

# CP 88 – Consultation on Regulations for Credit Unions on commencement of the remaining sections of the 2012 Act

Response to CP 88 – from

Ballinasloe Credit Union (Our Lady of  
Lourdes) Limited

Feb 2015

## Section 1

### *Introduction*

Ballinasloe Credit Union (BCU) is pleased to have the opportunity to comment on the Consultation on Regulations for Credit Unions on commencement of the remaining sections of the 2012 Act and responds as below.

Every effort has been made to follow the format of the Central Banks original document for ease of reference.

In consequence of the methodology employed in the Consultation Paper the CBI (the Bank) seeks answers only to questions pertaining to the Bank's views as contained within the document. However this response will attempt to answer the questions raised and highlight other areas of concern to the credit union.

BCU is concerned that the entire document seeks to constrain and / or restrain the development of the credit union itself and the credit union movement in general. In particular BCU refers to the lending *limit*, savings *limits*, *limits* on investments etc. as outlined in the sections.

Note the reference to "*limits*".

Also a noted feature of the Bank's document is the absence of any rationale for its proposals as outlined within CP88 - even though the Bank requests a rationale for any suggested changes to the bank's approach herein. It would be beneficial if the credit union was able to be aware of the Bank's rationale or thought processes in the compilation of the consultation paper.

## Section 2

### ***Background***

**2.1** The Board of BCU notes that the Bank's reference point is the Commission on Credit Unions – in particular Chapter 10 – Legislation and Regulation of Credit Unions<sup>1</sup>. The Board notes that “the Commission recommends that regulations made pursuant to the legislation should be necessary, effective and proportionate ...<sup>2</sup>. It also notes that “Regulations made by the Central Bank would set out the detail ...following full and meaningful consultation with the credit union sector”<sup>3</sup> The Board regrets that this consultation has not occurred before the issuing of the consultation paper. In particular the Board notes that the Central Bank has already undertaken a Regulatory Impact Analysis (RIA) of its own CP88 – but only on options relative to regulation and not on any of the specific proposed regulations. The Board opines that this RIA might have been better undertaken after the receipt by the Central Bank of representations made on the consultation paper.

**2.2** The Board notes that the following sections of the 2012 Act have not yet been commenced:

- ◆ Section 8 Savings;
- ◆ Section 10 Borrowing;
- ◆ Section 11 Lending;
- ◆ Section 12 Investments;
- ◆ Section 13 Reserves; and
- ◆ Section 30 Liquidity.

and that the CP88 addresses these matters.

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<sup>1</sup> Report on the Commission on Credit Unions Chapter 10 p.117

<sup>2</sup> Section 10.2.4 of the Report of the Commission on Credit Unions

<sup>3</sup> Section 103.2 of the Report of the Commission on Credit Unions

**2.3** The Board notes that the CB is proposing to introduce requirements that will apply to the following areas:

- ◆ Reserves;
- ◆ Liquidity;
- ◆ Lending;
- ◆ Investments;
- ◆ Savings;
- ◆ Borrowings;
- ◆ Systems, Controls and Reporting arrangements; and
- ◆ Services Exempt from additional Services Requirements.

This response will deal with these matters in a similar fashion as these are outlined in the CP88 document.

***Section 3***

***Purpose of this Consultation***

BCU notes that following commencement of the remaining sections of the 2012 Act, the Bank is proposing to introduce regulations in all the above areas as recommended by the Commission on Credit Union and that views are sought in respect of these matters.

## Section 4

### ***Comparison of the existing regulatory framework and new requirements in draft regulations.***

The comparison chart provided in CP88 is a useful document, however nowhere within the CP88 is it acknowledged that the Registrar for Credit Unions (RCU) at the Bank has in fact, by letters of Direction and Requirement, implemented many of the proposals within the CP88 already. The Board refers in particular to lending limits on credit unions (58% as per the Bank's own admission at Christmas 2014), restrictions on the maximum savings (@ €100,000 per member), liquidity requirements, etc. In fact one wonders why the proposed regulation is necessary at all given that the RCU has implemented much/many of its proposals, credit union by credit union, for the past number of years. BCU has been subject to such restrictions for the past 5 years.

A particular requirement of the RCU across all credit unions during the recent past is the requirement to have 10% of a Regulatory Reserve (minimum). The Board asks where such a requirement arises and what /where is the rationale which informs the Central Bank's view relative to this matter. (It is not sufficient to suggest that it is a WOCCU guideline).

The additional lending requirements are also another way of limiting a credit unions core business. Again no rationale is provided other than "these requirements are informed by regulatory actions taken by the central bank arising from lending practices in individual credit unions".<sup>4</sup> Whilst the introduction of these additional requirements may strengthen the *regulatory framework* they will not add any measurable improvement to the core business of credit unions - which is its lending facility. The low volume of lending (<30% of assets across the movement) at year end 2014 might lead one to believe that the CB should be encouraging the lending function at credit unions and not be putting additional obstacles in the way of this essential business of credit unions.

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<sup>4</sup> CP88 page 13

## **Section 5**

### ***Reserves***

#### ***5.1 General Comments***

As stated above a particular requirement of the RCU across all credit unions during the recent past is the requirement to have 10% put into a minimum Regulatory Reserve. The Board asks where such a requirement arises and what /where is the rationale which informs the Central Bank's view relative to this matter.

The current minimum reserve requirement is 10% of assets. The movement as a whole has far greater reserves and a requirement to hold additional reserves for operational risk is unnecessary. BCU notes the power of the Bank to impose reserve requirements on a credit union (or in general on all credit unions) as outlined in the CUA 1997 (as amended) Section 45. Again no rationale has been provided for the current requirement and no indication or example is given as to the volume of any additional reserve which the Bank may propose.

#### ***5.2 RRR of 10%***

The removal of the requirement to transfer 10% of the surplus to the statutory reserve reflects perhaps the strengthened reserves of credit unions but the Banks' powers in respect of reserve requirements leaves credit unions exposed to overzealous credit union regulators. In the past when a credit union had achieved or exceeded a 15% statutory reserve it was not required to further enhance same. The absence of such a maximum in the proposed regulation is ominous.

The absence to a reference in the proposed regulation to reserves which are risk weighted is regretted. Such a scheme, based on risk weighting the credit unions assets would be more appropriate. The Banks proposals in respect of regulatory reserves are the product of "pick a figure" regulation only, given that no rationale has been provided for this (or any of the reserve proposals).

### **5.3 New Credit Unions**

The requirement for a newly registered credit union to have a statutory reserve “sufficient to support the credit union’s anticipated growth ...”<sup>5</sup> implies that no new credit union will again be established due to this requirement to have a statutory reserve in place as soon as it is set up. Again the bank has not given any indication of the source of such a reserve for a new credit union.

### **5.4 Answer to the CB question**

The CB requests an answer to its question<sup>6</sup> re its views on reserves. Ballinasloe Credit Union asks that the CB looks to the credit union movement to build sufficient reserves relative to the credit unions individual risk rating. This risk rating should be based on a formula/ international standard which recognises the risk attaching to the assets on the balance sheet. Putting absolute percentages into law or regulation should not be undertaken.

In addition credit unions should be able to cross guarantee one another thus enhancing the co-operative nature of the movement. The movements collective reserves are in excess of 15%<sup>7</sup>.

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<sup>5</sup> CP88 p15

<sup>6</sup> CP88 p18

<sup>7</sup> PEARLS report ILCU 12.2014

## **Section 6**

### ***Liquidity***

#### ***6.1 General Comments***

Liquidity is an essential requirement of the day to day business of a credit union. The volume of the liquidity requirement is however questionable and it should be the subject of debate and consideration.

##### ***6.2.1 Liquidity by Regulatory Direction***

Currently the CB has a liquidity direction in many credit unions (probably similar in numbers to the 58% of credit unions which have lending restrictions). The current requirement is 20% of unattached savings – which is a considerable sum of money when it is actually assessed. (i.e. BCU's unattached savings stands at €65 million. 20% of same = €13 million). This is an enormously high figure. It is interesting that the CB states that the 20% will remain in place and that it does not form part of the consultation. Again one must consider where the 20% originated and the basis of the Banks decision that this is the minimum requirement.

##### ***6.2.2 Short term Liquidity Ratio***

The proposal is that 10% of unattached savings should be available within 8 days. This is a further restriction on the current requirements. This is a new feature of liquidity proposed by the Bank but without any supporting rationale. The Bank now suggests that a letter from a financial institutions stating that the credit union has access to a particular investment will suffice for the liquidity requirement is noted. It is our direct experience that the Bank would not in the past accept such a letter as proof of liquidity access.

## **6.3**

The present liquidity requirements are stated to remain in place with some additional short term liquidity requirements being proposed. The liquidity requirements of 20% (minimum) of unattached shares being in liquid form, has had severe repercussion on the investment return to the credit union. Again one questions the 20% as being a reasonable liquidity requirement – in the absence of any rational explanation as to the need for such a high percentage requirement – except that it is set out in

S.I. 515 of 2010. In movement terms based on a savings pool of say €10 billion, a liquidity requirement across the movement stands at a minimum of €2 billion. It appears an extraordinary sum to have available in liquid form and there is no evidence to date of any such need or requirement<sup>8</sup>. (The liquidity constraints will also severely impact the credit unions ability to source good returns on its investments portfolio). Again a rationale for such a liquidity requirement is not clear within the document.

That this paper suggests an additional liquidity requirement (8 days) as being necessary is ludicrous.

#### **6.4**

The inclusion of members' deposits in the unattached savings should be reconsidered. Invariably members deposit accounts are time bound savings and are not available "on call" in a similar manner to a members shares and consequently should not be a requirement for liquidity cover.

#### **6.5**

The above should be considered as this credit unions response to the CB question re comments on the draft liquidity regulations.

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<sup>8</sup> Even the resolution of Newbridge Credit Union did not impact unduly on the movements' liquidity – and this was arguably the movements' greatest test to date).

## ***Section 7***

### ***Lending***

#### ***7.1 General***

The core business of credit unions is savings and loans. Curtailing its business activities will prevent credit unions from achieving their potential. Is this what Regulators should do? Is this – a credit union movement restricted by regulation - what the Bank seeks to achieve by restricting the core business of credit unions? Establishing a relationship between the lending function and the reserves of a credit union is a new approach - and again the absence of any explanatory rationale is noted. That a loan portfolio should have a reserve is practical – and such a reserve is in place in all credit union i.e. the Bad Debts Reserve - why then tie the lending exposure limits to the Regular Reserve Ratio (RRR)?

#### ***7.2.1***

Within the overview of categories the Bank has outlined significant regulation which will impact the credit unions core business – lending. The Bank seeks to curtail the maximum loan (concentration limits), the categories of loan and the timelines of loan repayments. One wonders has the Bank defined / regulated the categories of lending of other lending institutions?

The rationale for lending limits and maturities is difficult to comprehend – given that no rationale is included in the document. Apart from general concerns expressed by the Registry there appears to be no factual basis that curtailing lending – by lending limits and or loan maturity time limits – benefits the credit union. “The ability of the loan applicant to repay shall be the primary consideration in the underwriting process of the credit union”<sup>9</sup>. The proposals as outlined seem to undermine this statement and it requires additional primary considerations – categories, values and timelines – as outlined in the proposals.

#### ***Personal Loans***

This category of loans is probably the most significant element of a credit unions’ loan portfolio and within the proposed categories it can contain classes of loans i.e. home improvements, car loans,

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<sup>9</sup> CP88 p30/31

holiday loans etc and each of these classes can be at different rates of interest. This in large measure reflects the status quo and there is no proposed % limit of the overall portfolio which is welcomed.

### ***Commercial***

It is noted that commercial loans < €25,000 are excluded from the commercial category when assessing the overall category limits. This is a welcomed development in that credit unions can provide access to credit to owner / single employee business such as plumbers, electricians, farmers etc.

### ***Community Loans***

It is noted that community loans are those which are advanced to community or voluntary organisations which further the social, economic or environmental well being of individuals within the common bond and various classes are listed<sup>10</sup>. However absent from the document is a reference to the creation of employment by the voluntary organisation. Perhaps this specific aim should be recognised within the new lending regulations.

### ***House Loans***

The specific definition of a house loan should not be confused with borrowings by members with a view to home improvements – which should be classed as a personal loan for the purposes of avoiding any confusion. It is noted that a house loan must be secured by a first legal charge. However in borrowing for a substantial renovation of a house the credit union should be able to secure a second charge on a property – thus enhancing its security. This type of lending in our experience is usually undertaken by mature individuals and households – therefore there is security in registering a second charge on a property. This security then requires to be recognised when making reserve allocation for doubtful debts.

### ***7.2.2 Concentration Limits***

The concentration limits as proposed are related to the credit unions regulatory reserve. No rationale is advanced for this correlation. Loans should be reserved based on their risk characteristics and this should be reflected within the bad debts provision. The issuing of loans with a reference to the Regulatory Reserve seems arbitrary – given that no rationale is advanced for the relationship. The % as outlined seems adequate. However a monthly report to the Board seems excessive if the loan is performing, however if it is not performing then the report would be required monthly.

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<sup>10</sup> CP88 p26

### **7.2.3 Large Exposure Limits**

The current limit @ 1.5% of a credit unions assets, given the size of some credit unions asset base, could represent a significant figure. However the proposed change to 10% of the RRR will in fact make little or no change to a larger (> €100m) credit union's ability to service such a loan. The reporting requirement is noted. However BCU expects some discussion should the Bank, in the future, propose to limit the total large exposures.

### **7.2.4. Maturity of Lending**

CP76 indicated that the maturity period was proposed at 15 years. CP88 now proposes 25 years maturity. Longer term lending is just that - long term. Seeking to limit it to a defined period is of little value. Given the borrowing associated with mortgage lending in the current climate it could be argued that a mortgage in the future may become a generational matter i.e. the house and its associated mortgage will be passed from parent to offspring before it will be completely repaid. Limiting this to 25 years as proposed is in fact obliging credit unions to opt out of supplying mortgages in some situations.

### **7.2.5 Related Party Lending**

This Section deals with "Related Person Limits". BCU notes that there is no reference to related persons within the CU Act 1997 (as amended). Directors, Members of the Board Oversight Committee and members of the Management Team (employees) should be treated in the same manner as any other credit union member – their individual rights, as members, should be sacrosanct and not be interfered with. The proposal to identify an additional restricted group is representative of the Bank overstepping its authority perhaps and it may have Data Protection issues. The extension of the restrictions (proposed) to related "members of the family"<sup>11</sup> is unnecessary. In particular the Bank makes no reference to the independent means that a family member may have to repay his/her own loan. The threshold on reporting on such loans as proposed (€2,000) is ridiculously low. The Bank should confine itself to the regulation of "officer" as defined by Section 2.2 of the CUA 1997 (as amended) and not seek to install an additional category of restrictions.

It is noted that the Bank "is not proposing to introduce limits on related party lending at this time".

Nor should it in the future without due consultation with stakeholders.

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<sup>11</sup> CP88 P75

## **Section 8**

### **Investments**

#### **8.1 General**

It is noted that little change is proposed by the Bank in respect of investments and that the Guidance issued in 2006 has in large measure been retained. The absence of any reference to investment by credit union in social projects (i.e. health/school bonds, social housing etc) is noted with regret.

##### **8.2.1 Investment Classes**

The proposed removal of equities as an investment class is noted. Again no rationale has been put forward by the Bank for the removal of the equities. Currently equities are limited to 5% of the portfolio. It is a useful option to have available even though (colloquially) it has been underused to date.

The introduction of limits for investments in Industrial and Provident Societies is not required. Credit unions should be able to support like minded institutions and not be limited by reference to the *regulatory reserve ratio*.

##### **8.2.2 Counterparty exposure**

The retention of the 25% counterparty exposure is noted.

##### **8.2.3 Concentration Limits**

The concentration limits of 70% (Irish and EEA State Securities) and 30% (Bank bonds) is noted. However due to current regulatory directions many credit unions (including Ballinasloe) have been restricted by the Registry of Credit Unions from investing in bank bonds. Again the % allowed is referenced to the regulatory reserves – without explanation.

##### **8.2.4 Maturities**

The maturity limits change is welcomed.

## Section 9

### *Savings*

#### 9.1 General

Previously CP76 stated that ... credit unions “will be able to offer savings up to the lower of €100,000 or 1% of the credit unions assets”. Such a restriction will compel credit unions to *remain always as only the secondary provider of savings and loan services to members* and not the members’ **primary provider of financial services** – which is the aim of the BCU strategic plan. One suspects that if the Deposit Guarantee Scheme maximum guaranteed amount was less than €100,000 (i.e. €20,000) that this would be the maximum restriction. Again this begs the question - why only allow €100,000?, - what is the rationale behind such a figure? Such regulation (currently in force in BCU) has compelled members in good standing to open bank accounts – something which they were loath to do as they regard this credit union as their sole provider of financial services. Regulation by the Bank should not determine individual choice or compel a member to choose another financial institution for their savings. BCU requests that all financial institutions be treated the same in this respect i.e. similar limits or no limits.

#### 9.2.1 Deposits

It is noted that deposits cannot exceed a member’s shareholdings – but no rationale is provided for such a proposed restriction. A credit union in the future could change its profile by requiring just a modest shareholding to confer membership - and allocate any other members funds to deposit or other investment instruments. Such a development could lead on to proper asset liability management. Why restrict the credit unions ability to diversify its savings offerings to members by such restrictive practices as outlined in the deposit proposal?

#### 9.2.2 Maximum savings

Again it is noted that CP76 proposed maximum savings limits and even though the Bank has decided not to proceed with CP76 it still persists in trying to limit a credit unions ability to accept its members’ savings. Will the Bank insist that other financial service providers be likewise restricted? If regulation is required then the current section 27(4) of the 1997 act should be retained i.e. €200,000 or 1% of the

assets of the credit union whichever is the greater. The optimum position is the removal of all the savings restrictions.

The Banks reference to its RIA and the % impacted by this restriction is disingenuous - given that it has these restrictions in place across many credit unions for many years. Such regulation (currently in force in BCU) has compelled members in good standing to open bank accounts – something which they were loath to do as they regard their credit union as their sole provider of financial services.

***Regulation by the CB should not determine individual choice or compel a member to choose another financial institution for their savings.***

## **Section 10**

### ***Borrowing***

#### **10.1 General**

It is noted that little borrowing is undertaken by credit unions. However regulation should not be just for the immediate or near future time period. Regulation also needs to look to the future and at this point in time nobody knows what the requirement to borrow might be – i.e. refurbishment of credit union offices after ReBo restructuring etc might require a credit union to borrow. Borrowing funds from one credit union to allow another credit union to lend it to its members could be a future business arrangement by two, or more, credit unions.

#### **10.2 Draft regulations**

The proposal within CP88 is that a credit unions borrowing requirement should be reduced from 50% to 25% of its aggregate *savings*. Again in the absence of any explanatory rationale it is difficult to relate this particular proposed restriction to a credit unions savings when it might be more meaningful to relate it to the credit unions reserves.

## **Section 11**

### ***Systems, Controls and Reporting Arrangements***

#### **11.1 General**

It is noted that in general the proposals in section 11 of CP88 reflect current practice. However the additional reporting in respect of the annual accounts needs comment.

#### **11.2**

The annual accounts are prepared by independent auditors and are governed by agreed audit practices.

The additional requirement in respect of related party's disclosure is questionable. Currently officers savings and loans are reported. Now the Bank seeks to extend this to related parties. This will add another difficulty to the Nominating Committees job of attracting volunteers given that it is now proposed that the savings and loans of related parties will be disclosed in the annual accounts. Does the bank have a rationale for this?

#### **11.3.1**

The requirement that specific items (Risk Management Policy, BCP, Conflict of Interest policy and Ethics policy) be communicated to all officers is noted. However, presumably, the Bank will require evidence / proof that this has taken place (i.e. a signed document). Nothing within this proposal however requires evidence of an officers understanding of the actual communication. It should be sufficient to oblige Boards to have these matters discussed and recorded at a Board meeting – thereby ensuring the Boards understanding of the documents.

The Schedule 1 proposals seem reasonable.

## Section 12

### *SERVICES*

#### 12.1 General comment

Currently Statutory Instruments are issued by a Government Minister. This proposal moves that significant power to the Central Bank. Currently those upon whom the Statutory Instrument impact have an opportunity to influence the Government Department relative to the contents of any particular instrument. This access will be removed when the power devolves to the Central Bank. As such it is a diminution in the governance of credit unions (in this case in particular) and a democratic loss. Credit unions (and their representative bodies) have not been very successful in influencing the Bank relative to credit union matters in the recent past (ref the CUCORA 2012 and the Commission report).

The Bank has indicated that it is “supportive of credit unions developing additional services”<sup>12</sup> Yet the Bank will insist that the additional service be supported by a robust business case - when in fact all that might be proposed is to assist a local Chamber of Commerce in promoting the local town through a voucher scheme etc.

In addition the Bank will seek evidence that the Board of Directors of the credit union “has a sound appreciation of the nature of the additional service proposed and is fully informed of the strategic, governance, risk management, operational, financial and legal implications involved; and systems and controls are in place ...”<sup>13</sup>. Yet there is no reference by the Bank as to how it will assess or decide the credit unions proposal or indeed what time lines might be involved in responding to a proposal from a credit union. (The recent application for the CUSOP licence can only leave credit unions in dismay at the delay (33 months) in granting the licence at the Central Bank). A certain scepticism is applied by this credit union when judging this proposal.

The absence of any reference to debit card services and credit card services within this document is disappointing. Consequently, at a minimum, a timeline relative to new service applications needs to be displayed at this stage of the consultation process. In addition this consultation paper should deal with access to new debit cards and credit cards services for members.

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<sup>12</sup> CP88 p55

<sup>13</sup> CP88 p55

## **Section 13**

### ***Timelines***

It is noted that the Bank had its first information seminar on the day the CP88 was issued. Indeed it is a moot point if anyone in a credit union had seen the document prior to the first days information seminars. As such feedback on the day could only be superficial and it did not show the Bank as engaging in any meaningful way with credit union personnel during its initial public engagement.

## **Section 14**

### ***Regulatory Impact Analysis***

BCU notes that a Regulatory Impact Analyses (RIA) has been undertaken already by the Bank in respect of the Bank's proposals. The three options considered were;

- 1) Do not introduce regulations... etc
- 2) Introduce regulations on a tiered basis ... etc
- 3) Introduce regulations for all credit unions ... etc

and the Bank has chosen option 3 above.

It is noted that the bank did not actually do a R.I.A. on the actual proposals – and surely this is what is required. Perhaps in the light of the submissions to the consultation paper the Bank will conduct a meaningful Regulatory Impact Analysis – with suitable input from representative bodies and credit unions.

### ***Conclusion***

BCU having considered the proposals as outlined in CP88 finds that the level of direction and restriction within the proposals will inhibit the development of credit union into the future. There is a complete absence of any strategic developmental thinking within the document about the future of credit unions and the credit unions ability to service its members in any meaningful way with financial services. Instead there appears to be a conscious determination to reduce larger credit unions in size (restrictions on savings and loans) and to keep the other credit unions small and pliable for Central Bank purposes.

Any additional services a credit union wishes to offer must be firstly approved by the Central Bank – yet it is the same institution which took 33 months to decide on a Payments Institution Licence for the ILCU’s CUSOP. Will a similar timeframe be applied to individual credit unions – and will each one have to make the same case for providing similar services?

The development of credit union in the past half century was a magnificent achievement in the servicing of the unbanked with financial services. The banking crisis of the past decade has had little impact on credit unions – thereby indicating their resilience – based on their rootedness in local communities. In this respect the ILCU Savings Protection Scheme should be complimented on its great work undertaken in times of economic crisis.

The Bank, for its part, should regulate for the future development of credit unions and not seek to constrain their potential, in particular in respect of savings and loans, as outlined in the proposed restrictions and regulations within this Consultation Paper 88.