Introduction of a Tiered Regulatory Approach for Credit Unions

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Section 4

There is a big issue about the cost of compliance: whilst a Credit Union can't compete with a regulated money lender due to the light regulation of same, and Credit Unions are not in the business of lending money at those usurious interest rates, they must be able to offer returns on savings competitive with the banks and must be able to extend credit on terms not very different from the commercial lenders' rates. Regulatory costs can be very significant and that money is wasted when the regulations are not fit for purpose.
I don't see why a two tier approach is necessary. Larger Credit Unions would be expected to deploy more complex business models, but that is not necessarily the case. It would seem to make more sense to base the regulations on which lines of business an individual Credit Union in engaged in – if it extends the range of businesses then the regulatory burden increases.

The two tier approach as set out in this consultation paper would increase existing regulations on tier 1s and place additional burdens on the tier 2s including such expensive regulations as the requiring of a risk officer.

With these increased costs there is no guarantee that the additional regulations will make members savings any safer.

Sections 5.1 - 5.11

The proposed additional restrictions on borrowings, going from 50% of savings to 25% would be a very unwelcome development.

Section 6.2

This is important: it is dangerous to have prescribed provisions as spectacularly demonstrated by the equitable life failure. It is far better that the prudential concept is paramount in setting the provisions.

In addition, an overly cautious basis for calculating the provisions is inefficient and increases costs compared to the banks. While the banks have discretion in this regard which they use, and sometimes abuse, they have a competitive advantage over any institutions that have prescribed provisions. This is enough of an advantage to put the economic viability of the Credit Union sector at very serious risk.

Section 7.1

The issue of regulation should be dealt with in conjunction with the issues relating to the stabilisation fund.

It would also not make very much sense to change the regulations until there is confirmation of who the regulator will be: will the supervisory responsibility stay with the Central Bank into the future or will it be transferred to the ECB? If it is to remain with the Central Bank, will the Central Bank retain sufficient resources to fulfil this function after it loses its role in bank supervision?

The following points emerge from CP 76 but are not the points on which the Central Bank is seeking feedback. I make these points because I believe they give a context to the areas on which feedback is sought, and as such are relevant to the issues at hand:

Stabilisation Fund

There is a question about Credit Unions contributing to a stabilisation fund, presumably to act as an insurance fund to guarantee the solvency of the individual credit unions. This seems to make sense but it doesn't because in the situation where one credit union needs access to these resources, it is many times more likely that several will also need support; the fund is limited and in these circumstances likely to be overwhelmed. If the fund is to be so large that it will be sufficient in these circumstances, it will involve the Credit Union's having so much of their capital tied into the fund that their business efficiency will be significantly impaired.

What is actually required is a credit insurance policy, perhaps organised through the League, and reinsured in the London Market. This would give effectively unlimited resources if the circumstances required it, paid for by premiums paid though over longer time frames, when the risk of such a catastrophe is low.

The availability of insurance and reinsurance will be determined by the insurer's view on the credit worthiness of the individual Credit Unions as well as of the sector, including its profitability, NOT what the regulator thinks is its credit worthiness. The nature of the regulatory oversight, burden, and cost of compliance will materially affect these factors.

This being so both sets of regulation should be considered together, and not in the piecemeal fashion as is currently the case. This is a very good reason to delay the process of introducing any new regulations.

Prudential Requirements and Moral Hazard

Conforming to the regulations is not the same as being financially prudent. There are Fitness of Persons and Prudential rules, and these should be sufficient regulation in most of the areas of concern.

When those areas that should more properly be covered by prudential requirements are covered by formal regulations, a moral hazard is introduced because of the erroneous belief in the minds of the officers and directors of the regulated entity that conforming to regulations is the same as being solvent, therefore the management can do anything it likes so long as they comply to the regulations i.e. the excessive regulations introduce moral hazard and so increase rather than reduce the risk of failure.

Far better that the prudential rules are enforced, and if this were so, there would be no reason for regulator to direct operations on a micro level, which seems to be the goal of the consultative paper.