans be restricted when there is less risk attached to this type of lending. HSSCU would be of the opinion that the proposals in CP76 are contrary to section 35 of CUCORA 2012.

**5.3 Investments**

The current Investment guidelines are laid down in 2006 Central Bank guidance note on investments. The main features of the proposed changes are,

- Both category 1and 2 credit unions will be allowed invest in certain bank deposits, Irish and EEA State securities and the shares and deposits of other credit unions to a maximum duration of five years.

- Category 2 credit unions may also invest in “some investments in unsecured bank bonds and corporate bonds” and longer durations will be allowed than category 1.

- Investments in equities and collective investment schemes are no longer proposed.

- Counterparty limits relate to regulatory reserves rather than the full portfolio.

- Short term liquidity constraints are proposed
- No minimum credit ratings are proposed
- Maturity limit reductions in category 1 credit unions from 10 to 5 years and in category 2 a reduction to 7 years is proposed for senior bank bonds/corporate bonds

Credit Unions currently operate under the 2006 guidance note as issued by the Central Bank. Investment income is already under pressure given the low interest regime and the effects of Basel III on investment portfolios. HSSCU would question the rationale and basis for the CBI to introduce such a restrictive regime at a time when it is the most challenging period in history to generate investment income. In particular:

The proposals to curtail authorised investment classes and scale back maturity limits have no basis. Specifically, we would like to understand the CBI's rationale for excluding i) collective investment schemes, when they are serving credit unions very well for liquidity and income requirements ii) bank bonds for Category 1 when allocated to a small portion of the portfolio, they can provide an important contribution to income as well as a liquid means of diversifying counterparty risk

We do not understand the linkage of concentration limits (including counterparty limit) to regulatory reserves. It seems overly complex and we are not sure what the CBI is trying to achieve in this regard. HSSCU under the current proposals would need to diversify € 16M into lower yielding asset classes because of the non-availability of collective investment schemes and counterparty breaches due to the change in concentration limits. We believe that the proposals will mean that the management of investments is likely to become more onerous and investment income will decline. In addition, we are not sure if a sufficient number of counterparties operate in Ireland in order for credit unions to meet the proposed limits.

We feel that credit unions have been well served by the existing guidance note and the Trustee Authorised Investment Order and are struggling to understand the rationale for the material changes to the investment framework outlined. We would urge that a detailed impact analysis be carried out which assesses the implications for credit union investments, the impact on viability and the prospects for the growth of the movement. It is important that this analysis extends to all credit unions, both small and large, and to include those that have either low or high lending to savings ratios.

### 5.4 Savings

- Category 1 credit unions will be allowed offer savings up to the lower of € 100,000 or 1% of assets.

- Aggregate Liabilities in respect of deposits – Max of 50% of shares

- Category 2 credit unions will be allowed offer savings up to € 100,000.

- Aggregate Liabilities in respect of deposits – Max of 75% of shares

HSSCU is not aware of any limits placed on savings and deposits on any other financial institution and would therefore argue that the proposal is anticompetitive, and contrary to the objects of a Credit Union.

### 5.5 Borrowings

- Category 1 and 2 credit unions will be allowed borrow up to 25% of the total savings of the credit union.

HSSCU  would question the need for the bank to prescribe in an area where there have been no difficulties. We would suggest that the level of borrowing should equate to that allowed in any other sectors of the industry.

### 5.6 Additional Services

- Category 1 and 2 credit unions can provide services that are currently available under the exemption. Section 5.1.3 of the proposal gives a very vague view on further additional services depending on the submissions received and the nature and complexity of the service.

HSSCU would once again point to the objects of a Credit Union. We would ask why the bank feels it necessary to know what particular services credit unions wish to offer today. Member needs and requirements change consistently and members' requirements can change. We would suggest that there would be continuous engagement between the bank and the movement to ensure relevant services are delivered to members in a safe prudent and expedient manner.

### 5.7/5.8 Governance Fitness and Probity

- The existing regime will apply to category 1.

- Additional governance requirements will apply including the setting up of an asset and liability committee.

- “Dedicated” risk officer, compliance officer and internal audit function.

- An external review of the board will need to be completed every 3 years.

We would be concerned that before the proposed governance framework was embedded in the movement additional requirements and costs are being imposed upon credit unions. The bank needs to confirm what is meant by “dedicated” and why it is now felt appropriate that the board should be externally reviewed.

### 5.9 Reserves

- The current reserve requirement (10%) will apply and Category 1and 2 credit unions

- Consideration will be given to a risk weighted asset approach for category 2 credit unions

- Following commencement of Section 13 of the Act, Category 2 credit unions will be required to maintain a minimum operational risk reserve.

We would welcome the opportunity to discuss a risk weighted approach to reserves and provisioning, something which was promised in the past. We would question the need for an operational risk reserve and the potential cost this will add to service provision.

**5.10 Liquidity**

- The existing regime (20% of unattached shares)will apply to category 1 and 2 credit unions

- Section 35 liquidity requirements will also continue to apply

- 10% of unattached savings must be available up to seven days

- 15% of unattached shares must be available up to one month

- Additional liquidity requirements for category 2 credit unions based on stress testing and maturity mismatches.

The additional liquidity requirements will have an adverse affect on the investment portfolio as discussed earlier. We would once again point to the section 35 requirements which are already impacting negatively on credit unions that have member demand for longer term fully secured lending.

**Areas where the Central Bank is seeking views**

1. **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.**

We do not agree with the model being suggested, we believe that the proposed model is simply based on scale and does not take account of the nature scale and complexity of individual credit unions into consideration. The current proposal could see credit unions with €10m assets and €80m assets offering a similar service while credit unions in excess of € 100M could be offering enhanced services.

The current proposal makes no provision for groups of category 1 credit unions to provide services on a cooperative basis. It would appear that the only option would be to merge credit unions in an effort to reach the € 100m in assets.

The Commission Report set out a three tier model based on the current type 1,2, and 3 credit unions.

Type 1:- Assets of less than €10 million, with savings and lending limits more restrictive than currently apply, and with a proportionate regulatory model.

Type 2:- Assets of €10m to €100m., undertaking services similar to those currently being taken, with enhanced regulation.

Type 3:- Assets greater than €100m., with permission to undertake a wider range of investment and lending activities , and subject to additional prudential requirements.

The proposal from the Central Bank is a significant departure from the approach agreed to by the Commission. It is our understanding that the two tier approach was discussed at and rejected by the Commission. We feel the proposed framework to be over intrusive and directive in nature. We further believe that the intention of the commission was to allow for a less onerous regulatory regime for smaller credit unions, the proposals in CP 76 imposes an onerous regulatory regime on all credit unions which was never the intention of the commission.

2. **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?**

No, HSSCU believes that the fact that a two tier system exists in completely different jurisdictions is not a logical or compelling reason for two tiers to be imposed in Ireland. The Commission suggested a three tier approach for good reason. The Central Bank's proposal to exclude the Type 1(Credit unions with assets of less than €10m in assets) is a retrograde and serious step for the credit unions in question.

Smaller credit unions will struggle to meet the costs of the new prudential requirements, which, it could be said, are over-challenging to their nature, scale and complexity. The Commission Report envisaged that these credit unions would remain independent and that the Central Bank should apply regulatory requirements proportionate to the reduced levels of risk residing in these credit unions. It could be construed that the two tier model is designed to force smaller credit unions to merge which better serves the Central bank than the needs of Credit Unions and of their members.

3. **Are there any areas where credit unions could provide new additional products or services to their members?**

HSSCU would be of the view that the board of directors of a Credit unions should be in a position to decide what services are appropriate and required by its membership. We are surprised that as a regulator the Central Bank wishes to get involved in the area of product development and service delivery. This not the role of the bank which is evidenced by the fact that products in other regulated financial institutions are regulated solely based on risk and compliance.

4. **Do you agree that a provisioning framework should be developed for credit unions as proposed in section 6.2?**

HSSCU welcomes the proposal to update the existing provisioning framework but questions why this would be carried out under the auspices of tiered regulation. HSSCU proposes that the representative bodies should collectively review the current framework and make proposals to the bank based on what is best practice for credit unions and the sector in general.

5. **Do you agree that the tiered regulatory approach should be introduced at this stage?**

HSSCU believes that the tiered regulatory approach should be phased in on a planned basis following a full regulatory impact analysis over a 2 to 3 year period. Credit Unions are still in the throes of managing compliance with CUCORA 2012. HSSCU wishes to point out that the Credit union sector has been remarkably robust during the current recession and in general has avoided the calamitous predictions of many commentators.

6. **Do you agree with the proposed timelines set out in section 7.1, in particular the transitional period proposed between the publication and commencement of the regulations?**

HSSCU believes that the timelines for implementation should be agreed following a full regulatory impact analysis but that the transitioning of CUCORA 2012 should be taken into consideration when agreeing any timeline**.**