LISDUGGAN DISTRICT CREDIT UNION LIMITED

Response to Consultation Paper CP 88

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

February 2015

This document contains the views of the Board and Management of Lisduggan District Credit Union Limited (LDCU) on the proposals contained within Consultation Paper CP88.

Introduction

LDCU welcomes the opportunity to participate in the Consultation on Regulations for Credit Unions on commencement of the remaining sections of the 2012 Act (“CP88”).

We have carefully considered CP88 proposals and their potential impact on our own credit union and the sector and set out below are a number of constructive observations and recommendations that are aimed at enhancing the regulatory framework for the future and finish by raising some further relevant issues for consideration.

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

The rationale for a minimum reserve requirement of 10% across all credit unions should be explained as this approach does not accord with other international credit union movements. The proposed regulation does not differentiate between credit unions of varying asset size.

LDCU recommends that risk-weighting of assets for credit unions be included in regulations having due regard for net risk exposure, the limited range of asset types in credit unions and assets such as investments where extensive regulation already applies.

LDCU further recommends that it be left to individual Boards of credit unions to assess the need for any additional reserves having regard to their risk appetite and the nature, scale and complexity of its business.

LDCU disagrees with the requirement that newly-registered credit unions should be required to hold an Initial Reserve Requirement on top of a Regulatory Reserve Requirement plus any Operational Reserve the Central Bank of Ireland may require.

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

LDCU welcomes the Central Bank proposal to expand the definition of assets that qualify as liquid to include, any investments with more than three months to maturity where the credit union has an explicit written guarantee that the funds can be accessed by the credit union in less than three months, excluding penalties on interest or income.

LDCU has concerns with regard to implementing an additional liquidity requirement at this point in time. We note the Regulatory Impact Analysis (“RIA”) which states that 20% of the sector’s total investments have a maturity of less than eight days, whilst 17% are held on demand.

Credit unions are achieving low returns on investments and will continue to do so for some time. A restriction, such as proposed, is going to make improved returns harder to achieve.

Further, the short term liquidity ratio does not take account of Rule 31 of the Standard Rules for Credit Unions (Republic of Ireland) which LDCU believes caters for appropriate control and management of short-term share demand.

Rule 31 - Restrictions on withdrawal of shares and deposits

(1) Notwithstanding anything in these rules or in any contract, the credit union may require not less than sixty days' notice from a member of his intention to withdraw a share in the credit union and a member may not withdraw any shares at a time when a claim due on account of deposits is unsatisfied.

LDCU recommends that the liquidity regulations be reviewed on an ongoing basis given the significant external matters impacting the credit union sector such as exceptional Investment Environment and Bank’s Implementation of Basel III Liquidity Ratios.

LDCU believes that the one year transitional period proposed for liquidity requirements should be reviewed and extended in light of the extraordinary investment environment in addition to the multiple challenges being faced by the movement as a whole.

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

LDCU recommends that the issue of credit unions providing House Loan category (Category 4) type of lending to members is deserving of thorough consideration with a view to making a House Loan specific regulation at the end of the process.

LDCU requests the Central Bank of Ireland define the Loans to Other Credit Unions category (Category 5) and clarify that credit unions will still be able to make loans for home renovations and improvements (without having a first charge on property) under the Personal Loan category (Category 1).

LDCU notes that the draft Regulations propose to retain the existing Section 35 limits which are too restrictive. LDCU requests that the new Regulations revise the percentages upwards.

LDCU acknowledges the need for consistent asset liability management by credit unions. However, why propose a 25 year maximum on loans but a 10 year maximum on investments?

The lending concentration limits proposed do not take in to account the merger processes currently underway in the credit union movement. LDCU recommends that limits be linked to the growth of each credit union, allowing credit unions to manage and control its own loan book. Therefore, LDCU believes that credit union boards and management are best placed to consider and agree on concentration limits within their own credit unions.

LDCU queries why the Central Bank of Ireland is proposing to move from the current system (% of total assets) that credit unions have used in the past.

Maximum large exposure limit permitted to a borrower or group of connected borrowers under the proposed Regulations is €39,000 or 10% of Regulatory Reserve, whichever is the greatest. In the case of LDCU such a restriction has a very significant adverse impact, in that it would reduce such exposure by approx. 20%.

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

LDCU recommends;

1. that the authorised classes of investment should be expanded and that the Central Bank should avoid restricting authorised investment classes so that credit unions have the ability to create diversification by allocating appropriate proportions of the portfolio to higher yielding growth assets. Credit union's investment policies should dictate whether certain investments are appropriate and consistent with the objectives and risk appetite of the credit union while observing the regulatory framework at all times.
2. that credit unions should have the ability to allocate surplus funds to a wider choice of asset classes which contribute different benefits to the portfolio. Credit unions have developed their investment policies which are underpinned by improved risk management structures that are subjected to a higher level of regulatory scrutiny. Credit unions should therefore have the scope and autonomy to select and approve appropriate individual asset classes or subsets of asset classes, to assign suitable limits and to determine whether individual investments are consistent with the investment objectives of the credit union having regard to the "nature, scale and complexity" of individual credit unions.
3. Credit unions should be permitted to diversify investments across a range of asset classes and to non-financial counterparties whose performance is unlikely to be correlated to that of credit unions or the financial sector as a whole.

LDCU recommends the following amendments to the authorised investment classes:

1. **Corporate Bonds:** LDCU recommends that corporate bonds with a minimum rating of ‘A’ should be included as an authorised investment class. Their inclusion would provide important diversification benefits as credit unions would have an opportunity to allocate a portion of investment portfolios to non-financial counterparties whose performance is not correlated to that of credit unions or the broader financial sector. We recommend the inclusion of a minimum issue size of €100million and also suggest that the concentration limit should be amended to ensure that total investments in bank and corporate bonds should not exceed 70% of the total value of the portfolio.

2. **Equities:** The 2006 Guidance Note allows for up to 5% of the credit union’s investment portfolio to be allocated directly to equities. We recommend that equities should continue to be authorised under proposed regulations. In the investment universe, the most cautious portfolio mandates include equity exposure and investments in equities provide the only means of accessing real growth assets for credit unions. LDCU accepts that equities may not be appropriate for certain credit unions and indeed, they may not be permissible investments as per credit unions own investment policies. However, we believe that more sophisticated credit unions with more enhanced risk management mechanisms should be allowed to allocate a limited proportion of the portfolio to equities if deemed appropriate and consistent with the investment objectives, constraints and risk appetite as laid out by their investment policies. We further recommend that euro-denominated ETFs which track stock indices should also be included as permissible investments so that credit unions can mitigate stock specific risk and access a means of diversifying portfolio exposure beyond companies who are primarily euro- based to include international companies and stock indices.

3. **Bank Bonds:** LDCU recommends that the definition of authorised bank bonds should be expanded beyond senior bank bonds to include bank bonds with a fixed maturity date of no greater than 10 years for the following reasons:
    a. It would provide a larger universe of bank bonds available for investment because Tier 2 bonds would be authorised in addition to senior secured and unsecured bonds.
    b. It would provide access to a higher yielding subset of bonds.
    c. With the advent of the EU Bank Recovery and Resolution Directive (BRRD), senior unsecured debt will be eligible for bail-in. As a result, one could argue that the risk inherent in senior unsecured bank bonds has increased and the 'gap' in perceived risk between senior unsecured and Tier 2 bonds has narrowed considerably as evidenced by a declining yield differential between the two tiers of bonds. LDCU views certain Tier 2 bonds as a suitable investment for credit unions in the event that the features of the bond are consistent with the investment objectives, constraints and risk appetite of the credit union as laid out by their investment policies.

4. **Transitional period of two years:** LDCU believes that the two year transitional period for investments should be extended for a further 12 months until 2018, as a result of the extraordinary investment environment, in addition to the multiple challenges being faced by the movement as a whole.

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

LDCU are surprised that despite the RIA findings it is proceeding with the proposal to restrict individual member savings to €100,000. In our credit union, 3 members would be impacted. Our overarching concern is that if these members were compelled to withdraw amounts in excess of €100,000 there could be adverse personal impacts for them if such excess funds were cashed and kept in their homes.

In our view, the proposal is anti-competitive as members are being forced to save with banks and the proposed liquidity requirements will assist in the protection of member savings in any event. LDCU has serious concerns including reputational risk for the wider credit union movement, competition law issues, and a possible indirect State aid issue to the extent that the banking sector may gain an unfair State sponsored competitive advantage in attracting deposits in excess of €100,000 or otherwise benefit from the outflow of funds from the credit union sector.

LDCU believes current limits are appropriate, as it allows for savings to increase along with the natural growth of the credit union while also taking account of mergers and amalgamations.

LDCU query what other financial institution and/or participants in the Deposit Guarantee Scheme are subject to a similar limit.

LDCU considers that it may not be possible to force a member to withdraw savings (within 6 months or any other timeframe). The Central Bank is attempting to seek something in Regulation which may be beyond the control of the credit union thereby placing it in breach of the new proposed restriction through no fault of its own.

LDCU rejects the proposal on the above grounds as well as the consequence of further driving savings from the credit union sector to banks.

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

LDCU considers the proposed regulation is appropriate to current market conditions and allows for the controlled and managed development of credit unions.
Whilst Credit Unions do not generally have a requirement to borrow, it is possible that such borrowing be a requirement sometime in the future. Not only is the percentage reduced, but the cap on savings could have a further impact on the borrowing

amount permitted. LDCU therefore suggests a review within a designated period after commencement.

vii) 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.

LDCU is in agreement with the Central Banks' view on increasing transparency for members. Clarity should be provided on level of detail to be reported in relation to performance of credit union loan book.

viii) 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.

LDCU requests that the range of services set-out in Schedule 2 be extended having regard to ongoing innovation in the insurance sector and the wider range of insurance products available to the public;

Insurance Services categories to be extended by addition of the following:

- Payment Protection Insurance
- Pet Insurance
- Mortgage Protection Insurance
- Disability Insurance
- Critical Illness Insurance
- Loss of Employment Insurance

Conditions to be fulfilled be extended to include the credit union may retain any commissions obtained from the provision of such services

Savings Card

(a) That is to say a service by which a credit union member may apply savings to an electronic card issued by the credit union

(b) Condition to be fulfilled –

the credit union must account in its books for all such transactio**ns**

LDCU recommends that supplementary guidance be provided by the Central Bank on the process for applying to the Central Bank for approval for services not listed as exempt.

ix) 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. **Transition Period**

   LDCU are concerned that the six month period which CBI is proposing to allow credit unions to make any necessary changes to systems, policies, procedures etc. is not adequate. This is particularly so as there is such a broad range of systems and procedures impacted, such that credit unions may not be in a position to comply with the new Regulations.

2. **Additional Transitional Arrangements**

Remembering that the clock starts on the additional transitional arrangements once the Regulations are commenced, LDCU feels that following are too short and CBI should extend the relevant time period:

i. **Liquidity** - LDCU believes that the one year transitional period proposed for liquidity requirements should be reviewed and extended in light of the extraordinary investment environment in addition to the multiple challenges being faced by the movement as a whole.

ii. **Investments** – LDCU believes that the two year transitional period for investments should be extended for a further 12 months until 2018, as a result of the extraordinary investment environment, in addition to the multiple challenges being faced by the movement as a whole. LDCU further believes it is no longer appropriate to expect credit unions to operate within static conditions while the global banking industry imposes ongoing changes which will directly impact the sector. LDCU therefore recommends, that the transitional period is extended.

iii. **Savings** – LDCU are requesting that this limit be withdrawn. In the event that it forms part of the regulations, LDCU recommends that existing member excess savings balances be 'capped' and not increased but that there be no requirement to reduce such amounts in place at the date of commencement of the final regulations.

iv. **Borrowing** – immediately if no cost, otherwise within two years of commencement.

Further Issues for Consideration

1. **Review Clause**

In circumstances where the financial services system in the Republic of Ireland continues to operate with ongoing uncertainty and concern, it is vitally important that the Regulations make clear provision for review within a designated period.

To that end, LDCU believes that it is wholly in line with its statutory mandate in respect of credit unions that the following provision be included in the Regulations:

(1) The Bank shall, in consultation with the credit union sector, not later than 2 years after the commencement of these Regulations, commence a review of their operation.

(2) A review under subsection (1) shall be completed not later than six months after its commencement.

(3) Having completed the review the Bank shall prepare a report setting out the assessment arrived at and the reasons for that assessment.

(4) A copy of a report prepared under subsection(3) shall be provided to each credit union registered in the State and to such other bodies as appear to the Bank to be expert or knowledgeable in matters relating to credit unions as soon as reasonably practicable after it has been completed.

2. Regulatory Impact Analysis

1. LDCU understanding of an RIA is that it, in part *"helps to identify any possible side effects or hidden costs associated with regulation and to quantify the likely cost of compliance on the individual citizens or the business"*[1] .

2. In this regard, the Regulatory Impact Analysis provided as part of CP88 has not been helpful in assisting our credit union in understanding what the possible side effects, the costs (either hidden or obvious) and the actual impact of the proposed new Regulations would be.

3. Note the following extract from the Final Report of the Commission on Credit Unions:

"*When setting out new Regulations, the Commission recommends that the Central Bank undertakes a Regulatory Impact Analysis (RIA) in line with existing requirements and having regard to international best practice".*

LDCU are disappointed that CBI has not complied with the Commission's clear recommendation around RIAs.

[1] Page 3, *Revised RIA Guidelines : How to Conduct a Regulatory Impact Analysis*, Roinn an Taoiseach, June 2009