

Chapter 15 Response to CP88

In reference to the Central Bank of Ireland Consultation

*Paper 88 on Regulations for Credit Unions, below is a
submission on behalf of the eighteen (18) Credit Unions
across the midlands region who constitute Chapter 15*

Introduction

Chapter 15, as a cohesive group of 18 credit unions across the midlands region of Ireland wish to commend the Central Bank (CB) on publishing CP 88 in which it lays out the latest steps for Regulations for Credit Unions on commencement of the remaining sections of the 2012 Act. The whole process of consulting the regulated on suggestions for improving the standard of regulation and supervision of Credit Unions is one that we fundamentally agree with and we urge the CB to continue to develop this very sensible and appropriate policy of constructive dialogue on matters of mutual concern. For very many decades credit unions did not have the benefit of challenging but supportive regulation and therefore had to effectively self-regulate so the current process of consultation with our regulatory authority is indeed a welcome change.

In advance of compiling this response we have carefully read your proposals and attended your roadshow at different venues and subsequently held working meetings on the various aspects of your proposals. We therefore proffer the following comments not as a knee-jerk reaction to your proposals but having considered deeply their implications and their potential effect on Chapter 15 and on the whole credit union Movement in the Republic of Ireland.

Summary Analysis

The agreed analysis of all our credit unions is that the thrust of many of your proposals is very strong on controlling / constraining / limiting credit union activity and development but very very short on supportive and developmental measures which could help credit unions to safely grow their businesses for the good of their communities. In the aftermath of a seriously damaging banking crisis this country needs to develop a strong credit union sector as a diverse alternative to the for-profit banking sector but these proposals so obviously limit and unnecessarily ring-fence credit unions that we must seriously question the rationale and motivation for many of your proposals.

Response to Individual Proposals

1. Proposed Cap on Member Savings

We disagree fundamentally with the proposal to reduce the maximum individual savings level to €100,000 which we feel is totally inadequate. CUs are extremely concerned about this reduction and they view it as *anti-competitive* as no such restriction exists for other financial institutions. It should be evident that there will be occasions when genuine credit union members will wish to save sums of this nature and larger (e.g. retirement lump-sums, or house sales,). It is simply wrong to propose that CUs be denied the right to give their loyal members the service they require at times like this. CUs will strongly contest this new proposal and below we cite additional reasons to reject this proposal as follows;

- In modern Ireland €100,000 is not considered a large amount so how can the CB estimate that this as an adequate personal savings limit?
- The proposed limit aligns with the DGS which potentially sends out a message that CUs are somehow *not to be trusted* with any larger amounts. If a savings limit of €100K is imposed on CUs it will have negative connotations and this is unfair and could inflict reputational damage on Credit Unions. It is therefore *discriminatory*.
- Applying a fixed amount limit to all CU's irrespective of asset size lacks refinement and is inappropriate considering the differences in size and complexity of CU's
- Any proposed limit should be related to asset size.
- Chapter 15 actually believes the limit prior to the 2012 Act was appropriate for CUs in Ireland so we fail to see any rationale whatsoever for now moving in 2015 to such a restricted and prescriptive limit of €100K.
- For a €100M asset CU this will mean a change from a savings limit of €1M to the proposed €100K.
- Credit Union ethos involves an aspiration to endeavour to serve members "from the cradle to the grave". This proposal will make our aspiration legally unattainable as CUs will no longer be able to deliver full services so this proposal is undermining the whole credit union ethos.
- This will compel good CU members to open bank accounts even though they do not wish to, as they are happy to deal with the CU as their financial service provider.
- This proposal is in fact so discriminatory that it removes the choice of an individual CU member and effectively forces them to choose another financial institution for their savings. *Should not all financial institutions be treated equally?*
- Implicitly this proposal seriously limits a CUs options in terms of asset liability management. It removes any previous flexibility in terms of for example using term deposits to help address mis-matching of funds. In most countries worldwide term deposits are a common feature of the CU landscape and we fail to see the CB's rationale for reducing / removing such options from Irish CUs.
- Rather than imposing such inappropriate savings restrictions we would respectfully ask why the CB does not encourage CU's to offer a full range of savings products and

to build and manage their savings portfolios prudently through smart asset liability planning withing their overall strategic plans.

2. Regulatory Reserve Proposal

Before addressing the RR proposal in CP88, Chapter 15 wish to question the basis for the current 10% requirement which CB insists upon. In many countries worldwide a lesser requirement is deemed adequate by regulators. For example the FSA in London deem that Northern Ireland Credit Unions are sufficiently reserved at 8%. Internationally in fact 8% is a generally agreed norm across many jurisdictions. Therefore Chapter 15 believes that experience and research clearly demonstrates that holding a 10% reserve is above what is reasonably required and furthermore a very broad reserve like this is a blunt instrument which takes no account of individual CU risk profiles. The reality in the Irish movement today is that most CUs are sound, well capitalised and well reserved. CUs are also adequately provisioned for potential loan portfolio losses, investment portfolios are low risk and therefore we fail to see where the problem is that this new proposal seeks to address. On any true risk based assessment CUs would have a *lower reserve requirement* than they already have so increasing the reserve requirement seems excessive and irrational.

In summary Chapter 15 is strongly of the opinion that there is *No Need* for an additional reserve requirement for CUs – unless the statutory component is reduced to 8% in which case an additional 2% risk based component (based on scale and complexity) could be considered. On this basis we feel it would be helpful if CB were to explain why CUs in Ireland are subject to a 10% Regulatory Reserve and Chapter 15 would call on CB to share this rationale.

3. Categorisation of Loans

CP 88 proposes lending categories and associated monetary limits for each category within a CUs loan portfolio. From an overall perspective we feel that introducing such a series of lending limitations is a very blunt and imprecise approach which can only militate against efficient and effective lending practices at individual CU level. The role of the Board of Directors of a CU is to set down appropriate lending policies for each individual CU (taking into account its own unique characteristics and profile) which ensure the loan portfolio is managed in the most prudent and efficient manner for the benefit of its members. In our opinion boards of directors are better placed to decide high-level policy on how best to apportion and manage their lending portfolios. However, the thrust of CP88 is to *micro-manage CU loan portfolios* through regulation rather than by allowing those closest to the coal-face to apportion and manage different lending categories, - as happens with other regulated entities. This is unfair and unwarranted regulation.

In specific terms Chapter 15 would like to make the following comments re this proposal;

Lack of clarity re categories.

- The main problem with the categorisations is that no clear definition of categories is provided so how can we assess the true implications of this proposal without clarity?

Housing Loans:

- The term House Loan is problematic because it is not defined clearly enough.
- CP88 definition of “housing loans” indicates that all loans to improve a house will require a first legal charge to secure a property. This is impractical and unworkable.
- Loans to improve or renovate a house should not be in this category and should not require a legal charge.
- Such a charge should be at the discretion of the Board of Directors.
- We ultimately believe that loans of this type should be included under personal loans and should NOT of necessity be included as Housing Loans.
- The maximum lending term of 25 yrs will in some circumstances be too short for genuine housing needs so to insert such a prescriptive limit into Regulations for CUs is excessive and is a misguided use of regulatory power. It is a blunt instrument which will unnecessarily limit CUs ability to make otherwise prudent long-term lending decisions. It will also restrict loyal CU members from borrowing for housing purposes and force them into the hands of the profit-led sector. Once loans are based on prudent principles loans terms longer than 25 years should of course be permissible.

Concentration Limits:

- The proposed 5yr and 10 yr limits at 30% (was 40%) and 10% (was 20%) are respectively too low and very restrictive. – This is particularly the case in relation to House loans. These proposals need to be increased to more realistic levels.
- We also recognise that in reality the previous 40% and 20% were available only to a limited number of CUs that could fulfill certain conditions.
- To repeat a point made throughout this submission we believe in general terms that CU Boards are best placed to assess concentration limits rather than having it defined by regulation. We believe this is again too blunt of an instrument and we strongly believe there are *other better ways to monitor and supervise CU performance*.

Commercial Lending

- The proposal to limit commercial lending to 50% of Regulatory Reserve is far too low particularly when loans to farmers and the self employed are concerned. These two sub-categories account for a large segment of the portfolio of rural CUs so the proposal in CP88 does not appear to us to have any merit or effect any positive change and it particularly discriminates against rural CUs.

Loans to “Related Parties”

- CP88 introduces a discriminatory approach to the relatives of CU personnel and as a consequence discriminates against Credit Union personnel themselves.

- It is unnecessary and unworkable that spouses / brothers / sisters / fathers / mothers etc of Boards of Directors and Management teams should be treated less favourably simply because of their family relationship.
- Insisting that loan applications from such members must be passed by special committee and reported to the board each month is simply discriminatory.
- This proposal is also unworkable and should be completely withdrawn because it inadvertently creates a “second class” member.
- The definition is so wide that it can not be effectively implemented as CU’s will find it almost impossible to be continually aware of relevant relationships which might contravene the regulation.
- If this proposal is imposed it will create yet another serious impediment to the recruitment of CU volunteers.

In short “the ability to repay” should continue to be the prime consideration when assessing loan applications and chapter 15 rejects the proposals in CP88 which it sees as over-zealous and over prescriptive regulation which has the potential to undermine rather than support good underwriting practices in CUs.

4. Proposed Liquidity Requirements

The CP 88 proposal for a new short-term liquidity ratio of at least 10% of unattached savings is excessive and unnecessary. Such a measure will consign CUs to a zero return on 10% of their savings which will further hinder their ability to build income.

Having come through what was effectively a worst case scenario (financial crash) the experience of CUs over the last five years has proven that the current requirement of 20% of unattached savings within three months is more than sufficient for any foreseeable shock. In this regard Chapter 15 would firstly like to challenge the assumption that in normal trading circumstances that a 20% liquidity requirement should be accepted as necessary. While again CP88 is silent on this matter Chapter 15 would like to know on what basis is the figure of 20% chosen by CB? Chapter 15 suspects this figure like some others may be arbitrarily chosen and we feel it is *already too high* and as such undermines CU income.

The CB must realise that CU viability is already being hindered by regulations and introducing proposals like this which we feel are excessive will cause additional pressures on CU income for no apparent reason. Requiring CUs to hold 10% of funds “on call” within 8 days will, - to say the least of it, be detrimental to their profitability, particularly in the current situation where some investment houses are now actually charging CUs to hold these funds.

Additionally we wish to make the following specific points:

- There are significant issues around the requirement to have written guarantees so Chapter 15 feel there should be NO Requirement for written guarantees.
- Investments realisable at short notice should be recognised within the 20% / 10%

- CUs who have Government Bonds or bank bonds should have such investments included in the definition of what is liquid, i.e. if it is “marketable” it can effectively be cashed at any time so it should definitely be included within the definition of what is liquid.
- Including members’ deposits in the categorisation of “unattached savings” is not at all logical or necessary. Deposit accounts are time bound savings instruments and are not available “on call” in a similar manner to shares. Treating deposits as exactly the same as shares is so ridiculous a policy that we again fail to see where this proposal is coming from.
- On a general note we feel that similar to many countries worldwide the role of CU deposits should be expanded rather than limited as they hold much potential in the overall management of CU assets.
- In summary the liquidity proposal in CP88 seems mis-guided if not downright wrong.

5. Investments

- The option to retain Equities is a useful option and should not be removed.
- There is no rationale offered by CB for the removal of this investment option.
- The 10 year maximum for investments is far too limiting and is a real barrier to CUs becoming involved in any kind of central lending mechanism through which they could perhaps provide mortgages or for social lending etc.

6. Proposal on CU Borrowings:

While this issue is not currently a problem Chapter 15 feels that there may be future requirements for inter-CU lending so we feel the current situation should be maintained.

Particularly because the CU landscape is changing radically with many mergers and transfers of engagements imminent we cannot predict requirements so it is critical not to unnecessarily remove potential funding channels from CUs into an uncertain future.

7. Reporting Requirements

Chapter 15 is of the opinion that this proposal is unnecessary and excessive in its application. Examining the detail of the proposed reporting requirements we are of the opinion that;

- The proposals are discriminatory in their focus.
- The proposals arguably infringe the rights of families of the Board and management.
- Disclosure requirements in relation to Credit Union officers within the existing legislation is sufficient.
- These proposals may cause some individuals to question their constitutionality

- These proposals will create a further obstacle to the recruitment of able volunteers
- Such disclosures in relation to the “performance of the loan book” are inappropriate from a business perspective. Such information could be commercially sensitive so disclosing it could be hugely damaging to CUs
- The existing reporting requirements are adequate for transparency

Finally, while this proposal is clearly connected to the “Related Parties” issue we would recommend that the “related parties” regulation should be removed in the first case

8. Initial Reserve for New CUs

CP 88 proposes a mandatory Initial Reserve for new CUs. There is no quantification of the size of such reserve. CUs believe that this will be a further impediment to the creation of new CUs, as they would need an external organisation such as ILCU to help them put it in place.

9. Additional Services

CP88 makes no reference to debit card services and credit card services. Chapter 15 can not understand this omission as this consultation paper should deal with debit card and credit card services for members.

In addition chapter 15 is disappointed that there is no timeline relative to new service applications in this consultation paper.

Conclusion

In framing CP88 the CB has linked its origins to the Commission on Credit Unions. The report of that commission however outlined that any regulations made should be *necessary, effective and proportionate* and clearly outlined that regulatory changes should only follow *full and meaningful consultation*. We in chapter 15 are not aware of any adequate consultations in advance of CP88. In addition one clear outcome of the commission was a commitment from CB to undertake a meaningful Regulatory Impact Analysis (RIA) before issuing any new proposals but again Chapter 15 has seen no evidence of any serious commitment from CB to carry out a proper RIA. Considering the potentially far reaching effect of these proposals we believe this to be a serious omission on the CB’s behalf.

In this consultation paper CB have retained many of the provisions of the previous consultation process (CP 76) – this despite the clear opposition of many stakeholders. In addition the apparently arbitrary nature of many of the current proposals and the absence of rationale all undoubtedly feed into CU dissatisfaction with the whole regulatory approach. Rightly or wrongly CUs believe that instead of focussing on the future stability of CUs and their ability to provide financial services there is a determination on the CB’s behalf to restrict

CUs of all sizes. Right throughout CP88 we find a level of direction and restriction that will inhibit the development of CUs into the future, and there is a complete absence of any developmental or enabling approach within the CB's proposals. Unnecessarily inhibiting CU business activities through inappropriate regulatory imposition is wrong and is not something regulators should do. We do not want to believe that restricting a CUs ability to deliver co-operative financial services is something the CB are setting out to achieve because this would be in nobody's interest except perhaps our competitors. However, Chapter 15 sees no similar efforts to inhibit other financial institutions from running their businesses or from making huge profits through their banking activities.

We can also not forget that CB is currently enforcing ongoing directions and restrictions in many CUs across our area which makes some CP88 proposals sound a little academic in that CB are already enforcing ad hoc lending caps, liquidity requirements, savings restrictions etc. Chapter 15 would really like an explanation around these seeming inconsistencies.

The development of the CU Movement over the past 50+ years has been a magnificent achievement, particularly in its delivery of financial services to the previously unbanked. In recent years any fair-minded observer will admit that the CU sector has come through the current financial crisis remarkably well, - indicating the strength and resilience of the CU model which we believe is directly linked to its unique institutional structure and the fact that CUs are rooted in local communities. With all the experience the CB has gained of other institutions crashing we respectfully say that now is the time to regulate for the future development of Irish credit unions and not seek to constrain their potential, particularly in respect of savings and loans.

In summary, Chapter 15 believes that in the round CP88 seeks to restrain the development of the credit union movement. To state the obvious there seems to be a massive divergence of priority between what the CB wishes to impose on CUs and the real business interests of these same CUs. Imposing the CP88 proposals may very well strengthen the regulatory framework but if taken en-mass they will just as surely undermine the very foundations upon which CUs are built - their core business of savings and lending. CUs are already on the ropes due to restrictions and increased compliance costs so rather than tighten the noose any further we would ask the CB to allow CUs to run their businesses without impediment while by all means challenging them, - but in a supportive manner.

As CUs committed to serving our communities on a not-for-profit basis which is the essence of good citizenship, we fear we are about to be killed off by over-zealous regulation - unless you change your approach.

.....ENDS

On Behalf of Chapter 15.....

Signed: *Paul D'Arcy* (Chair) **Margaret Egan** (Secretary) **Mary McCormack**
(Treasurer)