St. Columba's Credit Union
Submission Date: 26th February 2015
Ref: Consultation on Regulations for Credit Unions on commencement of the remaining sections of the 2012 Act

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

As noted within CP88 the impact of the reserve requirements on credit unions should be minimal as the requirements are in line with the Regulatory Reserve Ratio for Credit Unions (August 2009).

Nonetheless, our preference is that a risk-weighted approach to reserve requirements is introduced. We believe that this will result in capital requirements that better reflect a credit union's risk profile thereby improving the overall resilience of the sector. We note that the prudential standards applied by APRA (the Australian Prudential Regulation Authority which overseas banks, credit unions, building societies etc.) require the application of risk-weights to on-balance sheet assets in accordance with the risk classes set out in the standard.

Can the Central Bank confirm if a similar approach is envisaged and if risk-weights will be based on credit rating grades or fixed risk-weights as determined by the Central Bank?

It is our understanding that institutions regulated by APRA must, where appropriate, use the ratings of ECAIs (External Credit Assessment Institution) to determine the credit rating grades of an exposure and that the institution may use certain CRM (Credit Risk Mitigation) techniques in determining the capital requirement for a transaction or exposure. However, APRA may determine the risk weighted amount of a particular on-balance sheet asset exposure of an institution if it considers that the institution has not risk-weighted the exposure appropriately.

S.45 (1) provides that…"…**'assets'** mean such assets as the (Central) Bank from time to time specify for the purposes of this section" and S.45 (3) allows for the application of risk weightings to assets for the purposes of calculating the regulatory reserve requirement.

Can the Central Bank confirm whether it proposes to introduce supplementary ratios i.e. based on 'total assets' (minimum requirement) and 'risk-weighted assets' - the latter being used as a basis for determining the level of additional reserves that a credit union should maintain in respect of operational risk?

We accept that a credit union must maintain adequate reserves having regard to the nature, scale, complexity and risk profile of its business. We are conscious that the introduction of different denominators (i.e. total assets ↔ risk-weighted assets) may impact strategic choices e.g. disposal of certain higher risk assets that might be performing well but adversely impact the risk-based capital ratios.

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

Liquidity requirements are linked to the credit union's need to meet liabilities as they arise. The existing requirement to maintain a liquidity ratio of 20% relates to cash and investments having no more than 3 months to maturity has worked satisfactorily heretofore.

We recognise that the draft regulations endeavour to align credit unions with the LCR (Liquidity Coverage Ratio) of Basel.

It is our understanding that the objective of the LCR is to promote the short-term resilience of the liquidity risk profile of banks. It does this by ensuring that banks have an adequate stock of unencumbered high-quality liquid assets (HQLA) that can be converted easily and immediately into cash to meet their liquidity needs for a 30 calendar day liquidity stress scenario.

There are prescribed liquidity run-off rates that a bank must use to calculate its total net cash outflows over the 30-day stress period.

As noted in our submission i.r.o. CP76 our concern is twofold:

(a) Proposed % requirement relative to CRR/LCR run off rates (i.e. 5% for 'Retail Deposits')
(b) 7-Day Requirement given that the LCR relates to a 30 Day Requirement

We would like to understand the rationale w.r.t. the 7-day requirement and believe that the proposed ratio for 7-day of 10% is too high given that most of our accounts are insured and that all our members would be considered as retail depositors.

We are conscious of the 'on-demand' nature of credit union savings, notwithstanding we have analysed the liquidity profile of our credit union over the past few years and the results highlight a negligible liquidity requirement relative to the proposed additional requirement to maintain at least 10% in cash and investments with maturity of less than 8 days.

We accept that SCCU would meet the proposed additional requirement if an impact analysis was conducted but would argue that the dysfunctional nature of the market has led to same. Introducing the regulations as proposed will adversely impact future earnings capacity once the market reverts to a more normal structure.

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

It is the responsibility of the board and management for safeguarding the assets of the credit union, while providing loans to members. Autonomy w.r.t. Board policy development is weakened by the imposition of prescribed concentration limits. We believe that commercial lending should be aligned with risk appetite, risk tolerance and the risk profile of the credit union. Policy development should be steered with compliance to prudent business practices and controls to manage the risk associated with the various categories of lending to the forefront.

Whilst the proposed concentration limits do not adversely impact St. Columba's Credit Union at present we would question the imposition of same at a movement wide level.

We believe that any proposed lending framework should be reflective of the size and complexity of the credit union and its lending capabilities.

We support the framework promoted by DICO (the Deposit Insurance Corporation of Ontario) w.r.t. lending limits. Whereby credit unions are required to establish and implement prudent lending limits that are linked to the

- knowledge and expertise of management and staff;
- business environment in which the credit union operates;
- credit union's risk tolerance; and
- strength of the credit union's capital (ability to absorb losses)

The introduction of a credit risk rating system (measuring the level of risk of an individual loan, loan class and the loan portfolio) would corroborate and support the risk-weighted approach advocated above.

We believe that the credit union sector can play a crucial role in the Public Private Partnership (PPP) arena. It has the potential to offer value for money and timely delivery of infrastructure when applied to projects of the right scale, risk and operational profile.

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

We advocate the proposals contained within the new S.43 whereby credit unions must manage their investments to ensure that those investments do not involve undue risk to members' savings and assess the potential impact on the credit union (liquidity, financial position etc.).

The dicta i.r.o. decisions needing to take account of the nature, scale, complexity and risk profile of the credit union is very relevant when considering the proposal to remove 'Equities' as a permissible class of investment.

SCCU like most credit unions has experienced a substantial change in our balance sheet asset mix (from loans to investments). Simultaneously, member savings have continued to be steady and strong. As a result loan-to-share ratios are at an all-time low. In the midst of this excess liquidity, credit unions need to keep assets productively deployed to avoid a drag on revenue.

Managing interest rate risk is largely a function of cash-flow management. Proper identification of bonds and bond-types that provide reasonably consistent and predictable cash flow, as well as securities that are readily sold (i.e. equities) in the secondary market, is critical.

As a corollary to the prevailing environment, we have seen many types and structures of bonds being promoted that show attractive nominal yields but often contain greater risk than is desired or acceptable. Many of these investments are structured as 'Bonds' or 'Deposits' to ensure compliance with the regulatory guidelines, with potential return linked to the performance of equities. Furthermore access (or liquidity) and indirect costs (set-up, commission payable to 3rd Parties etc.) are prohibitive.

We acknowledge that the returns from equities depend on a number of factors, such as economic conditions, market sentiment and company news. Over the long term, equity markets have endured fluctuating conditions to outperform real estate, bonds and cash deposits. Investing in equities does carry a higher level of risk than investing in these asset classes and we therefore expect greater volatility.

SCCU do not agree with the proposal to remove 'Equities' as a permissible class of investment as despite the above, when used as part of a well-diversified portfolio, equities have historically proven an effective method of growing capital over the long term and protecting against inflation.

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

The primary source of funding for credit unions is the raising of funds by shares and deposits. It is stated that the proposed requirement (cap on individual member's savings of €100,000) seeks to ensure credit unions' funding is sufficiently diversified while also protecting members' savings.

If as the RIA suggests, less than 0.11% of members and 1.18% of members' savings would exceed the proposed new maximum – why introduce at all given the potential reputational impact as noted below?

It appears that proposed cap is aligned to the Deposit Guarantee Scheme (DGS). It is important to stress that the DGS was established under Irish and European legislation to protect depositors in the event of a bank, building society or credit union authorised in Ireland being unable to repay deposits (e.g. where a liquidator has been appointed). It is also funded by the credit institutions covered by the scheme. A general health warning to members of SCCU w.r.t. the DGS, its limits and implications for members with savings in excess of €100,000 should suffice.

It is generally accepted that credit unions do not use borrowing as a source of funding, nonetheless it countenances for diversification. Diversification could be achieved with the introduction of other forms of permissible member funding (i.e. Tier l or Tier II type funding).

The proposal would seriously affect the social contract between members and the credit union, one which has been organically developed and nurtured very carefully here at SCCU. Please see our reasons below:

(i.) It is a poor service and very prohibitive for both members and the credit union if the member cannot save to their maximum capacity.
(ii.) Existing members with savings over €100,000, though technically breaching this proposed regulation, should absolutely be exempt.
(iii.) It is anti-competitive as other banking institutions are not being requested to do the same. We are therefore paying the price for the recklessness of the banks and simultaneously being branded with the same brush. Secondly, the net effect of this imposition will be that if a member is ordered to reduce savings, he / she may be inclined to move all savings / loans / accounts etc. thus compounding the negative impact of the proposed regulation on savings. Both points above point to the fact that this rule may be in breach of competition law.
(iv.) It undermines the ethos of the credit union and in doing so diminishes the customer service excellence we have diligently built up. This unique ethos and modus operandi that distinguishes the movement from other commercial financial service providers will be damaged.
(v.) It affects the reputation of the credit union as members will fear that we are going the same way as the banks. This dent in reputation and perceived (and actual) reduction in authority and accountability will be very poor PR for credit unions, not only for local and domestic members, but also on an international scale.

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

No concerns with proposal outlined in CP 88. As we have noted above, borrowing countenances for diversification – any further dilution of the proposed 25% limit would be a concern.

(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.

SCCU is fully supportive of systems, controls and reporting arrangements that strengthen the overall governance arrangements within a credit union.

We would like further information i.r.o. the proposed requirements of S.45 (1) (b) under 'Reporting and Disclosure in the Annual Accounts' i.e. the performance of its loan book. Is it the intention of the Central Bank to impose requirements outside of new financial reporting framework (i.e. FRS 102) disclosure requirements?

Commentary i.r.o. Credit Union performance (investments, loans etc.) can be captured as part of the Chair's address to AGM.

(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.

Availing of the expertise of CUSOP (Payments) Limited, SCCU would like to see **'Debit Cards'** added as a service exempt from the additional services requirements. CUSOP is licenced and regulated by the Central Bank as a 'Payments Institution' with independent governance and it is in the process of developing a range of services that include a platform to develop debit card and internet banking products.

(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.

- ➢ Transition Period of six months to allow credit unions to make any necessary changes to systems, policies procedures etc. is acceptable
- ➢ Additional Transitional Arrangements, notwithstanding the objections outlined above

- The transitional arrangement proposed i.r.o. the draft liquidity regulations is reasonable
- We do not consider the transitional arrangements i.r.o. the draft savings regulations as attainable (age profile of members concerned in SCCU of note).