Introduction of a Tiered Regulatory Approach for Credit Unions

Consultation Paper CP 76

Tipperary Credit Union Limited Submission

Date: March 2014

Section 4.8 - Question (1)

'"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".

Response

Introduction:

Tipperary Credit Union does not agree with the proposed tiered regulatory approach for credit unions as outlined in the Central Bank's Consultation Paper CP76 'Consultation on the Introduction of a Tiered Regulatory Approach for Credit Unions. It does agree with the fundamental recommendation in the report of the Commission on Credit Unions for the 'introduction of a tiered regulatory approach with requirements that are proportionate to the nature, scale and complexity of business undertaken'. However it is not happy with the approach taken to tiered regulation, both in the Commission Report and in the CP76 Paper.

Tipperary Credit Union had and still has, major concerns regarding the three tier approach to regulation as promulgated by the Commission Report, especially in relation to Type 2 Credit Unions (i.e., Credit Unions with Assets of between ten and one hundred million euros), and the two tier approach (Category 1 and 2) as outlined in the Consultation Paper CP76.

TCU considers that the Asset Range (€10 to €100 million) for Credit Unions captured under the type 2 proposals are too wide ranging and unfair to both Credit Unions falling at the lower and upper levels of this range. There is a vast difference in the operational requirements for Credit Unions at the lower end of the Asset scale as compared with those at the higher end.

TCU also believes that the restrictions on a Credit Union's business outlined in the Commission report for Type 2 Credit Unions and the restrictions outlined for Category 1 Credit Unions in the CP76 Paper (i.e., limited commercial lending and limited ability to invest in longer maturities and in government bonds) could destabilise the existing business model for some credit unions, including Tipperary Credit Union, damage the growth prospects for credit unions; reduce the products and services currently offered to members, and seriously affect the viability of the Credit Union itself.

Under the proposed structure, Tipperary Credit Union, with Assets of €93 million, has no option but to attain Category 2 Status as its current business model (See Page 6 below) would be severely restricted if it was classified as a Category 1 Credit Union. Agreement also needs to be reached on the products and services that can be offered in each category, and in particular, restriction on Lending, Investments and products on which the Consultation Paper CP 76 is silent on (e.g. Secured Loans, both personal and commercial).

Section 4.8 - Question (1) – SUMMARY Points

1. Tipperary Credit Union does not agree with the proposed tiered regulatory approach for credit unions as outlined in Paper CP76. It does agree with the 'introduction of a tiered regulatory approach with requirements that are proportionate to the nature, scale and complexity of business undertaken'. However it is not happy with the approach taken to tiered regulation, especially the €100 million Asset cut-off point. We would like clarification on how the €100 million Asset cut-off point was arrived at?
2. We would also like clarification of what is meant by 'close to' €100 million as this is extremely important to Tipperary Credit Union (currently with Assets of €93 million)
3. Clarification is needed as to what level of assets are required before a credit union can apply for Category 2, i.e., does the credit union have to have assets '*close to or above €100 million'* or will a Credit Union's current performance and operational capacity be taken into account, irrespective of Asset size?
4. The Consultation Paper, in paragraph 4.3, page 15, states in relation to Category 1 Credit Unions that *"all credit unions able to offer a range of activities and services comparable to those that they currently offer.* Further analysis of the Consultation Paper reveals an apparent contradiction in the comments above. The proposed split of Credit Unions into Category 1 and Category 2 Credit Unions and the proposed restrictions and limits attaching to each category would seem to preclude Credit Unions in being able to offer "*a range of activities and services comparable to those they currently offer*"
5. There may be constitutional issues regarding the restriction of credit to certain members, especially 'restricted persons'
6. Rather than the proposed Category Split based solely on Asset Size, Tipperary Credit Union would prefer to see Regulatory Categories based on a Credit Union's experience to date; financial performance; strength; capacity to deliver; governance structure; risk profile; products and services offered; IT and delivery systems; loan Book and Arrears performance as a basis for entry into a particular category. The Asset size of a Credit Union should only be used as a guide. Weighting should also be

given to a Credit Union's Loan to Asset Ratio, Capital Ratio, Financial Projections, and it's Return on Assets

7. What is the rationale for following the two-tier regulatory system in the UK and Ontario Canada? Were other models examined?
8. There appears to be an underlying assumption throughout Consultation Paper CP76 that only Credit Unions with close to or in excess of €100 million in Assets are capable of operating a sophisticated business model. Tipperary Credit Union (with current Assets of €93 million) considers itself a progress credit union, with the necessary scale, skills and competency to operate a business model over and above what is proposed for Category 1 Credit Unions.
9. A number of the business restrictions outlined in the Consultation Paper (for both Category 1 and Category 2 Credit Unions) will seriously affect TCU's current business model and could have a major effect on our financial projections and operating capacity into the future.

Detailed Comments:

Credit Unions 'Close to or above €100 million'

The proposed tiered regulatory approach outlined in the Consultation Paper CP76 suggests a two tiered regulatory approach, i.e. Category 1 Credit Unions (incorporating Type 1 and Type 2 Credit Unions as proposed in the Commission's Report), and Category 2 Credit Unions (Type 3 in the Commission's Report). In paragraph 4.5 on page 16 of the Consultation paper, it states that *"it is expected that in general, credit unions that apply to become Category 2 credit unions will have assets close to or above €100 million".* We assume that this figure of €100 million in assets has been taken from the Commission Report. However, there is no logic, rationale or workings in the Commission's report as to where they came up with this figure of €100 million, nor is there any explanation in the Consultation Paper. We would like clarification on how this €100 million cut-off point was arrived at and would also like clarification of what is meant by '*close to'* €100 million as this is extremely important to Tipperary Credit Union with current assets of €93 million, possibly rising to €97 million by the end of 2014.

Applying to become a Category 2 Credit Union

Paragraph 4.2.2 on page 14 says that a credit union can *"apply to become a category 2 credit union"* and this is welcome. However, clarification is needed as to what level of assets are required before a credit union can apply, i.e., does the credit union have to have assets '*close to or above €100 million'* or will a Credit Union's current performance and operational capacity be taken into account, irrespective of Asset size?

[Credit Unions able to offer services 'comparable to those that the currently offer?]

The Consultation Paper CP76 correctly identifies (In Section 1) the objects of Credit Unions as being the '*accumulation of savings*' and the *'creation of sources of credit'*. A regulatory approach must be adopted to regulate the sector, and this is not disputed.

The Consultation Paper further states in Section 1 that credit unions *"that are capable of and wish to offer a more sophisticated model would be subject to a more sophisticated regulatory regime proportionate to the nature, scale and complexity of the credit union".* Again, this principal is not disputed.

The Consultation Paper, in paragraph 4.3, page 15, states in relation to Category 1 Credit Unions that *"all credit unions able to offer a range of activities and services comparable to those that they currently offer".* This would seem to imply that credit unions, such as Tipperary Credit Union, can continue to offer the products and services they currently offer, which would include, in our case, secured loans, long term lending, Investments in Government Gilts up to ten years, etc.

However, further analysis of the Consultation Paper reveals an apparent contradiction in the comments above. The proposed split of Credit Unions into Category 1 and Category 2 Credit Unions and the proposed restrictions and limits attaching to each category would seem to preclude Credit Unions in being able to offer "*a range of activities and services comparable to those they currently offer".* Also, a number of proposed restrictions, specifically in relation to limiting member savings to €100,000; limiting loan terms to 15 years; limiting of loans to 'restricted persons' and limiting investment terms to 5 years, would appear to go against the 'objects' of a credit union in relation to accumulation of savings and the provision of credit. There may also be constitutional issues regarding the restriction of credit to certain members.

Flexibility within the Current Regulatory Framework?

Paragraph 4.1 on pager 13 of the Consultation paper says that *"the nature, scale and complexity of a credit union is determined by the individual characteristics of that credit union….The blend of these characteristics will vary for each credit union and this is taken into account in the application of regulatory requirements in the regulatory framework. This provides credit unions with the flexibility to operate different aspects of their business with differing levels of nature, scale and complexity within the current regulatory framework".* This statement is welcome but we have a concern regarding the term '*current regulatory framework'* and fear the above aspiration may change.

Tipperary Credit Union's view of the make-up of the Tiered Categories

Tipperary Credit Union has no issues with the Central Bank introducing a tiered regulatory approach for Credit Unions. However, the proposed two tier approach is considered too restrictive, especially regarding the €100 million cut-off point and the restrictions proposed for those Credit Unions below €100 million.

Rather than categorise Credit Unions by specific Asset size on what they can and can't do, TCU would expect to see Regulatory Categories based on a Credit Unions experience to date; financial performance; strength; capacity to deliver; governance structure; risk profile; products and services offered; IT and delivery systems; loan Book and Arrears performance as a basis for entry into a particular category. The Asset size of a Credit Union should only be used as a guide. Weighting should also be given to a Credit Union's Loan to Asset Ratio, Capital Ratio, Financial Projections, and it's Return on Assets.

It may happen that a two tier system suffices, but progressive and successful credit unions (below the current €100 million mark) would not be excluded. We feel that a two tier Credit Union System, based solely on Asset size, will force Category 1 Credit Unions to downsize, as their ability to grow is restricted and lending opportunities are missed.

International Jurisdiction – Two Tier Model

Paragraph 2.3 on page 10 of the Consultation Paper indicates that two international jurisdictions, the UK and Ontario, Canada, regulate their credit unions on a two tier basis. What is the rationale for choosing these two jurisdictions and what other models were considered?

Tipperary Credit Union – Concerns for its current Business Model

The Commission Report recommended that *"credit unions that are capable of operating a more sophisticated business model should be allowed to offer a wider range of products and services and engage in a broader range of lending and investment activities subject to more sophisticated requirements".* Tipperary Credit Union accepts this recommendation.

However, there appears to be an underlying assumption throughout Consultation Paper CP76 that only Credit Unions with close to or in excess of €100 million in Assets are capable of operating a sophisticated business model.

Tipperary Credit Union would contend that there are a number of Credit Unions with Assets below €100 million, including ourselves, who have successfully operated a sophisticated business model to date and whose results and operation have demonstrated this.

Tipperary Credit Union - Current Business Model:

Tipperary Credit Union (with current Assets of €93 million) considers itself a progress credit union, with the necessary scale, skills and competency to operate a business model over and above what is proposed for Category 1 Credit Unions. Tipperary Credit Union has the following characteristics and attributes:

- Good Governance systems in place, in compliance with the requirements under the Credit Union Act 1997 to 2012
- Good risk management processes in place
- Fully abides by the Fitness & Probity requirements. Abides totally with the Minimum Competency Requirement, with all staff and a majority of volunteers holding a recognised qualification
- Has robust and good IT systems in place (Wellington Computer Systems, SAGE and NSSL)
- Offers multiple loan products, ranging from Community Development Loans at 5.5% APR, Secured Loans (1st Legal Charges) at 6% APR, Education and Covered Loans at 6.6% APR, Car Loans at 7.4% APR, Business and Home Improvement Loans at 7.5% APR and Personal Unsecured Loans at 9.9% APR
- Has the 40% Section 35 lending limit for loans over five years, of which 15% is allowed over ten years.
- Offers a secured loan (mortgage) product to its members for the past ten years. These are loans for personal or commercial purposes (houses, land, sites, extensions, etc.,) between €40,000 and €225,000, secured by way of a first legal charge, fully underwritten and for terms of up to twenty years.
- Undertakes an external loans book review on a quarterly basis (carried out by Grant Thornton using the 'roll-rate' methodology'). TCU carries a Bad Debt Provision in excess of €1 million over the provision recommended by the Grant Thornton 'roll rate' provisioning method.
- Has consistently kept it's A1 default ratio below 6%
- Has Reserves in excess of 15%, with a Statutory Reserve of over 11%.
- To mitigate against falling Investment rates, TCU has invested heavily in Irish Government Gilts since 2011, especially the bench mark 2023 ten year bond. TCU's return on its investments is maintained at over 3%.
- Maintains current liquidity of over 30% of its unattached savings on an on-going basis
- TCU Is fully SEPA compliant.
- Has invested heavily in EFT services and has operated Direct Debits for over 12 years. Note, Over 60% of our loans are repaid by Direct Debit.
- Has its own Sort Code, and uses the services of BNP and BOI EFT services

- Has its own ATM machine, and is linked to the ATM network nationwide (through CU Solutions and BOI)
- Has an on-line, interactive Web Site, with EFT capability
- Operates a SAGE 200 Accounting package, which can report results by cost centre and by branch.
- Operates a Head Office and five sub offices, all linked to the central computer system
- Has 30 staff, 15 full time and 15 part time, 11 Directors, 3 Board Oversight Committee members, all required committees in place, including a Risk Committee, Audit Committee, and Remuneration Committee.
- Has good policies and procedures in place
- Has a comprehensive Strategic Plan in place (2013 to 2018)
- Has a business continuity plan in place

A number of the business restrictions outlined in the Consultation Paper (for both Category 1 and Category 2 Credit Unions) will seriously affect TCU's <u>current business model</u> (outlined above) and could have a major effect on our financial projections and operating capacity into the future. Specifically, restrictions on lending – secured loans, lending term up to 15 years, and investment terms up to 5 years will affect and change fundamentally or current business model.

Section 5.12 - Question (I)

'"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 supporting rationale"

Response

Introduction

The answer to this question is that Tipperary Credit Union agrees with some of the proposals, disagrees with others and has fundamental concerns on at least two proposals, namely those relating to Lending and Investments.

Under the strengthened regulatory framework, as set out in the Credit Union Act 1997 - 2012, the Central Bank may impose requirements on all credit unions or a category or categories of credit unions facilitating the introduction of a tiered regulatory approach. The key areas where the Central Bank proposes to make regulations are lending, investments, savings, borrowings, additional services, governance, reserves and liquidity.

Stating the obvious, the Central Bank's remit is to regulate the Credit Union sector. Their aim is regulate Credit Unions by means of a tiered regulatory approach, the mechanics of which are currently under discussion. They are also charged with strengthening the sector by acquiring additional regulatory making powers in a number of areas, including lending, investments, etc. Regulation of the sector is taken as a given. Micro-managing the credit union sector through the imposition of strict operational parameters, fundamental changes to the credit union's business model, restrictions on lending, savings and investments etc., is another thing and needs to be analysed carefully as to the effect these changes will have on the future of the movement.

It is accepted that the existing credit union model is flawed, particularly in the governance area, and these deficiencies have been correctly addressed in the Credit Union Act 1997 to 2012 as amended. However the core objective of a credit union is still to lend money and manage member savings. Savings not lend out have to be invested prudently. Over-burdening the Credit Union sector with excessive and wide ranging operational restrictions, especially in relation to savings and loans, could affect a Credit Unions ability to grow and prosper.

The vast majority of a credit union's Income comes from Loan interest and from Investment interest. To fund its operations, money is received from member savings. Restrictions in these areas, as proposed in the Consultation Paper CP76, may seriously affect the future viability on many credit unions.

Currently, Loan Income is falling as loan books decline. The asset mix in the Balance Sheet is changing, with loans as a percentage of Assets below 25% in many credit unions. (Note: Tipperary Credit Union's Loans to Asset Ratio is currently at 36.5%). Conversely, Investments as a percentage of Assets are rising but Investment returns are declining and are at historically low levels. Savings, however, continue to increase. New member numbers continue to increase. Cash reserves continue to increase. The profile of Credit Union members is changing with the percentage of borrowing members declining and below 20% in many credit unions (T.C.U current has a 24% borrowing members to total member's ratio)

Non-interest Income (Fees and Commission) is practically non-existent in the Credit Union movement (less than 0.1% of Total Income) and is not even on the table for discussion. As the main Interest income sources decline rapidly, credit unions, in our opinion, need to seriously address the area on non-interest income.

The Consultation Paper CP76 proposes limiting the categories of loans which credit unions can offer; limiting the amount of certain loans; limiting the term that loans can be offered for; limiting the amount a member can save in the credit union; limiting where a credit union can invest its surplus funds; limiting the length of time that investments can be made; and introduces lending limits for 'restrictive persons'. The introduction of some of these restrictions, in Tipperary Credit Union's view, will further dampen Income expectations (both loan and investment income) and reduce loan demand as product options are reduced or prescribed.

The Consultation Paper remains silent on the introduction of Income generating products (except for home loans which will be discussed below), or for the growth in non-interest income, fees or charges. In addition, Costs on credit unions will rise due to additional reserve requirements, increased provisions and regulatory and other costs.

Summary Points - Section 5.12 - Question (I)

1. Tipperary Credit Union agrees with some of the proposals, disagrees with others and has fundamental concerns on at least two proposals, namely those relating to Lending and Investments
2. Micro-managing the credit union sector through the imposition of strict operational parameters, fundamental changes to the credit union's current business model, and restrictions on lending, savings and investments etc. needs to be analysed carefully as to the effect these changes will have on the future of the movement.
3. Non-interest Income (Fees and Commission) is practically non-existent in the Credit Union movement (less than 0.1% of Total Income) and is not even on the table for discussion.

4. The introduction of some of these restrictions, in Tipperary Credit Unions view, will further dampen Income expectations (both loan and investment income) and reduce loan demand as product options are reduced or prescribed.
5. A number of the business restrictions outlined in the Consultation Paper (for both Category 1 and Category 2 Credit Unions)k, particularly in relation to loans and investments, will seriously affect TCU's current business model (see Page 6) and could have a major effect on our financial projections and operating capacity into the future.
6. Tipperary Credit Union is of the view that the proposed four classes of lending – Personal Loans, Commercial Loans, Community Loans and Loans to other credit unions, is too restrictive and does not take account of the classes of lending currently in operation in some credit unions, including Tipperary Credit Union. TCU believes that the above categories should be sub-divided into 'Secured' and 'Unsecured' Loans, with different limits and loan terms applying to each of the sub-divisions.
7. Category 1 Limit of 25% of Regulatory Reserve in relation to Commercial Lending is very restrictive, especially for Credit Unions at the higher end of the Category 1 scale. Many credit unions will have exceeded this figure already, so will have no hope of growing their commercial loan book into the future. TCU believes that this limit should be increased to that similar to what is proposed for category 2 credit unions, i.e., 100% of Regulatory Reserve
8. Tipperary Credit Union has been of the view for some time that the maturity restrictions in place under Section 35 of the Credit Unions Act are too restrictive and anti-business
9. TCU needs clarification on where it would stand in the proposed new regulatory regime regarding the existing Secured Loan Products it offers and what would happen going forward.
10. Section 35 limits in relation to Re-Negotiated loans, and particularly the restrictions on members borrowing again for some time, following a re-negotiation, are also affecting business
11. Tipperary Credit Union falls into the category of Credit Unions that currently carry our limited lending in relation to 'Home Loans'. We feel, however, that further detailed analysis is needed in this area, specifically, what is meant by 'Home Loans'? In TCU, any loan over €40,000, up to a maximum of €225,000, has to have security by way of a first legal charge over property or land. These loans are a mixture of 'home Loans' in their truest sense, i.e. Loans to build new houses and Loans to purchase family homes They also include loans to purchase a site; loans to purchase farming land; loans to build extensions; loans to buy-out council mortgages; loans to build farming sheds, bulk tanks, slatted sheds; loans to purchase business premises, as well as community loans

12. Restricting loans to family members, based on restricted person limits may prove problematic and open to a legal challenge.
13. Clarification needed in respect of the figure for total large exposures of *'up to 500% of the Regulatory Reserve':* Is the figure correct?
14. Tipperary Credit Union would like a clear definition of what is meant by 'Commercial Loans'. The definition provided is too broad.
15. Tipperary Credit Union is concerned about the proposed Investment restrictions for Category 1 Credit Unions. As currently proposed, TCU, with Assets of €93 million, may fall within this Category. It is proposed that the maximum maturity for Investments would be five years, of which 50% can be invested after three years. TCU believes this is too restrictive in the current low interest rate environment and would damage its business.
16. TCU needs clarification on where it would stand in the proposed new regulatory regime regarding the existing Investment Portfolio it holds, and in particular to its strategy regarding medium and long term Government Gilts.
17. TCU also believes that an analysis of all Credit Union Investment portfolios should be undertaken to see the effect the proposed Investment changes would have on existing and projected Investment Income and the structure of the portfolios. This should be done for proposed Category 1 and Category 2 Credit Unions.
18. Tipperary Credit Union does not agree with the proposed restriction that "savings should be limited (for any one member) to the lower of €100,000 or 1% of Assets for Category 1 credit unions or €100,000 for category 2 credit unions"
19. In relation to Category 2 Credit Unions which will require an 'Asset and Liability Committee', could draft terms of reference be provided for this Committee?
20. In section 5.7.2 it states that Category 2 credit unions require a "dedicated risk management officer, dedicated compliance officer and a dedicated internal audit function" What is exactly meant by 'dedicated'. Does it mean doing away with dual roles?
21. TCU would like to see this Operational Risk Reserve classified as a 'General Reserve' as opposed to a Capital or Statutory Reserve
22. Clarification needs to be provided on what is meant by 'additional short term liquidity requirements' for Category 1 and 2 Credit Unions?
23. It is proposed in Section 5.10.1 that "assets of a credit union to be held in liquid form will be at least 10% of unattached savings available up to seven days and up to 15% of unattached savings available up to one month." This is a significant change to the current liquidity requirements of 30% of unattached savings to be held in three month or less short term funds and will further reduce Investment Income.
24. Tipperary Credit Union has asked the Central Bank to consider allowing Irish Government Gilts be treated as Liquid Investments on the basis that they are readily saleable

25. The proposal on 'additional requirements in relation to the frequency of business continuity testing' needs to be set out in more detail.

Section 5 – Comments on specific proposals in the Consultation Paper CP 76

Detailed Comments:

Section 5.1.1 Lending, Section 5.1.2 and Section 5.2

A number of the business restrictions outlined in the Consultation Paper (for both Category 1 and Category 2 Credit Unions) will seriously affect TCU's current business model (See Page 6) and could have a major effect on our financial projections and operating capacity into the future. Specifically, restrictions on lending – secured loans, lending term up to 15 years, and investment terms up to 5 years will affect and change fundamentally our current business model.

5.2.1 Classes of Lending

Tipperary Credit Union is of the view that the proposed four classes of lending – Personal Loans, Commercial Loans, Community Loans and Loans to other credit unions, is too restrictive and does not take account of the classes of lending currently in operation in some credit unions, including Tipperary Credit Union.

TCU believes that the above categories should be sub-divided into 'Secured' and 'Unsecured' Loans, with different limits and loan terms applying to each of the sub-divisions.

Tipperary Credit Union has been very successful to date in promoting and selling its **'Secured Loan '**product. These loans can be in relation to 'Secured Personal Loans', 'Secured Commercial or Business Loans' or 'Secured Community Loans'. There are also unsecured loans sold under these categories, as well as a combination of secured and unsecured loans advanced to some members.

In Tipperary Credit Union, any loan over €40,000, up to a maximum of €225,000, has to have security by way of a first legal charge over property or land. These loans are a mixture of 'home Loans' in their truest sense, i.e. Loans to build new houses, Loans to purchase family homes (new and existing), loans to buy-out Council Mortgages, but they also include loans to purchase a site; loans to purchase farming land; loans to build extensions; loans to buy-out existing bank mortgages; loans to build farming sheds, bulk tanks, slatted sheds; loans to purchase business premises, as well as community loans, such as loans to build Soccer / GAA stands, purchase land for football pitches, etc.

Tipperary Credit Union is very successful in offering unsecured loans up to €40,000 in aggregate to any one member; loans up to €40,000 secured by shares; and loans over €40,000, up to €225,000, secured by way of a first legal charge over property or land. The prime security for any loan, however, is the members 'ability to repay the loan'.

Unfortunately, S35 of the Credit Union Act, in relation to the amount of lending we can carry out over five and ten years, restricts us in our ability to increase lending in certain areas, particularly for loans in excess of €40,000, i.e., Secured loans. Currently, TCU can lend (under the S35 40% extension limit) only 25% of its loan book over 5 years and 15% over ten years. With a loan book of €34 million, the maximum TCU can lend over ten years is €5.1 million. At February 2014, TCU had lent €4.6 million, or 13.5% over ten years (the vast majority for secured loans), leaving only €500k available to lend.

5.2.2 Concentration Limits

The proposed Limits for lending to other Credit Unions (12.5%) and for Community Lending (25%) appear fair.

The Category 1 Limit of 25% of Regulatory Reserve in relation to Commercial Lending is very restrictive, especially for Credit Unions at the higher end of the Category 1 scale. For a credit union with Assets of €90 million and a Regulatory Reserve, of say, €10 million, then the maximum they can lend for commercial loans, under this proposal, is €2.5 million. Many credit unions will have exceeded this figure already, so will have no hope of growing their commercial or business loan book into the future. TCU believes that this Category 1 limit should be increased to that similar to what is proposed for category 2 credit unions, i.e., 100% of Regulatory Reserve

5.2.3 Maturity Limits

Tipperary Credit Union has been of the view for some time that the maturity restrictions in place under Section 35 of the Credit Unions Act are too restrictive and anti-business. TCU has operated for many years and has successfully maintained the 40% extension limit for loans over five years. TCU has worked within these limits but is finding that the 15% limit on lending over ten years is seriously restricting us in promoting any long term loan product.

TCU can lend (under S35 extension limits) 15% of its loan book over 10 years. With a loan book of €34 million, the maximum we can lend over ten years is €5.1 million. At February 2014, TCU had lent €4.6 million, or 13.5% over ten years leaving €500k available to lend. This is equivalent to only five loans at €100k each. Once we reach the 15% limit we have to stop lending. There is no point then in spending huge sums on marketing and promotions for a long term ‘secured’ loan product or a ‘Home Loan’ product unless the Section 35 term restriction are relaxed significantly.

TCU needs clarification on where it would stand in the proposed new regulatory regime regarding the existing Secured Loan Products it offers and what would happen going forward. As it is proposed, TCU may fall into Category 1 and be restricted to 10% lending over ten years and a maximum loan term of 15 years. This is despite the fact we have successfully operated the Section 35, 40% extension limit for many years and have a good clean secured loan book already in place. TCU’s top 50 loans are all long term loans, secured by way of a first legal charge, and all performing well. Our main concern is that the existing S35 limits is currently restricting our ability to lend good quality loans and thus is restricting business. Further restrictions may dampen future business prospects and growth, irrespective of which category we are in.

Section 35 limits in relation to Re-Negotiated loans, and particularly the restrictions on members borrowing again for some time, following a re-negotiation, are also affecting business. A credit union, with say, 5,000 borrowing members, of which 500 have been re-negotiated, has lost 10% of its borrowing member power. This is having an impact on loans advanced by credit unions and was evident in many Credit Unions last December when lending was down significantly across the board.

Home Loans

Section 5.2.3 on page 23 of the Consultation paper says that *“currently credit unions are not prohibited from providing home loans to members. However, home loans are subject to the maturity limits contained in section 35(2) of the 1997 Act. Based on the Central Bank analysis a small number of credit unions currently carry out limited lending in relation to home loans. Consideration is being given as to whether category 2 credit unions should be permitted to provide a specific class of home loans to members within the lending limits, including maturity limits”*

Tipperary Credit Union falls into this category of Credit Unions that currently carry our limited lending in relation to ‘Home Loans’. We feel, however, that further detailed analysis is needed in this area, specifically, what is meant by ‘Home Loans’? Tipperary Credit Union has been very successful to date in promoting and selling its ‘Secured Loan ‘product. As stated earlier, any loan over €40,000, up to a maximum of €225,000, in TCU, has to have security by way of a first legal charge over property or land. These loans are a mixture of ‘home Loans’ in their truest sense, i.e. Loans to build new houses and Loans to purchase family homes They also include loans to purchase a site; loans to purchase farming land; loans to build extensions; loans to buy-out council mortgages; loans to build farming sheds, bulk tanks, slatted sheds; loans to purchase business premises, as well as community loans, such as loans to build Soccer / GAA stands, purchase land for football pitches, etc.

The top 50 loans in TCU are all secured loans or mortgages, secured by first legal charges and are all performing well.

S35 of the Credit Union Act, in relation to the amount of lending we can carry out over five and ten years, restricts us in our ability to increase lending in this area. Currently, TCU can lend (under S35 extension limits) 15% of its loan book over 10 years. It is currently at 13.5% lent over ten years. Once we reach the 15% limit we have to stop lending.

There is no point then in discussing the introduction of a 'Home Loan' product for us unless the Section 35 term restriction are relaxed significantly. If this were to happen, then TCU welcomes the proposals in relation to Home Loans (principle private residence) set out in Section 5.2.3 of the Consultation Plan.

Section 5.2.4 Restricted Person Limits

On first reading, the proposal that "the aggregate of lending to restricted persons can be up to the greater of €200,000 or 5% of the Regulatory Reserve" seems reasonable. However,

- TCU assumes that this limit refers to any one restricted person and not an overall credit union limit.
- Assuming a €10 million Regulatory Reserve, limit at 5% would be €500,000. This amount seems reasonable. However it may prove problematic for some Credit Unions, especially Community Credit Unions, where some extended families are large and not necessarily connected financially to each other. Our fear would be that if we refused a member credit on the basis of other family members' aggregate borrowings with the Credit Union exceeding a particular threshold, then this may lead to a legal challenge and may be unconstitutional.

Section 5.2.5 Large Exposure Limit

Proposed Large exposure limits seem reasonably

Please clarify if the figure for total large exposures of 'up to 500% of the Regulatory Reserve' is correct?

Section 5.2.6 Lending Practices and Polices

As stated earlier, Tipperary Credit Union believes that the lending practices for rescheduled loans contained in Section 35 Regulatory Requirements for Credit Unions, especially in relation to a member's ability to re-borrow after a period of time, following a reschedule, is having a negative impact on new business lending. Rescheduling takes place for a variety of different reasons and some members, who genuinely go into arrears (say following an extended maternity leave) and then regularise or reschedule their loan, find themselves unable to borrow for at least a year. This is a major concern and annoyance to some members.

It is accepted that some members get themselves into financial difficulty and may never recover fully. Advancing additional credit in this circumstance is high risk. However, there are many other situations where a member (with a perfect credit record to date) may experience a temporary difficulty, such as the loss of a job, death in the family, separation / divorce, etc., but make suitable arrangements to regularise their account and resume their perfect repayment record thereafter. It is unfair to penalise this type of borrower by not allowing them to borrow again for at least a year.

TCU would like Section 35 reviewed, especially in relation to the impact it is having on the Credit Union movement and our members.

Tipperary Credit Union would like a clear definition of what is meant by 'Commercial Loans'. Section 5.2.1 of the Consultation Plan defines a Commercial Loan as "*a loan, the primary objective of which is to fund an activity whose purpose is to make a profit*". This is fair enough where loan applications are obviously for business purposes and the amount is significant (say over €20k). In this scenario, the proposed requirement in Section 5.2.6 for a '*credible business plan and robust financial projections'* seem justified. However, if a taxi man applies to borrow, say €3k to repair his car, or a farmer requests a loan for feedstuffs of say €5,000, or his wife, who is financially connected to him, requests a holiday loan of €4,000, then these could be classified as commercial loans and a request for a credible business plan and robust financial projections in these instances, seem way over the top.

Investments - Section 5.1.1, 5.1.2 and 5.3

Tipperary Credit Union does not accept some of the proposals for Investments as set out in Section 5.3.2 for Category 1 Credit Unions

Tipperary Credit Union is concerned about the proposed Investment restrictions for Category 1 Credit Unions. As currently proposed, TCU, with Assets of €93 million, may fall within this Category. It is proposed that the maximum maturity for Investments would be five years, of which 50% can be invested after three years. TCU believes this is too restrictive in the current low interest rate environment and the effect Basle III is having on Credit Union Investment returns. These proposals take no account of a large credit union's existing portfolio or its structure or maturity profile.

Tipperary Credit Union's objective is to achieve an average return on its investments of around 3% per annum for the next three years. Its current Investment portfolio of €60 million breaks down as follows:-

- €21 million in Liquid, Short Term Investments (less than 3 months) held in BOI, PTSB and AIB deposits. This represents 35% of the Investment portfolio and 30% of its unattached Savings of €70 million.
- €15 million in medium term Fixed Rate Deposits with Irish Financial Institutions. (Up to a maximum term 5 years). This represents 25% of its Investment Portfolio, and
- €24 million in medium and long term Irish Government Gilts (up to a maximum term 10 years). This represents 40% of its Investment Portfolio. Of this figure, €7 million (30%) is invested in Government Gilts over seven years)

TCU is achieving 0.5% to 1% return in its short term liquid investments. It is achieving, on average, 3% on its medium term investments and an average return of 4.5% on its Gilt Portfolio. **Overall, at February 2014, TCU achieved an average return of 3.3% on its Investments.**

TCU adopts a passive investment strategy regarding its investments, and aims for 100% Capital Security and a modest rate of return. Any restriction in our ability to invest in Irish Government gilts up to ten years will have a serious negative effect on the financial performance of our Credit Union. There is no value in short term gilts at present and short and medium deposit rates also are low.

TCU needs clarification on where it would stand in the proposed new regulatory regime regarding the existing Investment Portfolio it holds, and in particular to its strategy regarding medium and long term Government Gilts.

TCU also believes that an analysis of all Credit Union Investment portfolios should be undertaken to see the effect the proposed Investment changes would have on existing and projected Investment Income and the structure of the portfolios. This should be done for proposed Category 1 and Category 2 Credit Unions.

Savings – Section 5.1.1 , 5.1.2 and 5.4

Tipperary Credit Union does not agree with the proposed restriction that savings should be limited (for any one member) to the lower of €100,000 or 1% of Assets for Category 1 credit unions or €100,000 for category 2 credit unions. The accumulation of savings is one of the key objects of any credit union and the proposed restriction of this magnitude (as compared to the existing limit of 1% of Assets) would seem to be contrary to a credit unions objective of accumulating savings.

Tipperary Credit Union accepts that there is a cost to maintaining savings – dividend, Insurance, administrations, but surplus savings can be invested at a 'margin'. Growth for credit unions depends on savings and the proposed restriction could affect a credit union's ability to reaching category 2 status.

Savings are also a cheap source of funds for credit unions and the dividend payment is, in effect, the Credit Union's 'cost of funds'. The key for Credit Unions should be to 'manage the margin', i.e. ensure that the margin (income less cost of funds) is sufficient to cover costs, provisions, reserve increases and other distributions.

If savings are restricted, Credit Unions may have to resort to Inter-Bank borrowing as a means of sourcing funds. We could also lose members and potential members to the banks.

Borrowing - Section 5.1.1 , 5.1.2 and 5.5

No issue.

Additional Services - Section 5.1.2 and 5.6

No issue.

Governance and Fitness and Probity – Section 5.7

No issue with Category 1 proposal

In relation to Category 2 Credit Unions which will require an 'Asset and Liability Committee', could draft terms of reference be provided for this Committee?

In section 5.7.2 it states that Category 2 credit unions require a "dedicated risk management officer, dedicated compliance officer and a dedicated internal audit function" What is exactly meant by 'dedicated'. If a Credit Union currently has the CEO/Manager also performing the Risk Management Officer role, or has an assistant manager also acting as the Compliance Officer, then will this situation suffice or do the Risk Management Officer and Compliance Officer have to be separate roles, with no other functions or duties? If the latter is the case, then substantial extra salary costs will accrue to Credit Unions.

Reserves - Section 5.1.1, 5.1.2 and 5.9

Tipperary believes that a risk weighted asset approach should be implemented for both Category 1 and Category 2 Credit Unions

Tipperary Credit Union agrees with the proposals in relation to Reserves for both Category 1 and Category 2 Credit Unions, including the proposed 2% Operational Risk Reserve.

However, we would like to see this Operational Risk Reserve classified as a 'General Reserve' as opposed to a Capital or Statutory Reserve.

<u>Liquidity - Section 5.1.1, 5.1.2 and 5.10</u>

Could <u>clarification</u> be provided on what is meant by 'additional short term liquidity requirements' for Category 1 and 2 Credit Unions?

Under the current proposal, as outlined in the Consultation Paper (and which Tipperary Credit Union don't agree with) Tipperary Credit Union, with €93 million in Assets may fall into category 1 and therefore be subject to additional short term liquidity requirements, currently unspecified. At present, TCU abides strictly by the Section 35 liquidity requirement and maintains liquidity in excess of 30% on its unattached savings. Additional extra liquidity, which is unnecessary for us, would cost us money by way of investment income foregone

It is proposed in Section 5.10.1 that "*assets of a credit union to be held in liquid form will be at least 10% of unattached savings available up to seven days and up to 15% of unattached savings available up to one month.*" This is a <u>significant change</u> to the current liquidity requirements of 30% of unattached savings to be held in three month or less short term funds.

In Tipperary Credit Union's situation, we must keep circa €21 million short term, which represents 30% of unattached savings of €70 million. TCU earns, on average, 0.75%, or €157,500 per annum interest on this investment. If €7 million (10% of unattached savings) had to be invested for 7 days, and €10.5 million (15%) for 30 days, with the balance, €3.5 being invested for 3 months, then the Interest rate we could currently get on this arrangement would be less than we currently get, <u>resulting in a further fall in investment income.</u>

Tipperary Credit Union has asked the Central Bank to consider allowing Irish Government Gilts be treated as Liquid Investments on the basis that they are readily saleable. It is accepted that if this proposal was accepted, credit unions would have to account for gilts on a 'mark to market' basis as opposed to accounting for gilts at cost. If TCU was allowed to treat its gilts as liquid, then €21 million currently held in short term bank deposit accounts could be re-invested up to a five year period at <u>double the current interest</u> rate currently received.

<u>Section 5.1.13 Additional Services (Page 20)</u>

Positive comments noted.

Other Prudential Requirements - Section 5.11

Proposal for Credit Unions to have an Interim Audit reasonable but will be an additional cost on credit unions

The proposal on additional requirements in relation to the frequency of business continuity testing needs to be set out

Section 5.12 - Question (II)

‘”Are there any areas where credit unions could provide new additional 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”

Response

The most obvious new service, and one constantly looked for by a majority of our members, is the introduction of a **Debit Card** product

Tipperary Credit Union has been actively pursuing a debit Card Solution for the past year.

‘Smart Phone’ banking technology is also increasing at an alarming pace across the globe. Credit Unions need to grasp and adapt to this technology in order to stay relevant.

Section 6.3 - Question (I)

‘”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”

Response

Tipperary Credit Union agrees that a provisioning framework should be developed for credit unions as proposed in section 6.2 of the Consultation Paper CP76.

Please provide clarification as to the definition and meaning of the following

1. Collective Assessment of the Loan Book
2. Incurred but not reported exposures

Our understanding of the term ‘Collective Assessment’ is a review of the entire loan book based on previous experience of losses, provisions held, previous loans issued, repayment trends, purpose of the loan, occupation of the borrower and expected cash flows for every loan held. It is similar to the process adopted by Grant Thornton’s ‘Roll Rate Provisioning Methodology’. Please advise if this is correct.

Does the term ‘incurred but not reported exposures’ refer to the making Specific Provisions on ‘up to date’ performing loans, or, does it mean establishing a General Bad Debt Provision for performing loans, or a combination of both? Please clarify.

<u>Section 7.2 - Question (I)</u>

'"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 supporting rationale"

<u>Response</u>

Tipperary Credit Union agrees that the tiered regulatory approach should be introduced at this time, <u>subject to</u> the prior agreement of how the categories (whether it is a two category approach or more) facilitates and supports the operation of credit unions and what conditions a Credit Union need to satisfy in order to be able to join the top tier.

Under the proposed structure, Tipperary Credit Union, with Assets of €93 million, <u>must obtain</u> Category 2 Status as its current business model would be severely restricted if it was classified as a Category 1 Credit Union. We assume there are other credit unions in the same position and this key issue must be resolved

Agreement also needs to be reached on the products and services that can be offered in each category, and in particular, restriction in Lending and Investment, and products on which the Consultation Paper CP 76 is silent on (e.g. Secured Loans, both personal and commercial).

As stated in response to Question 4.8(1), Tipperary Credit Union does not agree with the proposed tiered regulatory approach for credit unions as outlined in the Central Bank's Consultation Paper CP76. It does agree with the fundamental recommendation in the report of the Commission on Credit Unions for the 'introduction of a tiered regulatory approach with requirements that are proportionate to the nature, scale and complexity of business undertaken'. However it is not happy with the approach taken to tiered regulation, both in the Commission Report and in the CP76 Paper.

TCU considers that the Asset Range (up to €100 million) for Credit Unions captured under the type 2 proposals (and proposed Category 1 proposal) is too wide ranging and unfair to both Credit Unions falling at the lower and upper levels of this range

TCU would prefer to see Regulatory Categories based on a Credit Union's experience to date; financial performance; strength; capacity to deliver; governance structure; risk profile; products and services offered; IT and delivery systems; loan Book and Arrears performance as a basis for entry into a particular category. The Asset size of a Credit Union should only be used as a guide. Weighting should also be given to a Credit Union's Loan to Asset Ratio, Capital Ratio, Financial Projections, and it's Return on Assets. It may happen that a two tier system suffices, but progressive and successful credit unions (below the current €100 million mark) would not be excluded.

The Commission Report recommended that *"credit unions that are capable of operating a more sophisticated business model* *<u>should be allowed</u>* *to offer a wider range of products and services and engage in a broader range of lending and investment activities subject to more sophisticated requirements".* Tipperary Credit Union accepts this recommendation and believes it has demonstrated to date that it is capable of operating a sophisticated model. It does not believe it should be excluded from the top tier which is based; it would appear, on an arbitrary €100 million figure or thereabouts, Asset cut-off point.

<u>Section 7.2 - Question (II)</u>

'"If it is to be 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"

<u>Response</u>

Assuming agreement of the 'categories', as referred to in response to Section 7.2 – Question (1) above, and agreement that the tiered regulatory approach should be introduced at this time, Tipperary Credit Union <u>does not agree in totality</u> with the proposed timeline for its introduction as set out in Section 1.

Tipperary Credit Union does agree with the timelines, as proposed, <u>up to the start</u> of the Transitional Period (Scheduled to commence in October or November 2014, and run for six months). However, **Tipperary Credit Union believes that this transitional period should run for <u>twelve months</u>,** instead of the six as originally proposed, up to October 2015 for the following reasons:-

- The introductory paragraph in Section 7 of the Consultation Paper correctly identified that Credit Unions are currently undergoing significant change in implementing the new regulatory framework. Time needs to be given to a Credit Union to successfully implement these changes. Additional pressure from tiered regulation requirements may complicate matters and lead to delays.
- In addition, restructuring of the credit union sector is underway, and we believe that this process will accelerate in the months to come. A Credit Union involved in a restructuring process or transfer of engagement will be under significant pressure

simply to get the process ‘across the line’. Added pressure from the introduction of a new tiered regulation could again lead to delays

- Perhaps wait until ReBo has successfully concluded its term of office (end of 2015) before introducing tiered regulation.

End

Thank you

Breda Mc Carthy, Credit Union Secretary

Patrick Shanahan, Credit Union CEO

18/3/14