"Introduction of a Tiered Regulatory Approach for Credit Unions"

A Submission by
Rathmore and District Credit Union Limited.

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Introduction

Credit Unions are financial co-operatives owned and controlled by, and operated for the benefit of, their members. A board of directors elected by and answerable to the general membership manages the Credit Union on their behalf. Every adult member has a vote irrespective of his/her shareholding.

"………. members of Credit Unions are just that: members. They belong to and have influence over their local Credit Unions in a way that would be unimaginable for banks and other financial institutions." *(Source: Amarach Research August 2009).*

Credit Unions operate on a not-for-profit basis under the maxim – not for profit, not for charity, but for service. Their democratic structure and non-profit orientation make Credit Unions uniquely different to all other financial institutions. We believe that this community based democratic structure, has created a sound, viable, solid, safe, strong, secure organisation which has in turn cemented a strong, loyal relationship with its membership. This is borne out by the Amarach Research document conducted in August 2009 entitled 'Investing in our Future'.

Methodology

The methodology used in this submission is based on the Purpose of the Consultation Paper CP76 and cover the following areas;

- the tiered regulatory approach
- the introduction and on-going operation of the tiered regulatory approach
- the activities, services and related requirements proposed for each tier
- the development of a provisioning framework for the Credit Union sector; and
- the timelines including the most appropriate time for the introduction of a tiered regulatory approach

Section 4: - Overview of the proposed Tiered Regulatory Approach for Credit Unions

Rathmore and District Credit Union Ltd (RDCU) would in general be in favour of a Tiered Regulatory Approach for Credit Unions. There is however a number of questions that should be answered with regard to the process that would need to be undertaken for an application to have a Credit Union categorised as a Tier 2 Credit Union. This statement will be expanded in further responses to the questions contained within this paper.

Section 5: - Overview of Categories

Rathmore and District Credit Union Ltd (RDCU) is in favour of the operation of the two category approach, however concerns regarding the restrictive nature of the limit of savings and investments is of concern. This will be expanded on further in this paper.

Section 6 – Provisioning

Rathmore and District Credit Union Ltd (RDCU) is in favour of a provisioning framework being developed. These practices are currently being undertaken by the Credit Union sector as part of its daily, monthly and quarterly processes that have been developed in line with the changes to legislation and regulation implemented in recent years and in particular Section 35 of the Credit Union Act 1997. This will be expanded on further in this paper.

Section 7: - Timelines for the introduction of the Tiered Regulatory Approach.

Rathmore and District Credit Union Ltd is not in favour of the proposed timelines for the introduction of the Tiered Regulatory Approach. It is believed that with the work being undertaken by the Credit Union Restructuring Board (REBO), which runs to 2015, the proposed date for commencement is too short, as there may be a substantial reduction in the number of Credit Unions in operation following the completion of REBO's function.

Within CP76, there are items that require further clarification and additional consultation listed hereunder;

1. Application process for a Credit Union to become a Category 2 Credit Union
2. Minimum Operational Risk Reserve Requirement
3. Proposed Savings Limit
4. Proposed Lending Products and Limits
5. Proposed Investment Limits and Products

6. Additional Services
7. Provisioning
8. Timelines

It is the view of RDCU that a number of the above proposals would lead to restriction and stagnation of the Credit Union movement. From the Consultation Paper, there is no evidence provided to support the reasoning behind the proposals.

Have Central Bank prepared an assessment of the impact of the proposed measures on the Credit Union Sector? Publication of such an Impact Assessment should be produced before agreeing timelines for introduction of a Tiered Regulatory Approach.
Mr. James O'Brien (Former Registrar of Credit Unions) speaking at the Regulatory road shows encouraged Credit Unions to seek further income streams in order to address falling revenues. As we await the announcement of a new Registrar to replace Ms. Sharon Donnery, the proposals in CP76 appear to

- Restrict Credit Union development.
- Restrict Credit Union ability to earn income.
- Restrict Credit Union growth to achieve or maintain a Category 2 status.
- Restrict Credit Union in offering personal lending at reasonable rates.

1. *Application process for a Credit Union to become a Category 2 Credit Union*

It is the understanding of RDCU that all Credit Unions are being classed as a Category I Credit Union, and an application to become a Category 2 Credit Union would need to be submitted by all Credit Unions even if close to or over €100m in assets.

- Who will make the assessment of the Credit Unions application for Category 2 status?
- How will the application process be assessed?
- What is the timeframe for a response to the Credit Union?
- Is there an appeal process if application is rejected?

At various road shows (including Regulatory Road Shows) conferences and seminars, concern and frustration has been expressed by Credit Unions at the delays in response from Central Bank. Whilst Credit Unions are expected to respond to Central Bank requests within given response periods, this has not been

reciprocated. For this reason, a standard Application Framework with a standardised reporting format should be developed and this would lead to a smoother application process with added governance for Credit Unions applying as established criteria would be the benchmark for Boards in considering applications.
The introduction of the approval process for Pre-Approval Control Functions has a clear framework and application process and worked effectively for Credit Unions and Central Bank alike. Perhaps such a strategy for the Category 2 application process could be developed?

2. *Minimum Operational Risk Reserve Requirement*
Operational risk has always existed. A need for a Credit Union to borrow (or to lend) will increase operational risk. The restrictions in investments and ability to generate income will also contribute to operational risk.
If such a reserve is proposed, is this additional to the Total Regulatory Reserve of 10%?
Is this reserve an additional reserve and how is the adequacy of the reserve to be calculated? Credit Unions must have a Statutory Reserve Requirement of 8% with a Total Regulatory Reserve Requirement of 10%.
The time frame for Credit Unions to meet the 10% reserve ratio has expired. Will there be a similar timeframe imposed to meet the additional requirements of the Operational Risk Reserve?

3. *Proposed Savings and Deposit Limits*
A proposed savings and deposit limit will cause stagnation within the Credit Union sector and affect both category 1 and 2. With a total deposit to total savings ratio also suggested, this will further increase operational risk for Credit Unions due to;
1. A need to offer more deposits to increase funds available for lending.
2. Create a potential mis-match in lending / deposit rates within the Credit Unions
3. Reduction of potential investment income due to priority of liquidity requirements.

If savings are limited to €100,000, is this to be applied retrospectively or allowed to happen as a natural reduction over time?

4. *Proposed Lending Products and Limits*

The ability of a Credit Union to maximise loan books and lending terms will be greatly restricted by the savings and deposits limits. There are however a number of positives from the lending, namely;

1. Ability to lend to other Credit Unions (this will occur as the Credit Unions with higher loan demand will require funds from other sources as it will not be available from savings and deposits).
2. The increase of the percentage of loans maturing >5 years for category 2 Credit Unions.
3. Introduction of a large exposure limit

What are the proposals to deal with a potential breach of the increased percentages for loans >5 years where a CU's loan book declines?
Are there timeframes proposed for coming into line with proposed percentages?

5. *Proposed Investment Limits and Products*

The products that are proposed as suitable investment type products for each category is similar in nature to the existing guidelines, albeit, the inclusion of Corporate Bonds in Category 2 is welcomed.
The exclusion of bank bonds as an option for a Category 1 Credit Union is significant. However, the inclusion of A-rated Corporate Bonds as an option for Category 2 Credit Unions provides an option for diversification and was an option proposed in a discussion paper produced by Rathmore and District Credit Union Ltd in March 2012.
Good investment practices would see diversity in portfolios in both counterparty and product types therefore the inclusion of Corporate Bonds gives added impetus to investment options. One drawback of investing in only A-rated bonds is that strong performing Irish corporate bonds that would naturally have a better rating only for the sovereign rating being low eg; ESB Networks/Electric Ireland.
Are there proposals to include Irish Corporate Bonds or will these be specifically excluded due to the sovereign rating?

6. *Additional Services*

Returning to comments made by former Registrar James O'Brien in his inaugural Regulatory Forum in 2010, he highlighted the Amarach Research Report carried out on behalf of the Irish League of Credit Unions. In the report, it indicated that both member and non-members would like to transact more of their financial needs through the Credit Union.

Additional services like debit cards and electronic fund transfers, direct debits etc are now the expected norm for any Credit Union.

It is however, possible that introduction of a tiered Credit Union sector at this stage, will prevent Credit Unions from being able to offer these services.

Deferring the implementation of the tiered regulatory approach may afford Credit Unions the opportunity to revise their business model to include these services and generate an income

7. *Provisioning*

Provisioning is undertaken by the Credit Union sector as part of its daily, monthly and quarterly processes that have been developed in line with the changes to legislation and regulation implemented in recent years and in particular Section 35 of the Credit Union Act 1997.

By its nature, provisioning is subjective. Knowing a member and their circumstances are key to decision making and how to deal with a member in financial difficulty.

It is unclear from the statement in Section 6.2 if the proposed provisioning framework will require a revision to Section 35 and rescheduling practices that are currently undertaken in Credit Unions.

It is also unclear if the proposed provisioning framework will be implemented in line with the timelines for the introduction of the tiered regulatory approach.

8. *Timelines*

It is the view of RDCU that the introduction of the proposed changes under CP76 is coming too early. The function of REBO due to be completed in 2015 should be allowed to complete before the introduction of these changes.

The impact on the Credit Union sector and number of larger Credit Unions that will exist post REBO is not yet available.

The Risk Management Framework that would exist in a larger Credit Union entity should by its nature, be far more robust than an individual Category 1 Credit Union. This would also need time to be tested by the new Regulated and Market environment within which a Category 2 Credit Union would exist before implementation across the sector.

9. Conclusion

While the tiered approach was included in the final commission report, the consultation process has only just begun and is considered premature in timing until such time as REBO completes its work.

Many of the proposed restrictions regarding savings and deposits do not serve the Credit Union member who wishes to have the Credit Union as their main financial provider of choice. The need for an impact assessment such proposals will have on the Credit Union sector needs to be completed before progressing.

We agree in having a *'Strong Credit Union in Safe Hands'* and those Credit Unions should be *'Safe, Strong, Secure'* whilst, remaining to exist in serving its members.

The proposals in CP76 will require further discussion and clarification so as not to lead to the stagnation and possible demise of the Credit Union sector.