SUBMISSION FROM

THE CREDIT UNION DEVELOPMENT ASSOCIATION

IN RESPONSE TO

The Central Bank of Ireland's Consultation on Regulations for Credit Unions on commencement of the remaining sections of the 2012 Act CP88

27th February 2015

Introduction

CUDA welcomes the opportunity to provide commentary in response to the Central Bank's paper on the proposed introduction of Regulations for Credit Unions on commencement of the remaining sections of the 2012 Act. We continue to support the introduction of a strengthened regulatory framework and welcome all consultation on consideration of the most appropriate mechanisms for achieving this goal.

Our observations are set out in two parts. We provide general commentary in Part 1 and elaborate on the requirements in order to maintain strong credit unions, provide the services and products needed by members and protect core credit union business – **lending, savings and investments**, and in doing so help future proof the provision of credit union services for the people of Ireland.

Part 2 sets out our responses in the nine questions put forward by the Central Bank. In answering the questions posed, we elaborate on a sustainable future for credit unions through prudent growth.

In our submission we highlight our serious concerns with the proposed regulations, in particular the perceived over regulation which suggests a desire for containment of the sector and could act as growth impediments for the sector. We will address the potential impacts the proposed regulations could have on credit unions.

Part 1: General Commentary

The Consultation Paper, as compounded by the findings in the Regulatory Impact Analysis (RIA), underlines where credit unions *are today* - the type of products and services they provide, capital requirements, and so on. The proposed regulations reflect this position – the credit union sector *as is.* This position is further compressed by the inclusion in the proposed regulations of additional restraints and limits – where, in the most part, there is no direct rationale to support them. CUDA shall expand further on the concerns around such restrictions and limitations under each of the prudential areas set out in the proposed regulations.

However, the overarching concern is simple - the proposed regulations fail to acknowledge that:

1. credit unions are struggling under the current business model, and,
2. future advancement is required through the ability to evolve and/or become highly specialised in niche products or services

Background

CUDA positively endorsed the Report from the Commission on Credit Unions as it was consistent with CUDA's vision for the viability and sustainability of the sector. The Credit Union and Co-Operation with Overseas Regulators Act 2012, following the findings of the Commission, and the incredible work of credit unions and the Registry of Credit Unions (RCU) put in place the enablers for a viable business model i.e. compliance, risk, internal audit functions, together with new governance requirements at Board level. These enablers have started the process of putting in place a sound foundation for an evolving sector. Regulation built upon sound enablers will provide the capacity to evolve. This is what the sector now requires and what we believe the RCU can provide.

However, unfortunately, the current proposed regulations are not aligned with the need for the business model to evolve. The provisions purport to draw a line around credit unions' '*as is'* business model of today and as a result, collectively, they could threaten the viability of many credit unions as they may not have the capacity to grow and generate income.

Sharon Donnery, Director of Credit Institutions, acknowledged that '*credit unions need to consider both the current level of operational costs and income generation (irrespective of source) and the resulting implications for their*

business model'. This, the former Registrar for Credit Unions claims *'goes to the very heart of viability and sustainability'.*[1]

Whilst operation costs continue to escalate, more acutely since 2012 due to personnel requirements and sector levies, the need to do more business and generate income is ever present and necessitates support, albeit in a prudent manner. However, the vision to evolve – to develop new products and services [seamlessly, yet prudentially] as members require them, to provide existing credit union services to more people, therefore, *to do more business*, is unfortunately limited under the proposed regulations.

CUDA's vision is to support credit union Boards and management develop their business model in a way that will allow the opportunity for prudent growth and enhance sustainability. On this basis CUDA cannot endorse the proposed regulations contained in the Consultation Paper. CUDA would ask the Central Bank of Ireland to please reconsider the proposed regulations, in particular where they impact on the core business.

The opening paragraphs of CP88 refer to the recommendations of the Commission's Report for a strengthening regulatory framework and the recommendation that regulation making powers be delegated to the Central Bank of Ireland. CUDA has for some time advocated the position to set aside a one size fits all regulatory approach. This view was supported by the Commission. It recommended a new tiered approach to regulation based on nature scale and complexity of the credit union. Isolating the recommendations, as the proposed regulations purports to do, dilute the spirit of the Commission's findings - for a strengthened regulatory framework within the context of tiered regulation.

In responding to CP76, CUDA recommended that tiered regulation should be introduced at soon as an appropriate tiered regulatory approach is defined. We fully appreciate the complexity of this requirement but would urge the RCU to keep working on this ultimate outcome. CUDA did not advocate the two tier model illustrated in the then Consultation Paper. CUDA proposed a simple, while effective, three tier business model which would encourage the vision of growth and sustainability within defined regulatory parameters.

CUDA argued in CP76 that the advantage of introducing a tiered regulatory approach at this juncture is that the credit unions have already undergone significant internal change. The prudent management of risk is central to the 2012 Act and to the Central Bank's supervisory approach, PRISM. It is, therefore, unfortunate that the proposed regulations encapsulate an ongoing one size fits all approach and, compounded by their punitive nature, provide insufficient consideration for the future advancement required to the credit union business model.

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[1] Presentation at the CUDA Annual Conference 25th January 2014

At this juncture in the evolvement of the sector, CUDA would ask that:-

1. The Minister for Finance

Reconvene the Commission on Credit Unions to ensure an alignment with the Commission's recommendations. The Minister may consider this proposal under the auspices of the Credit Union Advisory Committee [CUAC].

2. Central Bank of Ireland

i. **Facilitate a time bound forum of sector stakeholders to develop a defined tiered regulatory approach. This approach will also include a review of the lending requirements currently contained in Section 35.**

ii. Commence the remaining sections of the 2012 Act alongside regulations adopting **the current** legislative and regulatory position.

Part 2: Prudential Categories

We shall now elaborate on our concerns with regard to the proposed regulations. Our Responses are highlighted under each of the prudential areas as outlined in the questions posed by the Central Bank of Ireland.

1. Do you have any comments on the draft reserves regulations? If you have suggestions please provide them along with the supporting rationale.

Part 2 of the proposed Regulations: Reserves

Regulation 4: Regulatory Reserve Requirement A credit union shall establish and maintain a minimum regulatory reserve requirement of at least 10 per cent of the assets of the credit union.

CUDA does not agree with the regulatory reserve requirement of 10% of assets.

CUDA recommends a dual approach to the introduction of regulatory reserve requirements:

1. Implement the regulation with a requirement of a regulatory reserve of 8%, and,
2. Consider the appropriate methodologies to ensure the time bound introduction of a risk weighted approach

Rationale:
In August 2009 when the regulatory reserve ratio was being introduced, comprising of 8% statutory reserve ratio and an additional 2% of total assets required to meet the Regulatory Reserve Ratio, it was stated that in "the financial year commencing 1 October 2010, an option will be made available for credit unions that can meet certain criteria to calculate their Regulatory Reserve Ratio based on their risk profile"[2] – this remains outstanding. Both CP76 and the Feedback Statement on CP76[3] provide that consideration will be given to a risk weighted asset approach following restructuring of the credit union sector. Restructuring of the sector is an ongoing process. While ReBo has a finite life, there is no end date to restructuring.

The 10% regulatory reserve ratio is a blunt instrument and we had hoped to see a more innovative approach based on the nature, scale and complexity of the credit union concerned. However, in the absence of any analysis or detailed information from the Central Bank of Ireland on a process for risk weighted reserving we recommend the minimum reserve requirement of 8% of assets, together with operational risk requirement as determined by the credit union. In 2009, the 2% additional reserve requirements was introduced on the basis that an alternative more appropriate methodology would be applied, including a regulatory reserve ratio of 8% of total assets or a risk based regulatory reserve ratio whichever is the greater. Neither the consultation paper nor the associated RIA provides a basis for a regulatory reserve requirement of 10%, in conjunction with an additional operational reserve requirement. It would have been helpful if the RIA provided more background on the basis for the 10% requirement. As stated in previous CUDA papers and submissions, capital requirements should be established as a percentage of each credit union's risk-weighted assets, and that percentage should be continuously maintained. The required percentage should be calculated on a basis consistent with the Basel I standards for commercial banks.[4] An appropriate risk-weighting methodology automatically adjusts the actual amount of capital to the risk presented by the credit union's business model and the particular mix of assets that it produces.

We believe that this 8% should be the target that qualifies a credit union as being well-capitalised. If, at any time, a credit union's capital ratio drops below that level, its Board of Directors should be required immediately (a) to notify the

2 Regulatory Reserve Ratio for Credit Unions, August 2009, Registry of Credit Unions

3 Feedback Statement on CP76 - Consultation on the Introduction of a Tiered Regulatory Approach for Credit Unions, June 2014

4 We believe that, for the foreseeable future, the Basel 1 framework will continue to be appropriate for credit unions. Basel II and III were designed for the immensely more complicated operations and balance sheets of very large, international commercial banks.

Registrar of Credit Unions and (b) to adopt and begin implementing a written capital restoration plan. The Registrar could impose appropriate restrictions on the credit union's activities (e.g. to limit the rates of dividend / deposit interest payable, to require permission before opening new premises or extends its product range, etc.) until such time as the 8% is restored.

CUDA proposes consideration is given to the following issues:

Concern:	no consideration is given to risk inherent in different classes of assets
Recommendation:	include risk weighting in the calculation of the required reserve
Concern:	no consideration is given to the value of strong provisioning for bad debts
Recommendation:	include the value of any general provision in the calculation of risk weighted reserve
Concern:	no consideration is given to the value of operational risk reserve and any other reserve a credit union may have in place
Recommendation:	include the value of any other reserves in the calculation of the risk weighted reserve
Concern:	no scope to use more sophisticated Asset Liability Management techniques
Recommendation:	allow the use of more sophisticated Asset Liability Management techniques

Regulation 5: Initial Reserve Requirement
In addition to the reserve requirements in these Regulations and the Act, a newly registered credit union shall have adequate initial reserves that:

(a) are sufficient to meet the credit union's anticipated growth,

(b) take account of operating losses that can be expected to occur until the credit union reaches an operationally viable performance level, and

(c) are realised financial reserves which are:
- (i) unrestricted, and
- (ii) non-distributable.

We do not have a strong view on this, however, would question the unrealistic nature of the provision. We would recommend a phased approach for developing

adequate reserves for newly registered credit unions. We are not informed in the RIA whether the similar requirement as set out in the existing guidance has, to date, acted as a deterrent or has prevented a credit union registering.

Additional Recommendation

Section 45, 2012 Act: Operational Risk

We appreciate that the requirement to have in place additional reserve for operational risk is a matter for the credit union, and ultimately the Board. CP76 proposed that the Basel Basic Indicator Approach adapted for credit unions or an additional specified percentage of assets, e.g. 2%, may be considered as a base for operational risk reserving. We would welcome dialogue with the Central Bank of Ireland prior to the operation of Section 45. CUDA believes that both approaches, coupled with requirements for a regulatory reserve ratio [notwithstanding at 8%], are excessive and unwarranted, however, the Basel approach may more appropriately align credit unions with other industry providers.

2. Do you have any comments on the draft liquidity regulations? If you have suggestions please provide them along with the supporting rationale.

Part 3 of the proposed Regulations: Liquidity

Regulation 8: Interpretation

(1) In this Part **"liquid assets"** means the following unencumbered assets only:-

(a) cash;

(b) investments with a maturity of less than 3 months, excluding the minimum reserve deposit account and the deposit protection account;

(c) investments with a maturity of greater than 3 months, excluding the minimum reserve deposit and the deposit protection account, where a written guarantee exists to the effect that funds are available to the credit union in less than 3 months. Where a guarantee exists, the investments may be considered liquid assets to the value of the investments guaranteed, excluding penalties on interest or income.

CUDA welcomes the expansion of definition of liquid assets to include some investments with more than 3 months to maturity where the required guarantee is in place.

Regulation 9: Liquidity Requirements

(1) A credit union shall establish and maintain a minimum liquidity ratio of liquid assets of at least 20 per cent of its unattached savings.

(2) A credit union shall establish and maintain a minimum short term liquidity ratio of short term liquid assets of at least 10 per cent of its unattached savings.

CUDA recommends the removal of Regulation 9(2). Based on the information provided to us in the consultation paper there is no evidence for the necessity to regulate for a short term liquidity requirement. The rationale provided therein is based on the "on-demand nature of credit union savings". However CUDA is not aware, [and we are not provided with data] of the sector being unable to meet its obligations as they arise in this regard. This could be perceived as over-regulation.

Furthermore, as there is such a high volume of unattached shares, a regulatory requirement for short term liquidity ratio of at least 10% is onerous.

Rationale:
Many credit unions may currently be in a position to comply with this proposed requirement as longer term deposits are not providing additional yield. The RIA considers the position *as is* today [i.e. where 20% of total investments have a maturity of less than 8 days], however, when considering the need for growth in the sector we would request that the additional short term liquidity requirement remains on hold for the following reasons:

1. permit growth of income from investments and deposits should the market improve

2. await the bedding down of Basel III liquidity requirements on the wider banking sector to determine the full impact on credit unions, in particular to offset any further negative impact on credit union income

3. to allow for an improvement in the ratio between attached and unattached shares

4. there is no immediate liquidity risk as the RIA demonstrate credit unions currently hold significant liquid assets ratios

CUDA would ask the Central Bank to put on hold the requirement for short term liquidity and that the matter receives further review and impact analysis with the introduction of tiered regulation.

Additional Recommendation

Section 35 Regulatory Requirements for Credit Unions, October 2013

CUDA recommends that additional liquidity requirements for long term lending should be revised as part of the new regulations. Due consideration needs to be afforded to the level of attached shares, the nature and value of security assigned to longer term loans, and the evolution of longer term deposit products. There is an opportunity to develop a more meaningful asset and liability management framework and move away from the crude mechanism of Section 35, which served well in the past but has now become a restriction on development.

The proposed regulation, while potentially reducing the income earned by credit unions, fails to identify in the RIA the operational workload, and associated cost, and the increased regulatory risk of breaking a liquidity ratio due to the frequency that such short-term deposits would require to be rolled over.

Credit unions should be afforded the option of investing in assets that are both fully liquid to meet the liquidity requirements but also offer the prospect of a reasonable return.

3. Do you have any comments on the draft lending regulations? If you have suggestions please provide them along with the supporting rationale.

Part 4 of the proposed Regulations: Lending

Opening Observations

We recommend that Part 4 of the draft regulations is reconsidered.

Part 4 highlights:

1. concerns for the sector when loan books are falling or growth is very tentative

2. concerns for developing strategy and income generation compounded by additional lending restraints and limits where none currently exist

3. lack of incentive or grounds for improving the enablers (risk, compliance, skill) to include specialist and sophisticated platforms in which to develop new products and services and/or to become niche product providers

4. over reliance on regulatory reserve as a determining factor for lending capacities. No detailed recognition for nature scale and complexity of the credit union concerned, i.e. reserves, provisions, systems of controls, risk appetite, etc.

5. no encouragement or benefit to scale (through restructuring i.e. mergers, transfers) as no detailed recognition for nature scale and complexity

6. no encouragement for collaboration. Arguably, proposed regulations discourage collaborating. Many collaborative initiatives will be futile due to maturity limits/concentration limits

Categories, Concentration Limits and Maturity Limits
The proposed lending regulations cannot be viewed in isolation; together they have the potential to act as significant growth inhibitors.

Regulation 12: Categories of Lending
(1) A credit union shall only make loans that fall within the following categories:-
- (a) Personal loans;
- (b) Commercial loans;
- (c) Community loans;
- (d) House loans;
- (e) Loans to other credit unions.

(2) A commercial loan granted by a credit union, where the total amount of commercial lending granted to a borrower, or group of borrowers who are connected, is less than €25,000, is not subject to Regulations 13(a) or 17. A commercial loan is included in the calculation of granted commercial loans until the commercial loan has been repaid in full.

Regulation 13: Concentration Limits
A credit union shall not make:
(a) a commercial loan, where such a loan would cause the total amount of outstanding commercial loans of the credit union to exceed 50 per cent of the credit union's regulatory reserve,

(b) a community loan, where such a loan would cause the total amount of outstanding community loans to exceed 25 per cent of the credit union's regulatory reserve, or

(c) a loan to another credit union, where such a loan would cause the total amount of outstanding loans to other credit unions

Regulation 15: Maturity Limits
(1) A credit union shall not make a loan to a member:–

(a) for a period exceeding 5 years if, were the loan to be made, the total gross amount outstanding in relation to all loans with greater than 5 years to the final repayment date would exceed –

(i) 30 per cent of the total gross loan book balance outstanding at that time in relation to all loans made by the credit union, or
(ii) if the Bank so approves in writing, 40 per cent of the total gross loan book balance outstanding at that time in relation to all loans made by the credit union, or

(b) for a period exceeding 10 years if, were the loan to be made, the total gross amount outstanding in relation to all loans with greater than 10 years to the final repayment date would exceed –
(i) 10 per cent of the total gross loan book balance outstanding at that time in relation to all loans made by the credit union, or
(ii) if the Bank so approves in writing, 15 per cent of the total gross loan book balance outstanding at that time in relation to all loans made by the credit union.
(2) The Bank may impose on approval, for the purposes of subparagraph (a)(ii) or (b)(ii) of this Regulation any condition that the Bank considers appropriate.

(3) A credit union shall not make a loan to a member for a period exceeding 25 years.

CUDA recommends the revision of all three proposed regulations, above.

Rationale:

Categories

Categories of lending should be a matter for Boards as part of their strategic plan and as envisaged in Section 7.4 of the Report of the Commission on Credit Unions. We do not view the imposition of categories as a matter for regulation. This could be perceived as micro-management and over regulation.

Concentration Limits

Concentration limits, as proposed, prevent and discourage credit unions developing niche products and services which, in some cases, could be more suited to their common bond demographics.

Good and sensible lending policies and practices should determine scale of lending and not forced limitations. Statutory and regulatory provisions, including draft regulations 17 and 18 require appropriate policies and practices. Such policies and practices (including loan security and provisioning) are subjected to scrutiny under PRISM reviews and inspections. This permits and develops prudent lending. Obviously, such lending practices are also subject to internal and external audit. Furthermore, credit unions are required to submit prudential returns. Imposing concentration limitations *contains* credit unions in a manner that we do not believe supports the development of the business model in a way that will allow the opportunity for prudent growth and enhance sustainability.

The following chart [Chart 1] illustrates the concentration limits on 12 sample credit unions based on regulatory reserves:

Chart 1

Credit Union	RR/Statutory Reserve	Large Exp/ Connected Borrower	Commercial lending 50%	Community lending 25%	Lending to other CU 12.5%
1	**6,947,600**	694,760	3,473,820	1,736,910	868,455
2	**15,801,400**	1,580,140	7,900,700	3,950,350	1,975,175
3	**5,100,000**	510,000	2,550,000	1,275,000	625,500
4	**24,526,900**	2,452,690	12,263,477	6,131,739	3,065,869
5	**10,695,300**	1,069,530	5,347,650	2,673,825	1,336,913
6	**4,239,900**	423,990	2,119,950	1,059,975	529,988
7	**5,334,400**	533,440	2,667,200	1,333,600	666,800
8	**18,636,400**	1,863,640	9,318,200	4,659,100	2,329,550
9	**39,024,500**	3,902,450	19,512,250	9,756,125	4,878,063
10	**17,006,100**	1,700,610	8,503,050	4,251,525	2,125,763
11	**23,136,000**	2,313,600	11,568,000	5,784,000	2,892,000
12	**16,154,400**	1,615,440	8,077,200	4,038,600	2,019,300

The concentration limits provide a limited ability to lend in all categories; however this ignores the fact that such limits may not be consistent with the credit union's strategic plan, especially a credit union that has the ability to become a niche player within the financial service sector. Furthermore, credit unions will find themselves constantly monitoring concentration limits.

Maturity Limits / Section 35

However, the greatest concern with the proposed concentration limits is that they, themselves, are confined to the maturity limits, as most loans that would fall

under these categories are for terms greater than five years. This creates a double edged sword for the credit union.

The following chart [Chart 2] depicts current loan books of 3 sample credit unions. The proposed concentration limits are imputed alongside the permittable maturity limits. **It is evident that the maximum permittable percentages under the proposed concentration limits** [as set out in Chart 1] **are no longer achievable.**

Chart 2

	Maturity Limits				Proposed Concentration Limits			
					[Concentration limits are based on the regulatory reserves of credit union 1, 2, and 3 respectively]			
Credit Union	Current Loan Book	30% > 5 yrs max.	10% > 10 yrs max.	Allowable Total over 5 yrs	Large Exp/ Connected Borrower	Commercial lending 50%	Community lending 25%	Lending to other CU 12.5%
					[Are concentration limits achievable in light of maturity limits?]			
1	**51,032,000**	15,309,600	5,103,200	15,309,600	2,452,690	12,263,477	6,131,739	3,065,869
2	**10,093,500**	3,027.900	1,009,350	3,027.900	423,990	2,119,950	1,059,975	529,988
3	**41,792,200**	12,537,660	4,179,220	12,537,660	1,615,440	8,077,200	4,038,600	2,019,300

Should the proposed regulations be implemented credit unions will not only find themselves lending subject to the maturity limits (i.e. currently Section 35) but also the requirement to fit within the concentration limits of each category. And, in considering the concentration limits, clearly credit unions will be obliged to consider the **remaining capacity** under the maturity limits. In many cases the lack of capacity will prevent them successfully generating an income.

Regulatory Impact Analysis

The RIA is based on current Prudential Returns. The Commission acknowledged that credit unions are under-lent[5]. Part of CUDA's vision is to assist Boards and management address this problem through a variety of initiatives and collaboration. Clearly, as credit unions are under-lent, the new proposed measures will have little current impact – this is highlighted in the RIA which indicates the draft regulations low impact and cost implication. *However,* for many credit unions the current position is not a sustainable path. It would be helpful of the consultation paper or RIA provided an insight to future impact and considered the necessity for credit union to evolve and generate income.

[5] Chapter 7 Future Models of Credit Unions, page 79

Housing loans

This proposed category of lending requires specific observation. Currently credit unions are permitted to provide home loans for non-principal residence (e.g. holiday home) and can approve loans based on second charges on properties. The proposed regulation requires a credit union to hold a first charge and limits home loans to a member's principal residence. This is unreasonable and anti-competitive – such restrictions are not imposed on other house loan providers. Where credit unions develop their expertise to underwrite home loans they should then be permitted to do so. CUDA believes it is sufficient for a credit union to underwrite home loans based on the requirements set out in the new Regulations on residential mortgage lending[6], and on additional requirements as determined by their lending policies.

Furthermore, with regard to the definitions and in particular the following:-

> **"house loan" means a loan made to a member secured by property for the purpose of enabling the member to:**
>
> (a) have a house constructed on the property as their principal residence;
>
> **(b) improve or renovate a house on the property that is already used as their principal residence,**
>
> (c) buy a house that is already constructed on the property for use as their principal residence, or

We trust that a credit union is still permitted to provide a loan for home improvements, as they do so today, under the category of personal loans which is defined in the proposed regulations as:

> "personal loan" means a loan provided to an individual for personal, family or **household use**, once that use is for purposes unrelated to the person's trade, business or profession or the purchase of property"

It is very concerning that the issues in CUDA's Response to CP76 with regard to housing loans have not being adequately addressed. The maturity limits in the proposed regulations [i.e. Section 35 limits remain unchanged] prohibits scale, i.e. by placing a limit on lending over 5 years. Therefore, to categorise a group of lending as housing loans is misleading, as the maturity limits effectively bars credit unions providing housing loans in a viable manner.

[6] Central Bank (Supervision and Enforcement) Act 2013 (Section 48) (Housing Loan Requirements) Regulations 2015 (the Regulations).

The following chart [Chart 3] depicts the restrictions on the number of housing loans permitted under the proposed regulations:

Chart 3

	Current Loan Book	15% > 10 years	Number of Loans €120,000	Consistent growth over first 5 years	Avg Interest @ 2% for first 5 yrs	Next 5 years' income
1	29,945,000	4,491,750	37	898,350	50,300	89,800
2	30,371,100	4,555,665	38	911,133	51,020	91,110
3	37,745,400	5,661,810	47	1,132,362	63,400	113,200
4	48,015,700	7,202,355	60	1,440,471	80,670	144,050
5	57,221.200	8,583,180	72	3,842,970	96,131	171,660

Illustration purposes

It is evident from the above Chart that the returns from home loans is not sustainable, in particular due to the limited volume that a credit union can offer (for instance, with a loan book of €30 million a credit union is limited to 37 home loans). The obvious difficulty with this is that once the volume is reached (i.e. 37) the credit union is effectively barred from offering further home loans for numerous years *and indeed from any loans governed by the maturity limits proposed under regulation 15 that are greater than 10 years.*

Furthermore, credit unions are obliged to demonstrate the ability to underwrite such loans, and incur the cost of achieving the capabilities required. Without the ability to increase the volume returns, especially after 5 years, it is questionable, under the proposed structure, if a viable product line exists for any credit union to offer. Furthermore, the cost to implement this product line will far outweigh the limited earnings that can be made because of the limit restrictions. This is especially concerning for future developments for the sector.

CUDA recommends that with the introduction of new regulations the opportunity is taken to review the maturity limits (i.e. currently Section 35 which remains unchanged under draft regulation 15). Meanwhile, CUDA awaits the publication of revised requirements for a credit union when applying for longer lending limits.

Maximum maturity limit

What is the rationale for a maximum maturity limit of 25 years? **CUDA recommends** that this is removed as it is anti-competitive and over regulation. It

is with great frustration that the RIA deems it necessary to set out the current position *as is* today. We are aware that long term lending is not currently the norm, so the low impact analysis for this new limitation is not surprising. Please consider future growth requirements. Many first time purchasers of homes extend their loans beyond 25 years. As stated above, CUDA believes it is sufficient for a credit union to underwrite the loan based on the requirements set out in the new Regulations on residential mortgage lending. These lending Regulations do not impose any term restriction on home loan providers.

Regulation 14: Large Exposure Limit

(1) A credit union shall not make a loan to a borrower or a group of borrowers who are connected which would cause the credit union to have a total exposure to the borrower or group of borrowers who are connected of greater than €39,000 or 10 per cent of the regulatory reserve of the credit union.

(2) Where an exposure to a borrower or group of borrowers who are connected exceeds the limit set out in paragraph (1), the credit union must hold the amount of the exposure that is in excess of the limit in a realised reserve, separate from the regulatory reserve of the credit union.

(3) The requirement specified in paragraph (2) for exposures existing at the time of commencement of these Regulations shall not apply for a period of 2 years from the commencement of these Regulations.

CUDA recommends that the current position (as set out in Section 35) is reflected in the forthcoming regulations.

Alternatively, **CUDA recommends**, until such time as an appropriate tiered approach is developed, that the large exposure rate is based on actual reserve (i.e. regulatory reserve, operational risk, other reserves). This will ensure that the large exposure rate is more aligned to the current permitted rate.

The maximum exposure limit permitted for a borrower or group of connected borrowers under the proposed regulations is the greater of €39,000 or 10% of regulatory reserve.

Currently, the maximum exposure rate permitted for a borrower or group of connected borrowers is the greater of €39,000 or 1.5% of assets.

The following chart [Chart 4] depicts further limitations imposed on 3 sample credit unions under the proposed regulations:

Chart 4

Credit Union	Total assets	10% RR	Current max. exposure limit: **1.5% of assets**	Proposed max. exposure limit: **10% of RR**
1	50,000,000	5,000,000	**750,000**	**500,000**
2	100,000,000	10,000,000	**1,500,000**	**1,000,000**
3	200,000,00	20,000,000	**3,000,000**	**2,000,000**

In all cases the proposed maximum exposure limit under the draft regulations is more restrictive than the current maximum exposure limit of 1.5% of assets. The dissimilarity increases the greater the asset size of the credit union. This is a direct deterrent to scale.

Regulation 23: Lending Policies
A credit union shall, at a minimum, establish and maintain the following written lending policies:-

(a) Credit Policy;
(b) Credit Control Policy; and
(c) Provisioning Policy.

In part, the proposed regulation reiterates what is already required under legislation, and in that regard we question the requirement to include this regulation. **CUDA would recommend** that regulation expand on the data required in the lending policies and practices in order that credit unions can manage and determine their own growth strategy and not be curtailed by concentration and/or maturity limits.

Transitional Arrangements
CUDA has no difficulty with this provision. Obviously, the draft regulations, whatever the provisions, will have no impact on existing loans, despite the fact that an individual loan may not comply with new regulations.

4. Do you have any comments on the draft investments regulations? If you have suggestions please provide them along with the supporting rationale.

Part 5 of the proposed Regulations: Investments

Regulation 25: Classes of Investments

A credit union may only invest in euro denominated investments in the following:

(a) Irish and EEA State Securities;
(b) accounts in Authorised Credit Institutions;
(c) bank bonds;
(d) Collective Investment Schemes;
(e) shares of and deposits with other credit unions;
(f) shares of a society registered under the Industrial and Provident Societies Act 1893 to 1978.

CUDA does not agree with the removal of *Equities* as a class of investment. **CUDA recommends** that this class is re-submitted in order that the class of investments set out in the regulation is not more restrictive than current provisions.

Rationale:
CUDA has no difficulty with a limited concentration limit [i.e. 5%] to contain risk exposure in this regard. Furthermore, typically, credit unions that invest in equities do so guided by professional investment advisors.

It is not the current impact that is subject to concern, but future impact. Whilst current investments held in equities are low the door should not be closed entirely. It would be helpful if the consultation paper or the RIA provided rationale for the removal of the class based on prudence or in consideration of undue risk to member's savings. Hence the removal appears, and potentially acts, as a future growth impediment. This could be perceived as over regulation.

Transitional Arrangement
CUDA does not agree with the proposed regulation and therefore does not agree with related transitional arrangements. That said, clearly any investments in equities should be permitted to run to maturity.

Regulation 26: Counterparty Limits
A credit union shall not make an investment with a counterparty which, were that investment to be made, would cause the investments with that counterparty to exceed 25 per cent of the credit union's total value of investments.

CUDA recommends that the regulations do not impose absolute restrictions. CUDA would welcome more innovative wording that would allow scope to credit unions as determined by their risk appetite and depicted in their investment policy.

Rationale:
This would be in keeping with [the new] Section 43(5) which requires the Central Bank of Ireland, in prescribing regulations, to ensure that they are effective and

proportionate having regard to the nature scale and complexity of credit unions or a category of credit unions.

There is uncertainty in the current investment environment, and alongside the knowledge that many credit union business models must evolve, regulations that permit credit unions exceed the limits under prescribed conditions, such as on guidance of authorised investment advisors, would be welcome.

Regulation 27: Concentration Limits
(1) A credit union shall not make an investment in Irish and EEA State securities which would cause the investments in Irish and EEA State securities to exceed 70 per cent of the total value of the credit union's investments.

(2) A credit union shall not make an investment in bank bonds which would cause the investments in bank bonds to exceed 70 per cent of the total value of the credit union's investments.

(3) A credit union shall not make an investment in another credit union which would cause the investments in other credit unions to exceed 12.5 per cent of its regulatory reserve.

(4) A credit union shall not make an investment in the shares of a society registered under the Industrial and Provident Societies Acts 1893 to 1978 which would cause the investments in shares in societies registered under the Industrial and Provident Societies Acts 1893 to 1978 to exceed 12.5 per cent of the credit union's regulatory reserve.

CUDA recommends that Regulation 27(3) and (4) should reflect the current requirements.

Rationale:
The current operative requirements impose no limitation for investing in other credit unions or Industrial and Provident Societies. [The new] Section 43(2) empowers the Central Bank of Ireland to prescribe limitations having regard to the need to avoid undue risk to members' savings. It would be helpful if the consultation paper or the RIA provided an insight as to the rationale for now proposing a limitation to the current position. What analysis was conducted to determine 12.5% regulatory reserve as appropriate when taking into account investment risk?

Based on the information we are provided with in the consultation paper, less than 1% of credit unions have exposure to such investments. CUDA can see no direct requirement for the reduction and as a result it appears, and potentially acts, as a growth impediment.

Regulation 28: Maturity Limits
(1) A credit union shall not make an investment which has a maturity date which exceeds 10 years from the date of the investment.

(2) A credit union shall not make an investment which would cause the credit union to have more than 30 per cent of its investments maturing after 7 years.

(3) A credit union shall not make an investment which would cause the credit union to have more than 50 per cent of its investments maturing after 5 years.

CUDA welcomes the removal of maturity limits based on class of investments. However, in the current investment environment CUDA is concerned with the strict limitation as set out in regulation 28(2) and (3) above. As stated in our comments under Part 3, the opportunity to develop a more meaningful asset and liability management framework and move away from the crude mechanisms, such as Section 35, should now be taken and reviewed in the context of the current and likely environment. As credit unions, that choose to evolve, prudently broaden the range of services they provide for an increasing number of people they will also have developed the ability to manage an evolved array of investments. In particular, CUDA would like to see credit unions being afforded the opportunity to explore avenues under the Investments section of the 2012 Act in particular with regard to investment projects of a public nature (S43(3)(a)). However, the proposed ten year maximum term effectively shuts down this possibility and we would respectively request that the Central Bank reconsider the maturity limit in this regard.

CUDA would recommend the inclusion of subsection (4) to permit a credit union to exceed the percentage limits of 30% and 50% respectively on prescribed occasions, such as, the approval of the Central Bank of Ireland and grounded on professional investment advice.

Additional Observation
CUDA acknowledges that the recommendations made in submissions to CP76 were acted upon by the Central Bank of Ireland. In particular, CUDA had contributed to a detailed impact analysis conducted by Davy based on the proposals set out in CP76, the findings of which illustrated severe adverse impact on income potential, especially in relation to the then proposed changes to counterparty, collective investments schemes and the changes to investment classes and limits.

CUDA and Davy have again liaised on the proposed investment and related regulations. Whilst appreciating the need for oversight and regulation to offset risk, it is our view that in this fragile environment for credit union investment

growth doors remain open to potential growth areas and income generation. In this regard **CUDA would recommend** that a similar provision is contained in the regulation as is currently in Investment Guidance Notes of 2006, The Guidance Notes issued by the Registry of Credit Unions, provide that the "*limits contained in this guidance note shall not apply to 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."* CUDA would like to see the Registrar maintain this flexibility.

5. Do you have any comments on the draft savings regulations? If you have suggestions please provide them along with the supporting rationale.

Part 6 of the proposed Regulations: Savings

Regulation 35: Savings Requirements A credit union shall ensure that no member shall have savings which exceed €100,000

CUDA strongly opposes the limitations contained in this draft regulation.

Prior to the publication of CP88, CUDA, in association with CUMA, wrote to the Governor of the Central Bank requesting the removal of this provision. CUDA highlighted concerns with regard to reputational risk for the sector and competition law issues. In our view this proposed regulation is an unwarranted attempt at over regulation and is not in the best interest of credit unions or their members.

CUDA recommends the regulation is realigned with the limits currently contained in Section 37.

Rationale:

Reputational Risk

Putting a cap of €100,000 on savings effectively [yet incorrectly] tells the consumer that the credit union is not as safe a place for savings as other deposit takers. The Central Bank of Ireland has produced no evidence to support this theory, and CUDA does not believe this is the case. CUDA has calculated the minimum sum that will leave CUDA member credit unions as a result of the cap but for commercial reasons it is not appropriate to publish such figures. The Central Bank has access to such figures through Prudential Returns and the RIA has already provided us with some financial analysis - 1.2% of member savings

will exceed the proposed cap. However, unfortunately, we cannot assume that members will leave the permitted limit of €100,000 with the credit union and remove the amount that exceeds this cap.

Anti-competitive

CUDA is concerned that the limit is associated with the Deposit Guarantee Scheme (DGS). CUDA would view this as discriminatory in nature as similar restrictions are not imposed on Irish Banks. The limit suggests that savings are better protected elsewhere. The Deposit Guarantee Directive 2014/49 [transposition July 2015] will require all financial institutions to communicate clearly and precisely with depositors, at least on a yearly basis, the implications and protections afforded under the deposit guarantee scheme. This will ensure all depositors are fully aware of the implications of savings in excess of €100,000 and should satisfy the Central Bank of Ireland that credit union members can, *themselves,* make informed decisions. Furthermore, under the new Directive, in some circumstances the deposit guarantee scheme will guarantee sums of money in excess of €100,000, e.g. funds from the sale of a house held on deposit for a defined period. Credit unions will be unable to offer this service or reassurance to depositors and as such excludes them from such deposits.

Such limitations places credit unions in an anti-competitive position especially for credit unions that wish to develop and offer products comparable to other financial institutions, e.g. Banks. It is also questionable whether such a limitation will allow credit unions to meet members' needs now and into the future. The Commission noted in its Report that member needs are changing and credit unions will have to develop to meet these changes. It is crucial that credit unions have the ability to manage long term or significant deposits holdings, and are not restricted from doing do. As far back as 2006 in a published document[7] CUDA stated "to truly excel in their core business, credit unions need to begin by offering a much broader array of modern savings and lending products". It is time to allow credit unions, which have the ability, to manage extensive deposit and savings accounts.

Low Risk

The RIA provides that less than 0.11% of credit union members currently have savings that would not comply with the proposed savings cap, and this amounts to just 1.2% of member's savings. Therefore, there is a low operational risk to the current environment. *However,* the proposed cap will impact 55% of credit unions. In other words 55% will be obliged to ask their members to withdraw savings from their credit unions. This high percentage factors in a considerable reputational risk.

[7] Call To Action, Re-inventing Credit Unions for the 21st Century, 2006

No justification

CUDA is at a loss as to why the Central Bank of Ireland would impose such a provision. The consultation paper and RIA provides no rationale for the proposed cap of €100,000. Strong validation for the retention of the current operative position [i.e contained in Section 37] is provided by CUDA above. To propose a limit on savings based on 2014 Prudential Returns is a narrow and worrying trend. Savings' requirements would be more appropriately analysed based on **potential capital requirements.**

Transitional Arrangements

CUDA does not agree with the proposed regulation and therefore is not in agreement with related transitional arrangements.

6. Do you have any comments on the draft borrowing regulations? If you have suggestions please provide them along with the supporting rationale.

Part 7 of the proposed Regulations: Borrowing

Regulation 38: Borrowing Requirements A credit union may borrow money, on security or otherwise, so long as the total amount outstanding in respect of monies so borrowed does not at any time exceed 25 per cent of the savings of the credit union.

CUDA is not in agreement with limitations contained in this regulation. **CUDA recommends** the regulation is realigned with the limits currently contained in Section 33, i.e. that the permitted borrowing limits remains at 50%.

Rationale:

As there is no direct requirement for the necessity to reduce the borrowing limit to 25% of savings, the limit appears, and potentially acts, as a growth impediment. This could be perceived as over regulation. CUDA is unable to determine the Central Bank's basis for the new borrowing limitation.

CUDA recommends that the borrowing permitted limit remains at 50% for the following reasons:

1. Future requirements

Generally, credit unions have had no requirement to borrow. The lack of necessity, *as is* the position *today,* appears as the basis for reducing the limit from 50% to 25%.

CUDA would recommend that the borrowing limitation remains at 50% to provide scope for future funding requirements of credit unions. Ultimately, the Board are responsible for ensure that borrowing is aligned with the credit union balance sheet strategy and liquidity management policies.

2. Low risk

As the RIA points out, less than 4% of credit unions have borrowings and the largest amount borrowed is 5.6% of aggregate savings, and, coupled with the requirement to notify the Central Bank of Ireland of proposed borrowing under regulation 39 there is no direct necessity to limit the permitted borrowing capabilities. Whilst we are aware there is no obligation in the RIA to do so, it would have been helpful if it provided an analysis of the basis on which the new limitation of 25% is deemed a prudent percentage to borrow.

Transitional Arrangements

A transitional period of two years is a very blunt approach to adopt. The only rational business approach to adopt is that that credit unions are permitted to complete their contractual arrangements.

7. Do you have any comments on the draft regulations on systems, controls and reporting arrangements? If you have suggestions please provide them along with the supporting rationale.

Part 8 of the proposed Regulations: Systems, Controls and Reporting Arrangements

Regulation 44: Plans, Policies and Procedures

Plans, Policies and Procedures

(1) A credit union shall establish and maintain, in writing, all policies specified in section 55(1)(o) of the Act.

(2) A credit union shall ensure that the matters specified below shall be communicated to all officers in the credit union following any updates made, including the review, approval and update by the board of directors required at least annually:

(a) the risk management policy;
(b) the business continuity plan;
(c) the conflicts of interest policy; and
(d) the standards of conduct and ethical behaviour of officers.

(3) A credit union shall document, approve and update, at least annually, the matters specified in Schedule 1 to these Regulations.

(4) A credit union shall, at a minimum, establish and maintain information systems and management information policies which include:

- (a) a management information policy;
- (b) an information security policy;
- (c) an information systems change management policy; and
- (d) an information systems asset management policy.

CUDA has no difficulty with this provision as it reiterates what is already statutory requirements, including the requirements set out in Schedule 1 of the draft regulations; it is on this basis we would question the requirement for this regulation.

Regulation 45: Reporting and Disclosure in the Annual Accounts

(1) A credit union shall disclose the following in its annual accounts:

(a) the regulatory reserve requirement, the credit union's regulatory reserve expressed as a percentage of total assets, the additional reserves that the credit union holds in respect of operational risk expressed as a percentage of total assets, together with the credit union's dividend and loan interest rebate policy;

(b) the performance of its loan book;

(c) the total amount of loans outstanding to related parties and the loans to such persons as a percentage of the total loans outstanding;

(d) accounting policies for the valuation of investments; and

(e) accounting policy for income recognition on investments.

(2) A credit union shall separately analyse investment income and investment gains in the income and expenditure account (or notes) of the annual accounts of the credit union, as follows:-

(a) investment income and investment gains received by the credit union at the balance sheet date;

(b) investment income that will be received within 12 months of the balance sheet; and

(c) other investment income.

CUDA member credit unions welcome transparency. However, credit unions are obliged to adhere to accounting standards set out in FRS 102. We believe that these requirements will be adequate for the sector and will ensure consistency. In this regard, we do not think it is necessary to further regulate on reporting and disclosure requirements.

8. Do you have any suggestions on additions, amendments or deletions to the services and related conditions that are included in the draft regulations? If you have suggestions please provide them along with the supporting rationale. It should be noted that any further services proposed to be included in the regulations must not involve undue risk to members' savings, the financial stability of the credit union or the operational capability of the credit union.

Part 9 of the proposed Regulations: Services exempt from additional services requirements

It is disappointing to see statutory instruments [SI No. 223, 2004 and SI No 107, 2007] simply reflected in the draft regulations. In our response to CP76, CUDA called for a more sophisticated approach to providing additional services. Products and services will depend on the demand for new and emerging requirements by members. We caution against limiting products and services to a *list.* The reality is that the list becomes *closed* to new products and services. Additional products and services should be permitted to emerge depending on business models i.e. nature scale and complexity. The one size fits all approach takes no account of this.

We would encourage the regulatory requirement to provide that products and services which are consistent with the objects of the credit union are exempt.

The great difficulty for emerging products and services lies in the Section 48 process. Credit unions struggle to define the requirements for introducing a new product or service. There are no guidelines or parameters determining when a credit union will be permitted to offer a new product or service, and as credit unions are obliged to rely on an ad hoc basis it is difficult for a credit union to strategically plan business development. In order for the process to become an enabler to a viable business model, transparency is required under which credit unions make their applications through Section 48. CUDA recommends a time driven clearly defined approach, which provides clarity for both credit unions and Central Bank personnel/supervisors.

9. Do you agree with the proposed timelines for the introduction of the draft regulations set out in this consultation paper, in particular the transition period proposed between the publication and commencement of the regulations? If you have other suggestions please provide them, along with the supporting rationale.

(1). There is a great difficulty in answering this question. Obviously, the sector requires time to effectively implement new requirements into their everyday operations, and in this regard the transition period proposed of 6 months is the minimum time a credit union will require in order to do so. However, that said the sector is implementing a process that is flawed and not fit for purpose. The sector is, yet again, implementing a one size fits all approach, which may not be wholly appropriate for credit unions individually.

Aside for the transition period which the Central Bank of Ireland proposes, there are additional transitional arrangements contained within certain Parts of the draft regulations. We have addressed these individually, however, it is crucial that such transitional periods and time frames are not seen as a barrier to an alternative approach to one size fits all regulation, such as tiered regulation.

Instead, the time should be used constructively to develop an alternative approach to enable the sector to evolve, and individual credit unions to develop their business model.

(2). It is difficult to comment on the appropriateness of transition arrangements - until the Regulations are available and it is identified what changes have been incorporated therein, the final impact is unknown. However, perhaps the crucial issue is that the concerns with regard to transitional arrangements contained in various Parts of the draft regulations are considered by the Central Bank of Ireland, for example, current investment portfolios negatively impacted by proposed liquidity or investment provisions.

We look forward to any additional queries the Central Bank may have in relation to our recommendations set out above. We are happy to provide any additional information that the Central Bank may require.

Again, thank you for the opportunity to respond to the Consultation on Regulations for Credit Unions on commencement of the remaining sections of the 2012 Act.

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