Introduction of a Tiered Regulatory Approach for Credit Unions

A submission by

Waterford Credit Union

Introduction

Waterford Credit Union has considered the consultation paper CP76 and have prepared the following as its submission to the Central Bank Of Ireland.

Overall, we agree to many of the proposed changes and strongly believe that the approach will result in a stronger movement that will provide financial services for the people of Ireland long into the future.

The current Credit Union business model is simple in that it is effective provided there are adequate risk based approaches to the key components of the said model. A strong risk based credit management process for the provision and collection of credit coupled with a grounded prudent risk aware approach to investments should enable a functioning asset and liability management process to prosper and deliver any additional financial services that members require from their Credit Union. The Credit Union is built on principles that provide choice to its own particular community within an appropriate price range that will in turn reward the many members who provided the capital to enable the choice in the first instance.

Whilst the consultation paper exists to provide a framework for categories of Credit Unions to operate and become successful whilst embracing a tiered regulatory approach, the regulatory framework should not be created so as to negatively impact the current model where many Credit Unions are acutely aware of their members' needs and the required mix to make them successful within their own risk tolerances. With this in mind, our Credit Union believes that the principles of co-operation, social responsibility, open and voluntary membership, democratic control, non discrimination, education and the provision of services and returns to members should be at the forefront of any regulatory framework and that at no point should any of the principles be diluted or have their importance minimised.

Below, we have outlined by section the areas where we believe further consideration needs to be given to the proposals outlined in CP76.

Area (i)

Section 4.8

Fundamentally we agree with a tiered approach however in the 2 tier approach, Category 1 then becomes a "catch all" category and may lead to a diluted regulatory approach because of the volume of Credit Unions included in the category. By having an additional category, it would be possible to create an appropriate framework that may be more suitable to a more significant number of Credit Unions, thus providing an optimal regulatory approach to Credit Unions of a similar nature, scale and complexity.

Area (ii)

Section 5.12 (i)

Lending:

Waterford Credit Union agrees with the approach to lending classes, concentration and maturity limits outlined in the document. However, further consideration should be given to the Home Loan option for both categories. For example, a Credit Union wishes to remain in Category 1 but has a market and a member requirement to provide home loans in excess of 15 years; it should be within their remit to do so. By retaining all other limits outlined in the document, the inability to write a home loan in excess of 15 years means the loan may be too expensive for a member who wishes to borrow from the Credit Union and not the banks.

The restricted persons as in officers are already subject to additional measures above all members when applying for a loan and rightly so. However to impose further restriction and extend it to their families is discriminatory. It is penalising members who are willing to give their time and talent to the credit union in a voluntary capacity as directors, board oversight committees and volunteers. The Nomination Committee will be obliged to inform potential volunteers that this restriction will apply; this will not encourage volunteers.

Investments:

A limit of 5 years maximum maturity will have a debilitating effect on future income streams to Category 1 Credit Unions. Consideration should be given to maintaining the current term of 10 years. Waterford Credit Union's members availed of significant income from 10 year deposits (including tracker deposits) and long term government and bank bonds (greater than 5 years). This ensured a strong income from funds that were invested in low risk products, some of which were liquid through their accessibility to a secondary market. By reducing the term to a maximum of 5 years, this range of options becomes very limited. Obviously the need for independent advice and the close monitoring of the Credit Unions liquidity should be critical factors in any decision.

The limit of counterparty to 100% of the regulatory reserve held by a Credit Union is perhaps too inflexible also. From our experience, 200% would be more appropriate. For a Credit Union of €115m that holds €12m in a regulatory reserve, a investment portfolio of €84m would require 6 strong and suitable counterparties. An increase in the limit to 200% would require 4 strong counterparties, which is in line with guidance provided by the RCU.

Savings:

Imposing a maximum limit on savings breaches competition laws in our opinion. However whilst we do not disagree with the limit, it should be at the discretion of the Credit Union and not the RCU because in our opinion it should be member's decision as to where they invest their funds and not be limited by the RCU. Long term members may also wish to lodge payments such as redundancy, inheritance, insurance policies, house sale on a temporary basis and should not be denied this service.

Governance:

We believe that it is not necessary to have a "dedicated" risk officer, compliance officer or internal audit. The reason being is that we believe that we have adequately educated and competent employees that fulfil the roles currently. All roles will be subject to independent review on a timely basis by a suitably qualified firm (eg KPMG) and we believe that this approach will be of as much if not more benefit to Credit Unions as a dedicated approach.

The introduction of the new Fitness & Probity regime requires the Nomination Committee, Board of Directors and Board Oversight Committee to fulfil Due Diligence for CUFs and PCFs and Individual Questionnaires for PCFs. PCFs and new CUFs must be approved by the RCU. The Directors are also subject to review by the internal audit function, the Board Oversight Committee (at least four times annually), the ILCU Field Officer and the external Auditor. The Chairperson must also review the performance of each director. The proposal to have external reviews completed every three years is excessive and implies an element of doubt of capability in the above requirements.

Reserves:

The requirement for an operational risk reserve is welcomed however Credit Unions should have an input into the adaption of the Basel Basic Indicator Approach. Consultation with all stakeholders should be a requirement in order for all stakeholders to understand fully the requirements for additional reserves.

Liquidity:

We believe that current S.35 regulations are appropriate. A straight line approach of 10% (up to 7 days) and 15% (up to one month) held in liquid funds are excessive in our opinion. We suggest that there is a calculation based on the Cash Flow included in the Annual Return to assess the monthly / weekly requirements of each Credit Union. In our case the main funds exiting the Credit Union would include shares, deposits, stamp and loans totalling €5m to €6m per month. This is NOT a net figure; it is outgoings only. If this figure (€6m) was used as a base point for requirements as a % of the unattached shares, then in our case the requirements for a month would be 7% which is considerably less than the 15% suggested. Allowing a 1% buffer for any given month, we believe a 8% limit for up to one month and perhaps 5% for 7 days would be more appropriate.

Area (iii)

Section 5.12 (ii)

- As outlined above, Home Loans should be a business opportunity for both categories of Credit Unions, depending on the nature, size and complexity of the organisation.

Area (iv)

Section 6.3

Guidance on assessing the appropriate loan loss provisions will be essential to enable Credit Unions to calculate the required provision in line with what the RCU believes is best practice. The ideology is appropriate but the required backup is essential.

Area (v)

Section 7.2 (i)

We believe that the tiered regulatory approach should be introduced.

Area (vi)

Section 7.2 (ii)

We believe that the transitional period is too short and that the regulations should not come into force until April / May 2016. There have been many changes to the Credit Union movement over the last number of years and it is difficult to bring about change in as rapid a fashion as outlined in the proposed stages and timelines table (Oct 2014 to Mar 2015). Whilst many Credit Unions will work towards being prepared for the new approach, there is the everyday business to consider and the implementation of each Credit Unions strategic plan is a priority. We believe that the new approach will be included in the strategic plan but a time frame as short as that outlined above may be unrealistic.

Conclusion

The tiered regulatory approach is appropriate and it will bring about a stronger Credit Union movement. It is important that the RCU takes on board all submissions because the documents are undoubtedly submitted in good faith with the future of the Credit Union movement ingrained within. This consultation paper is a hugely important document that will frame the future of the Credit Union movement so it is critical that the movement build solid foundations for all stakeholders because the Credit Union movement's place in the Irish culture is both unique and critical as the Credit Union is the officers, the members and therefore the community of Ireland. It must be preserved and permitted to grow and flourish in a controlled responsible manner without negatively impacting on its place in our society.

The Board and Officers of Waterford Credit Union.