Introduction of a Tiered Regulatory Approach for Credit Unions

The proposals as set out in Consultation Paper CP 76 impose an unnecessary burden on Credit Unions.

These proposals are not in keeping with those intended by the Commission on Credit Unions.

The Central Bank should consider outlining broad regulatory parameters and setting standards that should be met before certain services are offered, rather than what is proposed in CP 76 which appears to be a micro-management approach.

The proposed approach as set out in Consultation Paper CP 76 is unworkable.

The proposals as set out in Consultation Paper CP 76 with their associated increased regulation would detrimentally restrict the supply of future volunteers who are important to the Credit Union Sector.

The rationale for much of the proposed tiered regulatory approach is not clearly demonstrated.

Credit Unions are already tightly regulated for example the PRISM framework is now in place.

The Commission envisaged that most credit unions would be in the lower tier and therefore not requiring additional levels of regulation to that which is currently in place.

The tiered regulatory approach should be considered together the stabilisation levy and not in the piecemeal fashion as is currently the case. The fact that they are being considered separately is a very good reason to delay the process of introducing any new regulations.

Sections 5.1 - 5.11

The proposals for the operation of the two category approach for credit unions set out in sections 5.1 - 5.11 are unnecessarily restrictive.

- Lending should be based on reserves rather than on assets. The restrictions on loan term are unnecessary.
- The proposed additional restrictions on borrowings, going from 50% of savings to 25% would be a very unwelcome development.
- It is necessary to define ‘Member of the family’ more precisely and more narrowly. This proposal would appear to be discriminatory against Directors who are also Members of CUs.

- The proposals on investments are restrictive and may be detrimental to credit unions and possibly threaten their future viability. These proposals would mean that credit unions would have to hold investments with six or more counterparties as opposed to the current number of four, which would force them to invest funds outside of Ireland. Credit unions should be permitted to invest in collective investment schemes, particularly as this would facilitate investment in State projects as envisaged by the Commission.
- The maximum savings, capped at €100,000, is restrictive and may have the impact of shrinking credit unions and threaten the long term viability of the credit union movement. Banks have no such limits placed on them.
- The proposals to increase the liquidity requirements would impact negatively on credit unions investment income.
- The proposed extra reserve is unnecessary. Credit unions would be unable to pay a dividend if all of their surplus had to go to reserves and lack of a dividend would mean that members would move their savings in search of a return.

Section 6.2

The provisioning framework as proposed in section 6.2 requires further clarification. 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

A longer timeframe than that suggested is needed given all the recent changes which credit unions are implementing. In addition we consider a longer transitional period is needed between the publication and commencement of the regulations than that set out in 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:

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.

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.