St. Columba’s Credit Union
Submission Date: 31st March 2014
Ref: Introduction of a Tiered Regulatory Approach for Credit Unions

(i) Do you agree with the proposed tiered regulatory approach for credit unions? If you have other suggestions please provide them along with the supporting rationale.

We (St. Columba's Credit Union) do not agree with the proposed tiered regulatory approach.

Interestingly, CP76 notes that only 2 international jurisdictions (out of 101 countries worldwide) operate a tiered regulatory approach for their credit union sector [the UK and Ontario, Canada].

Our preference is that a risk-weighted approach is introduced. We believe that this will result in capital requirements that better reflect a credit union's risk profile thereby improving the overall resilience of the sector.

We note that the prudential standards applied by APRA (the Australian Prudential Regulation Authority which overseas banks, credit unions, building societies etc.) require the application of risk-weights to on-balance sheet assets in accordance with the risk classes set out in the standard.
Risk-weights are based on credit rating grades or fixed risk-weights as determined by the standard and are broadly aligned with the likelihood of counterparty default. Institution must, where appropriate, use the ratings of ECAIs (External Credit Assessment Institution) to determine the credit rating grades of an exposure. Institution may use certain CRM (Credit Risk Mitigation) techniques in determining the capital requirement for a transaction or exposure.
APRA may determine the risk weighted amount of a particular on-balance sheet asset exposure of an institution if it considers that the institution has not risk-weighted the exposure appropriately.

We believe that a risk-weighted approach…"supports the continued operation of financially sound and well governed credit unions and facilitates the prudent development of the credit union sector" as envisaged by the Central Bank w.r.t. its regulatory approach proposed in CP76.

Of note, the Basel Committee on Banking Supervision links capital requirements to a % of an institution's risk-weighted assets.

(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? If you have other suggestions, please provide them along with the supporting rationale. It should be noted that tiering is possible where regulation making powers are available to the Central Bank. Where requirements are set out in the 1997 Act they apply to all credit unions and cannot be tiered.

<u>Lending:</u>

We believe that any proposed lending framework should be reflective of the size and complexity of the credit union and its lending capabilities.

We support the framework promoted by DICO (the Deposit Insurance Corporation of Ontario) w.r.t. lending limits. Whereby credit unions are required to establish and implement prudent lending limits that are linked to the

- knowledge and expertise of management and staff;
- business environment in which the credit union operates;
- credit union's risk tolerance; and
- strength of the credit union's capital (ability to absorb losses)

We would welcome further information w.r.t. rationale behind the 'restricted person' definition and proposed limits for lending to such persons.

The introduction of a credit risk rating system (measuring the level of risk of an individual loan, loan class and the loan portfolio) would corroborate and support the risk-weighted approach advocated above.

We believe that the credit union sector can play a crucial role in the Public Private Partnership (PPP) arena. It has the potential to offer value for money and timely delivery of infrastructure when applied to projects of the right scale, risk and operational profile.

Investments:

We believe the proposals are too prescriptive. The nature, scale and complexity of a credit union along with the capability of managing a diversified investment portfolio (internally and/or through outsourced expertise) should form the basis of any framework for investments.

We have conducted an internal regulatory impact analysis based on the proposals and the implications are very significant, namely

- > 50% of the Investment Portfolio would have to be restructured (reallocated to cash deposits or shorter term government bonds)
- Several 'breaches' of counterparty limits would ensue by using 'Regulatory Reserves' as a basis (equating to circa 30% of the Investment Portfolio)
- Assessing the impact i.r.o. the additional liquidity requirements, a fall of between 20% & 60% in investment income depending on the relevant counterparty (relative to deposit rates available for on call to 3 months). The impact is even more acute when changes to permissible investments are considered (relative to existing framework[1]).

The task and challenge w.r.t. restructuring that will ensue is exacerbated by the ongoing consolidation within the Irish banking sector and the volatility experienced within the EEA State Securities (or Sovereign Bond market) is also a concern.

The proposed amendments (i.e. prescribing 'low risk' investments), by their very nature reduces the perceived or inherent risk in the portfolio. Linking counterparty limits to the level of regulatory reserves seems at odds with this proposed framework. As noted above, our preferred model involves the introduction of capital requirements based on a risk-weighted approach to balance sheet assets (i.e. investments).

In addition, depending on balance sheet composition and the level of regulatory reserves, it is conceivable that a credit union could end up with a counterparty exposure in excess of existing regulatory guidelines (i.e. > 25% of the Investment Portfolio).

Savings:

We accept that the Central Bank may prescribe requirements and limits for the adequate protection of the savings of the member and appreciate the correlation of the proposed maximum (€100,000) to the Irish Deposit Guarantee Scheme but are concerned that such a prescription may give the appearance that credit unions are less safe than banks.
We believe that the proposed cap will obstruct/curtail future growth.

[1] *Guidance Note on Investments by Credit Unions (October 2006)*

Borrowings:

No concerns with proposal outlined in CP 76.

Governance:

We accept that Board Evaluations are recognised as an essential component of good governance practices. We believe that any such external evaluation needs to be proportionate and tailored specifically to the Board in relation to our industry (credit union sector).
Choosing the right evaluator is critical and clarification w.r.t. 'who' and 'what' will be evaluated along with the 'techniques' envisaged need to be answered.

Reserves:

Clarification regarding the basis of calculation for the operational risk reserve is vital. We estimate that a requirement of circa 1% is required using the Basic Indicator Approach.
Of note is that 'Basel III' differentiates in relation to systemically important financial institutions (SIFIs) recognising the need for an additional capital requirement (or loss absorbency) ranging from 1% to 2.5%.
Consideration of the nature, scale and complexity of the credit union and whether or not a risk-weighted approach to capital requirements is introduced is very relevant to any proposed basis of calculation.

Liquidity:

Liquidity requirements are linked to the credit union's need to meet liabilities as they arise. The existing requirement to maintain a liquidity ratio of 20% relates to cash and investments having no more than 3 months to maturity.
We recognise that the proposed 'additional liquidity requirements' endeavours to align credit unions with the LCR (Liquidity Coverage Ratio) of Basel. The Capital Requirements Directive IV (CRD IV) and Capital Requirements Regulations (CRR) which represent the EU implementation of Basel III have been agreed.
It is our understanding that the objective of the LCR is to promote the short-term resilience of the liquidity risk profile of banks. It does this by ensuring that banks have an adequate stock of unencumbered high-quality liquid assets (HQLA) that can be converted easily and immediately into cash to meet their liquidity needs for a 30 calendar day liquidity stress scenario.
There are prescribed liquidity run-off rates that a bank must use to calculate its total net cash outflows over the 30-day stress period.
Our concern is twofold:

(a) Proposed % requirements relative to CRR/LCR run off rates (i.e. 5% for 'Retail Deposits')
(b) 7-Day Requirement given that the LCR relates to a 30 Day Requirement

We would like to understand the rationale w.r.t. the 7-day requirement and believe that both proposed ratios for 7-day and 30-day availability (10% & 15% respectively) are too high given that most of our accounts are insured and that all our members would be considered as retail depositors.

Separately, we have analysed the liquidity profile of our credit union over the past few years and the results highlight a negligible liquidity requirement relative to the proposed additional requirements.

(iii) Are there any areas where credit unions could provide new additional products or services to their members? Should these be available to category 1 and category 2 credit unions or only category 2 credit unions? If you have suggestions please provide them along with the supporting rationale and the associated additional requirements.

We would support the introduction of products and services that enhance/supplement our core services (namely savings and loans) e.g. introduction of Hire Purchase, online/mobile banking.
S.I. No. 223/2004 (exemption from additional services regulations) could be supplemented in light of the progress and development of technology since the regulations came into operation.
We would advocate that other insurance services should be supplied centrally to benefit from economies of scale that ensue.

(iv) Do you agree that a provisioning framework should be developed for credit unions as proposed in section 6.2? If you have additional proposals please provide them along with the supporting rationale.

Yes, we agree that a provisioning framework should be developed to promote consistency and best practice w.r.t. provisioning policy and disclosure requirements.
Again, the framework should be closely linked to the 'credit risk-weighted' approach noted above.

(v) Do you agree that the tiered regulatory approach should be introduced at this time? If you consider that alternative timing is more appropriate, please provide suggestions, along with the supporting rationale.

We do not agree that the tiered regulatory approach should be introduced at this time. Our preference is for a risk-weighted framework to be introduced.

The scale of the changes proposed is also a concern. Given the present reliance on investment income (w.r.t. most credit unions' balance sheet composition) the impact of change may threaten the viability of the sector. Whilst we have experienced an increase in loan demand the rate of growth would not be commensurate or offset the potential adverse impact to income generation within the investment portfolio.

(vi) If it is considered that the tiered regulatory approach should be introduced at this time, do you agree with the proposed timelines for the introduction of the tiered regulatory approach set out in section 7.1, in particular the transitional period proposed between the publication and commencement of the regulations? If you have other suggestions please provide them, along with the supporting rationale.

N/A