Introduction of a Tiered Regulatory Approach for Credit Unions

Consultation CP76 – NABCO Submission

Introduction

NABCO welcomes this opportunity to contribute to the consultation on the introduction of a tiered regulatory approach for Credit Unions. The Association views this consultation as part of the process of implementation of the recommendations of the Commission on Credit Unions (CCU), whose report the Association fully endorses.

The current consultation also presents an opportunity to deliver on the potential offered by the Credit Union and Co-operation with Overseas Regulators Act and we encourage the Central Bank to embrace that opportunity. In this submission we present information on a public nature collective investment opportunity that could be supported by the Credit Union movement under the Act. The Association would welcome the opportunity to present further detail on this collective investment approach.

About NABCO

NABCO is the national organisation representing, promoting and developing co-operative housing in Ireland. Since our foundation in 1973, NABCO has:

- Supported the provision of approximately 5,000 homes across a mix of tenures through application of the co-operative model,
- taken responsibility for the ongoing management of nearly 1,800 homes available at affordable rents,
- promoted the development of locally affiliated co-operative societies, ensuring that services are locally and democratically managed,
- provided wider employment and community development opportunities such as Childcare and Community Services.

NABCO works with the Irish League of Credit Unions and Irish Co-operative Organisation Society (ICOS) to promote the co-operative model through Co-operative Alliance Ireland. NABCO is Ireland's only member of the International Co-operative Alliance, the guardians of the international statement of co-operative values and principles.

Credit Unions and Co-operative Housing

As two co-operative organisations, there is a high level of interaction between Credit Unions and the co-operative housing movement. At a local, membership level, most members of Irish housing co-operatives are also members of their local Credit Union. For many members of housing co-operatives their local Credit Union is their principal provider of financial services and the role of community Credit Unions in tackling the challenge of high-interest money lending in low income households cannot be overstated. For the co-operative housing movement, the maintenance of a strong network of community-focused Credit Unions is absolutely critical to our members' financial wellbeing.

At an organisational level, NABCO and the ILCU work together to advance the co-operative model as a business form, in line with the policy commitment to support co-operative enterprise given in the Programme for Government. Credit Unions also provided the mechanism for early members of home-ownership co-operatives to save for deposits for their homes and the first housing rental co-operative, in Coolock, Co. Dublin was part financed by a mortgage from the local Credit Union.

One of the primary principles of the co-operative identity is 'co-operation among co-operatives'. NABCO continues to work with the Credit Union movement to benefit members and the wider community. We do this at a local level by organising education and training events in concert with Credit Unions in our communities and as organisations we work together to find ways to support each other's objectives.

A Co-operative Approach to Restructuring

The Commission on Credit Unions recognised the need for restructuring within the Credit Union sector in order to ensure its long-term viability and relevance. The willingness of the sector itself to engage in restructuring can be measured by the engagement of close to half of all Credit Unions with ReBo since it began operations. Local Credit Unions, such as north Dublin's Progressive Credit Union, have begun to merge and reform. Groups of Credit Unions have also developed new approaches to shared services, such as Unity Co-operative in south Dublin.

The restructuring of the sector needs to occur in a way that respects the co-operative identity of Credit Unions as democratic, autonomous organisations. The CCU itself recommended that restructuring should happen on a "voluntary, incentivised and time-bound basis". In this submission we argue for an approach to supporting the restructuring of the sector that provides meaningful incentives for members at a local level to engage with change. Where members express a clear desire to protect a service that operates on a small, local and voluntary scale, there is no reason why that wish cannot be accommodated.

Incentivised Regulation

The need for a strong regulatory framework to support the long-term future of Credit Unions is widely accepted. However, a stronger approach to regulation does not necessarily imply a need for a more restrictive approach. In this submission we suggest that proposals in the current consultation do not provide incentives for Credit Unions to adapt and restructure and more widely, threaten the flexibility of the sector.

While some Credit Unions have experienced difficulties in recent years (in common with the whole financial services sector) and while a proportion of Credit Unions have fallen below standard in terms of liquidity and reserves, nonetheless, the sector as a whole has proven to be remarkably robust. Indeed, the CCU identified some of the key challenges facing Credit Unions as excessive liquidity and under-lending. The consequence of this for Credit Union members has been successive years of excessively low dividends.

In this submission we recommend adopting the view that many members of Credit Unions maintain share levels in excess of any foreseeable borrowing requirement because of a desire to support the co-operative ethos of the movement. A critical long-term challenge to liquidity and financial stability will arise if these members are dis-incentivised from saving by persistent low rates of dividend return, coupled with undue restrictions on Credit Unions from fulfilling their co-operative potential.

Legislative Potential

The introduction of a new regulatory regime for Credit Unions offers significant potential to deliver on the possibilities provided for in legislation. Among the objects of Credit Unions listed in the 1997 act is "the use and control of members' savings for their mutual benefit" and one of the classes of investment envisaged by the 2012 act is an "investment project of a public nature". The CCU suggested that "larger credit unions that are capable of operating on a more sophisticated basis should be allowed to offer a wider range of products and services and engage in a broader range of lending and investment activities."

The Credit Union movement currently has responsibility for the investment of savings approaching €12 billion. NABCO is strongly of the view that the potential application of this asset for the benefit of members and the wider community is not being fully realised. The restrictions on Credit Union investments in the 2006 Guidance Note unduly limit the freedom of Credit Unions to invest in a socially responsible way, where they so wish. The recommendations in the current consultation are even more restrictive than the Guidance Note and would be damaging to Credit Unions and to the principle of co-operation among co-operatives and would fail to give life to the powers explicitly provided for in legislation.

In this submission, NABCO argues for Credit Unions, where appropriate, to be provided with the flexibility to engage in the broader range of investment activities proposed by the CCU. In particular, we note the apparent removal of the ability of Credit Unions to engage in collective investment schemes, currently supported by the 2006 Guidance Note as well as the lack of provision in the consultation document to allow for investments of a public nature as envisaged by the 2012 act.

Investment Opportunities

As co-operative organisations, NABCO and the ILCU have been working together to develop a public nature investment project that would allow Credit Unions to collectively invest in co-operative housing through a Special Purpose Vehicle. The proposal would have the benefits of giving members a concrete sense of the co-operative values of their Credit Union while at the same time producing improved dividends through a state-guaranteed investment.

Collective investment offers the potential to lower the exposure of individual Credit Unions while maintaining strong levels of reserves and liquidity. NABCO is seeking a regulatory regime that would facilitate the exploration of such investment opportunities. The Association would welcome the opportunity to present further detail on this collective investment approach.

Detailed Consultation Responses

(i) Do you agree with the proposed tiered regulatory approach for Credit Unions?

We note the proposal to reduce the number of categories of regulation suggested by the Commission on Credit Unions from three to two. NABCO has no opposition in principle to reducing the number of regulatory categories if, in fact, two categories are so close as to be indistinguishable.

At the same time, it should be noted that reducing the sector to two categories risks, over the long-term, creating a substantial divide in the variety of services offered by the different categories. This risks generating a situation in which category 1 Credit Unions feel compelled to apply for category 2 status, perhaps against the instincts of their members. Restructuring within the sector should be incentivised and Credit Unions should not feel compelled to change their local and distinctive character.

Creating a significant gap in the services offered by Credit Unions across the different categories also risks leaving members of category 1 Credit Unions excluded from the full range of potential services that might be offered by the sector. This is especially the case where members live outside the common bond of category 2 Credit Unions. Consideration may need to be given to a relaxation of common bond requirements in the future.

(ii) 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?

Lending — We note and support the provision for community lending for both categories of Credit Unions.

We note that consideration is being given as to whether category 2 Credit Union should be permitted to provide home loans to members. We fully support retention of this option for, at least, category 2 Credit Unions. The proposed loan terms in regards to loan-to-value and maximum maturity are, however, unduly restrictive and will prevent Credit Unions from competing effectively with banks.

We support the inclusion of commercial lending for both categories of Credit Union and would suggest giving explicit support to lending for social enterprise.

Investments This is an area of considerable concern and disappointment. The current 2006 Guidance Note places heavy restrictions on Credit Unions in terms of their flexibility to invest members' savings in a way that maximises returns and realises a positive social impact.

The current proposals represent a tightening of the existing guidance for both categories of Credit Union. Maximum terms of investments are reduced from ten to five or seven years and the minimum number of counterparties is increased. The ability to utilise collective investment schemes appears to have been removed. The proposals do not provide an incentive to reform by allowing for more sophisticated instruments, nor do they support the 2012 act by allowing for investments of a public nature.

We would suggest, as an absolute minimum, that the current Guidance Note form the basic level of freedom available to all Credit Unions. For category 2, we propose that Credit Unions should be allowed to approach the Central Bank with proposals for additional investment instruments, subject to appropriate limits on reserves, liquidity and term-length.

Savings As noted in the consultation paper, Credit Unions finance most lending through savings, and borrowing by Credit Unions is extremely limited. In this context, maintaining high levels of savings, while posing theoretical liquidity challenges, serves to strengthen the overall stability of the sector.

We recommend removing the lower, 1 per cent of assets limit for savings for category 1 Credit Unions and removing any externally imposed limit for category 2 Credit Unions.

In relation to borrowings, governance, fitness and probity, reserves and liquidity, we have no comment.

(iii) Are there any areas where Credit Unions could provide new additional services to their members?

As noted in the consultation, Credit Unions are currently able to provide a range of services including phone and online access, EFT and ATM services, etc. Further adoption of these services across the movement would facilitate an enhanced role for Credit unions in the provision of the Basic Payment Account.

NABCO has no specific view on further additional services that should be provided by the movement except to recommend that a flexible and enabling approach is adopted towards innovation within the sector.

(iv) Do you agree that a provisioning framework should be developed for Credit Unions as proposed in section 6.2?

NABCO has no specific view on the adoption of the proposed provisioning framework.

(v) Do you agree that the tiered regulatory approach should be introduced at this time?

We recognise that the introduction of a tiered regulatory approach was a key recommendation of the CCU and we welcome the willingness of the Central Bank to explore this approach. In common with the Credit Union movement, we recognise the benefits of an improved approach to regulation and governance.

As discussed above, however, the tiered regulatory approach described in the consultation paper differs significantly from the proposals made by the CCU. A smaller number of categories has been proposed and both categories are subject to far more restrictive regulation than is currently the case. The more sophisticated approach proposed for larger Credit Unions by the CCU has not been provided for. We recommend detailed consideration of responses to this consultation and an openness to re-evaluating the restrictions proposed.

(vi) Do you agree with the proposed timelines for the introduction of the tiered regulatory approach set out in section 7.1?

In light of our comments above recommending a significantly different approach to the proposed restrictions, we suggest that the current proposed timeline is overly ambitious and more time may be required for detailed reflection and further consultation.

Since category 2 Credit Unions are proposed to have less flexibility than is currently the case, we are unconvinced as to the need to apply for category 2 status. We recommend that Credit Unions should be able to self-assess their category in the first instance.