Registry of Credit Unions

Central Bank of Ireland

PO Box 559

Dame Street

Dublin 2.

27th February 2015

CP88 – Consultation on Regulations for Credit Unions on commencement of the remaining sections of the 2012 Act

Dear Registrar,

The following Group of Credit Unions wishes to submit a collective submission in response to the recently issued consultation paper CP88 on the future regulation of the sector:

E-Services and Communications Credit Union Ltd
Health Services Staffs Credit Union Ltd
St Patricks Credit Union (ESB Staff) Ltd
St Pauls Garda Credit Union Ltd
St Raphaels Garda Credit Union Ltd.

This Group is currently working on examining the feasibility of a Shared Services Centre for Credit Unions. Combined, we currently service the needs of over 117,000 members and as at 30th September 2014 have assets amounting to €1.3 billion. It is envisaged that collectively, we can better position ourselves for growth through leveraging our combined scale to our advantage in ways that are not currently available to us.

We wish to state at the outset that we support the idea of a strong regulatory framework that will support the real, sustainable and viable growth of the credit union sector. It is our view however that the CP88 proposals have the opposite effect to the stated intention of strengthening the sector.

Rather, the regulations as proposed will precipitate a considerable decline in income across the sector with no corresponding risk-mitigation. They also have the ability to undermine the sector by potentially facilitating a flight of capital from credit unions. Further, the proposed regulations will serve only to constrain those competent, strong, progressive credit unions from investing in initiatives that will bring the sector forward.

Summary of Issues:

CP 88:

- Threatens an immediate flight of capital of almost half a billion euro from the sector
- Will lead to a direct decline in income of over €16million to the sector
- Will undermine the sector's reputation amongst members and in the public domain
- Curtails future growth & undermines consumer confidence
- Restricts consumer choice in relation to where funds are placed
- Puts Credit Unions at a disadvantage in comparison to other financial institutions
- Does not provide robust rationale for any of the key changes proposed
- Does not support those credit unions that have the capability of managing a more sophisticated business model.

Introduction:

Tiered regulatory approach:

This Group would welcome a tiered regulatory approach as recommended by the Commission on Credit Unions (2012). It is disappointing to note that this approach will not now be adopted as a well-structured tiered approach would have helped address the limitations of the 'one-size fits all' model of regulation that CP88 proposes. Further, appropriate, proportionate tiered regulation could also provide a regulatory framework that would support the strategies of well-managed, well-run credit unions who are attempting to address the challenges of growth and relevance that currently confront the sector. Not introducing a tiered approach at this time is, at best, a missed opportunity. We would request that the CBI strongly reconsider their approach to tiered regulation at this point.

Specific Areas for Comment:

The following section outlines the specific areas about which we have concerns. In each instance, we will outline the specific impact the proposed regulation will have on the Group and where possible, attempt to extrapolate out the sectoral impact also.

Section 5: Reserves:

Although the legislation (Section 45 (5)) outlines that "*a credit union shall maintain reserves…that (a) it has assessed are required in respect of operational risk…"* there is no specific outline of this in the proposed regulation. We therefore assume that it is for the individual credit union to make the assessment and they may actually hold a 'Nil' reserve if that is what their assessment indicates is appropriate.

The proposed regulations do not appear to take account of the fact that many credit unions already hold general reserves in addition to the required statutory and regulatory reserves. An analysis of the Pearls report for the sector at the end of the financial year shows that the sector had reserves of approximately 16% at the financial year-end (ILCU, PEARLS, SEP 2014) which is well above the 10% requirement. The report also shows that the P1 ratio average for the sector is 198.59% which clearly

suggests that the movement has excess provisions. Furthermore, many credit unions also have large loan provisions which in other jurisdictions, such as Northern Ireland, are treated as quasi-reserves. Any further reserve for operational risk seems excessive in this context.

Section 6: Liquidity:

Meeting the proposed liquidity regulations in CP88 will have the effect of the collaborative Group **foregoing over €1.03m in income per annum** based on current yields.

As all credit unions have different cash movements and investment profiles, it is hard to extrapolate the precise impact on the sector but conservatively, in our view, this regulation would potentially equate to **a loss of revenue of €10m to the sector**.

As outlined in CP88, over 56% of Credit Unions investments are maturing in less than 1 year, with 17% of investments are on demand already, so the rationale provided is this short term liquidity ratio should not be an issue. However, this is in the context of an unprecedented low interest rate environment, where credit unions are looking and waiting for products to invest in that will give a reasonable return. Furthermore, there is a counter-intuitive phenomenon in the market at present where unusually, on-call rates are similar or better than longer term rates.

Should the rate environment change, such proposed restrictions would impact even more severely on the potential returns for Credit Unions. With a low return market providing an already challenged income-generating environment for credit unions, any further blow to that income-generating ability raises business sustainability challenges.

Section 7: Lending

7.2.1. Categories of Loans:

House Loans:

CP88, as written, obliges credit unions to take a first legal charge on every loan issued for home improvements, however small. Based upon feedback subsequent to the Paper being issued, we understand that this is not the intention of the draft regulations and trust therefore that this will be clarified and amended accordingly.

7.2.4. Maturity of lending:

Maturity of lending is an area where it was suggested under CP76 that credit unions might be able to look at longer-term lending such as mortgages. Under CP88, the limits on lending over 10 years of 10% (albeit 15% in certain cases) and the extra imposition of a 25-year maximum is both constraining and, in our opinion, anti-competitive. The collaborative Group, currently examining a shared services model that could potentially provide a conduit for mortgages to members, would be in a position to issue a maximum of 130 mortgages before having to stop. The entire sector could issue less than 1,000 mortgages or less than three per credit union on average. Given that mortgages are a major component of any mature international credit union model, these proposals do not support a truly viable 'credit model' for the sector. We would request that the regulator engages with those credit unions with relevant expertise in this area before enacting any new regulations in this regard.

7.2.5. Related Party Lending:

There appears to be an anomaly in the thinking in relation to related party lending. Related party lending includes staff and directors and members of their family. There is a question as to why a family member of staff or directors might wish to join a Credit Union if there is more oversight on their loan applications than if they were a member of a Credit Union where they are not related to staff or directors. This appears to contradict the equal treatment of members and requires

clarification. Further, this regulation also may have the unintended consequence of creating an extra challenge in attracting and/or retaining volunteers.

Section 8: Investments

The regulations as proposed in CP88, do not allow for "*those credit unions that can demonstrate to the Registrar of Credit Unions that they possess the skills and systems necessary to manage a more complex investment portfolio"* as currently allowed for under the October 2006 Guidance note on Investments. This is reflective of the limitations of the 'one size fits all' approach to regulation that CP88 adopts which we contend will constitute a diminution in investment income that is as yet unquantifiable.

We also believe that confining investments to a maximum term of ten years is not supportive of the type of asset and liability management model that needs to be investigated for progressive credit unions and is particularly questionable in a time when the NTMA are issuing instruments such as 30-Year Government Bonds.

We would ask that the Central Bank consider the establishment of an expert group to address the investment element of regulation. The proposed regulatory changes fully indicate that such a request is a necessity.

Section 9: Savings

9.2.2. Maximum Savings

CP88 proposes that individual members in credit unions may only hold a maximum of €100,000 in savings. This proposed regulation has a number of issues of which the following are the most immediate.

1. **Potential for flight of capital:**

The collaborative Group currently has 957 members (approximately 30% of those affected by this proposal) who retain savings greater than €100,000 with the total of their savings equating to over €143m. Adhering to the proposal as outlined has significant potential to create a run which would not be contained to those members with over €100,000 alone.

If the 0.11% of members across the sector that hold savings greater than €100,000 withdraw ***all*** of their funds (a not unlikely scenario when someone is asked to withdraw *some* of their funds), this would see a flight of approximately €450million of funds from the sector. Such a large outflow of money from the sector would precipitate an even broader 'run' as it is unlikely that such an event would be contained to just €450million. This could cause a liquidity crisis.

2. **Income Loss**

Without access to the information that RCU have across the sector, it is difficult to measure precisely the loss of income to the sector that would emanate from this proposal. However, we can use some robust estimates. Even in the current low-rate market, a well-managed, balanced, well-spread, low-risk portfolio would comfortably obtain a yield of 1.5% per annum. This would equate to a loss of at least €712k in income annually to the collaborative Group.

However, this figure as the potential quantum of impact is understated. As seen in point 1, it is a more likely behaviour that, when asked to withdraw some of their funds, people are very likely to

withdraw ***all*** of their funds. In such a scenario, we would see an outflow of over €143m. This would result in **a loss of income to the collaborative Group of over €2.15m annually**.

For the sector, a flight of €450m would conservatively equate **to a loss of approximately €6.75m in income annually**.

In the recent past, some of the credit unions in the collaborative Group have brought in a local rule that restricted members bringing in 'new savings' over a certain limit. Given the nature of the loan-to-asset ratio and the small returns available in the market, these were considered funds that were not required at that time. This was an example of good governance and good management. Bringing a cap in on savings may make sense at a local level at certain times but enacting this as regulation is questionable in our view.

3. Sectoral Reputation

Regulation of this type could be construed as inferring that the credit union sector is not to be trusted with members' savings. Enacting regulations that limits every member to holding savings that are fully covered by the Deposit Guarantee Scheme has the potential to send out the message that credit unions are not capable of managing members' funds.

4. Anti-competitive issues:

We are at a loss to understand why members of credit unions should be precluded from holding amounts on deposit to a specific level determined by regulation. Such a restriction does not apply in the banking sector. So, in tandem with point number 3, banks are implicitly being provided with support by regulation that can only have the effect of facilitating a flight of capital to them from credit unions. This is difficult to accept and raises the clear question of anti-competitiveness.

5. Freedom of Choice for Members

There is a final substantive issue to this proposal. This proposal appears to us to be a restriction on the freedom of choice for credit union members. And what CP88 also appears to ignore is that they are not only members, they are the actual owners of credit unions. Enacting a regulation that forces entities to decline savings from their members and precludes members from making a choice irrespective of (a) existing market returns, (b) the state of the economy, (c) the level of loan-demand and (d) the position of an individual entity's balance sheet, is simply wrong.

Conclusions:

The Regulatory Impact Analysis (RIA) does not, in our view, address the viability of the credit union sector business model. We would view the level of analysis of many of the individual regulations along with the impact of the overall proposed regulations as not being sufficiently robust.

As shown in our submission, this Group of credit unions could lose €3.18m of annual income if these proposals are enacted. Further, we would definitively lose over €47.5m in savings with a strong potential to lose over €143m. Extrapolating out the numbers, the sector will potentially lose €16.75m in income annually and there is a direct potential for the flight of €450m in capital from the sector which would be unlikely to stop there.

The Group supports the idea of a strong regulatory framework that can underpin the real, sustainable and viable growth of the credit union sector. CP88 does not, in our view, provide this. If anything, as seen from both the financial impact and the constraints it imposes, the proposals if enacted, would serve only to ensure that strong, progressive credit unions are precluded from investing in initiatives that could underpin a strengthened credit union structure.

In 2013, RCU invited the Top 20 credit unions in the country to participate in a 'multi-debt restructuring' initiative which was a positive move in terms of RCU engagement. We would propose that RCU engages with such a similar Group to consider the future of the sector and the correct level of regulation in each of the relevant areas that would support rather than constrain that future.

We trust you will treat the contents of this submission with the seriousness we feel is merited for the sake of the future of the credit union sector in this country.

Yours sincerely,

Fergus Casey, CEO, E-Services and Communications Credit Union Ltd
Sean Hosford, CEO, Health Services Staffs Credit Union Ltd
Robert Cooper, CEO, St Patricks Credit Union (ESB Staff) Ltd
Brendan O'Leary, CEO, St Pauls Garda Credit Union Ltd
Claire Byrne, CEO, St Raphaels Garda Credit Union Ltd.