The Registry of Credit Unions

Central Bank of Ireland

PO Box 559

Dame St

Dublin 2

28th March 2014

Re: Introduction of a Tiered Regulatory Approach for Credit Unions

The Board of Directors and management team of St Canice’s Kilkenny Credit Union Limited (SCKCU) have assessed Consultation Paper CP76 in relation to its potential impact on SCKCU. The Credit Union supports the concept of a tiered regulatory approach but believes that some of the proposals will have a detrimental effect on the income of the credit union going forward, particularly in relation to investment income which currently makes up 56% of SCKCU’s income. In the current interest rate environment, returns on short term investments have been decimated and are likely to reduce further when the full effect of Basle III impacts.

SCKCU has assessed CP76 based on the assumption that it will qualify as a category 2 credit union and analysis is based on the September 2013 financial statements (see appendix). In preparing the submission the focus has been on where there are concerns and suggestions rather than commenting on all aspects of the proposal.

The main points in relation to the various sections are outlined hereunder.

Section 4

SCKCU supports the proposal to have two regulatory categories. The main issue in relation to the proposed approach is that even credit unions that are significantly above the €100m asset size have to apply for category 2 status. Through PRISM and other inspection mechanisms, these credit unions are already subject to on-going rigorous monitoring. It is the view of SCKCU that they should automatically be placed in category 2. Individual credit unions which do not meet regulatory or legislative requirements should be treated as exceptions, be communicated with and given guidance on what is needed to progress to category 2.

Where credit unions that meet the asset size requirements are prevented from progressing from category 1 status, this could have a detrimental upheaval on business. SCKCU feels that more clarification is needed on the application process and turnaround times and suggests that a standard template should be provided to credit unions to assist them in the process. SCKCU suggests that there should be a mechanism for approving applications that broadly meet the criteria but fall short in some areas and where these shortfalls that can be rectified within an agreed timeframe

Section 5

Home Loans

The possible introduction of a home loan product is welcome and SCKCU considers the maximum term of 25 years and LTV of 80% being reasonable for credit unions. More clarification is needed in relation to cases where members encounter difficulty and the home loan needs to be extended beyond 25 years and SCKCU suggests that there needs to be a mechanism for this. In addition clarification is needed on whether other credit union borrowings will be included in the 80% LTV calculation.

Restricted person limits

It is the view of SCKCU that Restricted Person limitations are extremely restrictive, discriminatory, unworkable and difficult to administer. They are also likely to dissuade volunteers. SCKCU estimates that with 11 board members and a senior management team of four, the restricted person limit will extend to approximately 60 members. If aggregate lending to this group of members is restricted to 5% of regulatory reserves, the maximum average loan will be €21k (€1.26m/60). Furthermore, if a small number of restricted persons are granted loans in excess of the average, others may find that they have little or no access to credit through their credit union. SCKCU strongly suggests that members who will fall in to the proposed Restricted Persons should not be discriminated against. It is the opinion of SCKCU that the current Rule 45 of the Standard Rules for Credit Unions and the credit union's Conflict of Interest policy are the most appropriate mechanisms for dealing with loans to officers.

Investments

SCKCU has an investment portfolio of €166m, from which more than 50 % of income is derived and considers the proposed term and monetary limits on investments to be penal. With loan to savings ratios at an all-time low, credit unions are becoming more and more reliant on investment income to remain viable. The impact of Basle III and falling interest rates means that credit unions need to have a balanced portfolio in terms of maturity profile and investment mix. Credit unions need to be in a position to invest in a broader range of products to maximise income within their pre-set risk appetite

Term limits

The deposit term limit of 7 years will not currently cause an issue for t SCKCU but it is questionable that there is any real merit in restricting deposits to 7 years. SCKCU suggests that category 2 credit unions be allowed to invest a defined percentage of portfolios in government bonds of up to 15 years in term, senior unsecured bank bonds of 10 years and corporate bonds of 10 years.

Monetary limits

SCKCU suggests that where monetary limits are being set they are based on the portfolio size rather than regulatory reserve size. SCKCU has an investment portfolio of €166m and the proposed limits, if ratified, would force a significant restructure of investments. This would mean that products that currently provide reasonable income would have to be diverted in to lower yielding investments, leading to significant erosion of potential surpluses.

SCKCU currently adopts a prudent attitude to investments and the investment committee has actively worked with advisors over the past number of years to reduce exposure to risk and volatility. The following would be specific areas of concern if limits were to change:

The proposed regulation would mean that SCKCU would require 7 counterparties. This in itself is not an issue and SCKCU currently has more than 7 counterparties but the top counterparty would be 28% higher than what would be permitted. SCKCU will continue to spread investments over a number of counterparties to mitigate against risk and to achieve reasonable income but feels that the current limit of 25% with any one counterparty is adequate. Credit unions must have the freedom to invest in the best performing products that fall within the risk appetite set by the board.

SCKCU currently has 106% (€26m) of regulatory reserves in Bank Bonds, 82% of which are ELG or Senior bonds, whereas the proposed limit is €12.6m. However bank bonds are less than 16% of the overall investment portfolio. Therefore SCKCU recommends that the proposed limit is withdrawn. Otherwise, the proposed restrictions will have a serious impact on the credit union's ability to generate sufficient income to maintain a healthy business.

SCKCU suggests that the proposed blanket embargo on collective investments schemes and equities is over-restrictive and believes that a broad mix of investments is needed to reduce risk.

Overall, it is the view of SCKCU that the restrictions imposed by the Trustee Authorised Investment Order and the Guidance note of 2006 are adequate to ensure prudent investment by credit unions

Savings

The rationale behind introducing a blanket ceiling of €100k per member in savings needs to be clarified. SCKCU currently has 82 members with savings in excess of 100k and operates on a limit of €200k per member. It is the view of SCKCU that this is an area that is best left to individual credit unions to set limits, depending on their size, member profile, investment returns and projected cash flows. Currently, members' savings, invested prudently make a significant contribution to income and if this changes into the future SKCKU could change the ceiling as appropriate, depending on investment returns. Should this restriction be introduced, clarification is required on whether or not members will be asked to withdraw savings in excess of €100k.

Additional Services

SCKCU believes that credit unions need to be able to respond to emerging technologies to retain members and remain relevant for members, particularly younger ones. Debit cards and other automated payment methods are a necessity in the current personal market and support the National Payments Plan. It is also the view of SCKCU that having payment systems that facilitate paypath and other forms of automated inward and outward flows along with debit cards will provide credit unions with a greatly improved knowledge of the financial position and spending patterns of members leading to improved underwriting of loans.

Although insurance and asset based finance products are not under consideration at present, provision should be made within the regulation for them in the future subject to appropriate risk assessment and business case analysis.

Governance

SCKCU considers that the term 'dedicated' in relation to RM and compliance officers is restrictive in that it may not allow the person carry out any other duties regardless of the management/operational structure of individual CUs. The appropriate resourcing of these positions should be a matter for individual credit unions and the emphasis should be placed on testing the effectiveness of the roles rather than whether they are dedicated or not.

SCKCU suggests that the Board Oversight Committee is the appropriate body to assess the Board of Directors and there should not be a requirement for external reviews every three years. It must be remembered that that board members are volunteers and there is already provision for assessment of board and board members. In addition, the nominating committee has a role in ensuring a broad spread of expertise. Credit unions will find it increasingly difficult to recruit good quality board members because of the pressures being placed on them as individuals.

SCKCU does not see the need for further reserves in credit unions as they are already well provided for. The new operational risk reserve requirement needs to be clarified in terms of calculation and how it is built up. If it is to be introduced, it should be phased over a period of five years.

Liquidity

SCKCU welcomes the extension of the definition of liquid investments to include investments with more than 3 months maturity if they can be accessed without penalty. Clarification is needed as to whether this can include State Securities and bonds that can be sold on secondary markets at market value.

It is the view of SCKCU that the proposal to place further limits on liquidity is penal, particularly with interest rates close to zero for very short term or call accounts.

SCKCU requires further clarification on what will be required under stress testing and ALM systems. Clarity is needed as to methodology for stress testing and the role of ALM vis a vis investment/finance committee. Also the impact of restriction of savings in relation to ALM needs to be assessed.

Other prudential requirements

It is the view of SCKCU that possible interim audits and excessive additional business continuity testing requirements will be costly and disruptive. Credit Unions have now engaged internal auditors, which along with external auditors, RCU inspections and board oversight committees provide adequate supervision.

Summary

To summarise, SCKCU believes that some of the proposals are over restrictive and if introduced would place enormous pressure on the credit union to generate sufficient income to support a strong operating model. It is in everyone's interest to have healthy and viable credit unions that can provide financial services for members. SCKCU also fears that the voluntary input in credit unions is being overly burdened in coping with all the regulatory requirements, pressures and limitations, which may in turn lead to challenges in recruiting quality board members into the future.

In conclusion, St Canice's Kilkenny Credit Union looks forward to further engagement in relation to the Tiered Regulatory Approach and should further information be required, please contact Claire Lawton, manager

Yours sincerely

Margo Moran

Secretary