St. Patrick's Credit Union (ESB Staff) Ltd.

Not for profit
Not for charity
But for service

Registry of Credit Unions

Central Bank of Ireland

PO Box 559

Dame Street

Dublin 2.

26th March 2014

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

Dear Registrar,

St. Patrick's Credit Union (ESB Staff) Ltd (SPCU) wishes to provide the following submission in response to the recently issued consultation paper on the future regulation of the sector - CP88.

SPCU, which was established in 1962, currently services the needs of over 11,500 members and as at 30th September 2014 had assets amounting to €295.5 million.

We wish to state at the outset that we support the idea of a strong regulatory framework that will support the real, sustainable and viable growth of the credit union sector.

It is our view however that the combined proposals, if enacted, will have the opposite effect to the stated intention of regulations "*strengthening the sector*". As we will show in our submission, the regulations as proposed (a) have the ability to de-stabilise the sector and (b) will serve only to weaken the sector by facilitating a demonstrable and considerable decline in income across the sector for no justifiable risk-mitigation.

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Summary of Issues:

Macro-issues:

CP 88

- Has the potential to cause a run on the sector that could see a flight of capital of close to half a billion euro – in the first instance
- Will lead to a direct decline in income of over €16million to the sector
- Has the potential to directly compel existing well-run large-scale individual credit unions to wind up
- Provides implicit support to credit union competitors
- Will undermine the sector's reputation amongst members and in the public domain

Micro-issues:

CP88

- As written (albeit probably not the intention), obliges all credit unions to take a first legal charge on every loan issued for home improvements, no matter how small
- Provides Asset and Liability management contradictions (eg. credit unions can give loans for up to 25 years but can only make investments of up to 10 years and can only take up to €100,000 in savings which may be less than the longer-term loan value for a member)

General issues:

- The one-size fits all approach to regulation is insufficient and disregards the Commission on Credit Unions findings
- The one-size fits all approach serves to punish the competent in order to discipline the incompetent
- The Regulatory Impact Analysis is not of an acceptable standard
- CP88 does not provide robust rationale for the key changes proposed.

Introduction:

CP88 is the latest consultation paper issued by the Central Bank of Ireland (CBI) in relation to regulation of the credit union sector. It super-cedes the previous consultation (CP76) which, in line with the Commission on Credit Union's report (March 2012), advocated the introduction of a tiered regulatory approach. Before commenting on some of the specific proposals, we wish to make some broader comments on the approach CP88 appears to take.

SPCU welcomes the approach adopted by the CBI in consulting with the sector. We also welcomed the introduction of a tiered regulatory approach as recommended by the Commission and it is disappointing to note that this approach will not now be adopted. A Tiered Regulatory Approach would have helped address the limitations of the "one-size fits all" approach to regulation and it would also have provided a framework to facilitate credit unions that are at varying stages of maturity.

This reversion to a 'one-size fits all' approach for regulation is not reflective of the fact that all credit unions are not the same nor does it take into account the 2012 Report of the Commission on Credit Unions whereby it suggested that "*credit unions should not be regulated on a one-size fits all basis*". The proposals in CP88 disregard the Commission's findings in relation to this.

RCU articulated verbally at a number of fora that tiered regulation is 'not off the table' and is just 'parked for the moment'. RCU also articulated in their May 2014 PRISM Risk Assessment Commentary that "*PRISM engagements have highlighted how a small number of progressive credit unions are building the capabilities they need ...* " [and] "*They see regulatory standards as minimum expectations*". Further, the Commentary states "*...That they are substantially compliant with the strengthened regulatory framework is a result of this commitment to achieving sound standards. It is notable that their standards and practices, eminently achievable by their peers, provide a basis for others to learn from and adopt*".

Not introducing robust but proportionate tiered regulation at this time is unhelpful to those competent, capable and well-run credit unions in the sector that wish to move forward and would like to see a regulatory framework that allows us to substantially address deficiencies in the business model. With CP88 failing to do so, and its proposals punishing the competent, SPCU contends that this constitutes an abrogation of responsibility.

Specific Areas for Comment:

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

It should be noted that in the consultation paper, submissions are invited to contain suggestions along with supporting rationale and we have done this where possible. Unfortunately, it is not always obvious what the rationale for the proposed change was in the first instance – a point we will return to later under the Regulatory Impact Analysis (RIA) section.

Section 6 Liquidity:

6.2.2 Short Term liquidity ratio

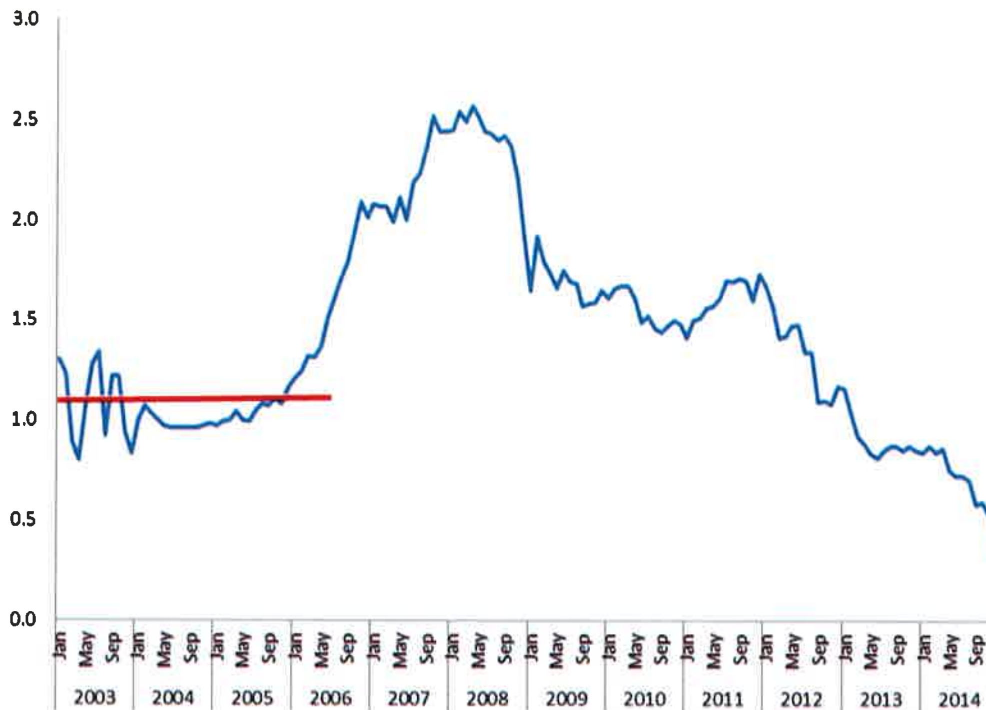
Meeting the proposed liquidity regulations would have the following loss-income impact on SPCU (numbers calculated on figures available at time of writing):

The short-term liquidity requirement is "*...at least 10% of unattached savings where short term liquidity is defined as cash and investments with maturity of less than eight days*" Under these proposed regulations, SPCU would need to put c.€25m on call to meet the short term liquidity requirements. Over the past 3 years, the average call demand on SPCU has been c.€1.5m per week. The short-term liquidity requirement outlines a 'maturity of less than eight days' which means that SPCU's short-term liquidity requirement will increase by approximately 1667% or 16 times the existing demand. The effect in real terms on bottom-line income would see SPCU foregoing over €240,000 in income per annum based on current yields.

As all credit unions have different cash movements and investment profiles, it is hard to extrapolate the precise impact on the sector using SPCU's profile. However, we can use Central Bank data back to Jan 2003 (see Figure 1), which compares Household Retail Interest Rates Spread Redeemable at notice to Overnight rates which *does* provide a robust sector impact analysis. The analysis reflects that the average 'difference' over the period is 1.4%. Taking a conservative assumption, where one can argue that the current low spread and the recent high spread are 'exceptional' and employing the pre-crisis 'spread' as a sustainable level (see the red line in Figure 1) the average is c. 1.1%. In this

scenario, the cost to a credit union is thus 1.1% on 10% of investments which for SPCU, would equate to an even greater income loss of some €270k per annum.

Figure 1: Household Retail Interest Rates Spread Redeemable at notice to Overnight rates:



Conservatively therefore, this regulation would potentially equate to a loss of revenue of €10m to the sector.

In a period of low yield and declining loan books, where credit union members, in line with the broader population, are net savers, any such rule enacted by the CBI may actually have the unintended effect of reducing the stability of credit unions. Naturally, this is unacceptable.

The rationale outlined in the Regulatory Impact Analysis (RIA) suggests that there may be less of an impact across the sector. However, the approach to investments across the sector may not be as mature as SPCU's and as the sector evolves through mergers and amalgamations, this will change. SPCU contends that the rationale for the proposed changes to liquidity regulations is not proven and therefore should not be enacted.

Section 7 Lending:

There are a number of requirements outlined under the heading of "Lending" and we wish to comment under the following areas:-

7.2.1. Categories of Lending

- House Loans

7.2.3. Large exposure limit

7.2.4. Maturity of lending

7.2.5 Related party lending

- Concentration limits

Section 7.2.1 Categories of Lending

House Loans:

Under Section 7.2.1 (pg 27), a house loan has various definitions one of which states:

(b) "improve or renovate a house on the property that is already used as their principal residence"

Under Section 7.3.2 Draft regulations; Requirement for House Loans (pg34), it states:

16. "Where a Credit union grants a house loan it shall ensure that the credit union holds the first legal charge on the property for each house issued after the commencement of these Regulations"

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

A further point in relation to the taking of a legal charge for house loans is that there are legal costs associated with taking first legal charges. It is difficult to put a precise figure on this as costs differ, but it is generally not viable or cost-effective to issue a 'house loan' with a full legal charge for sums

under approximately 50k. This 'cost-effectiveness' calculation will differ from credit union to credit union as the comparison will usually be with the standard loan rate applicable in each entity.

We appreciate that this is a tricky space and hard to find the 'right answer'. For instance, €50,000 in the Dublin area may help to improve or renovate a home to a certain level whereas €50,000 might buy a property in some rural locations.

SPCU would contend that the introduction of the regulation as proposed should be amended to ensure that there are no unintended consequences (such as the requirement for credit unions to obtain a first legal charge for a home improvement loan). This, and the potential issue of costs, could be addressed by deleting Definition (b) under 'House Loans' (pg 27) and amending Draft Regulations (7.3.2; 16 (pg34)) to include an amount, (for instance €50,000) and a percentage of LTV, over which the first legal charge is required. This could be set out along the following lines:

"*Where a credit union grants a house loan, it shall ensure that the credit union holds the First legal Charge on the property for each house loan issued after the commencement of these Regulations except in cases where either (a) the House Loan is under €50,000 or (b) the LTV is <30% and no greater than €75,000 where a legal charge is not required*". (We would also suggest that when setting out figures in regulation, there should be some protocol where these can be amended swiftly which would be necessary in volatile times).

It should be noted that individual credit unions may still wish to take a first legal charge in such instances but that would be a matter for the individual credit union, their credit policy and risk appetite approach.

Section 7.2.3 Large exposure limit - greater of €39,000 or 10% of regulatory reserve

The rationale as outlined in the CP88 Paper for the proposed change to the Large Exposure Limit is that it "*will now be calculated based on a credit union's reserves rather than assets so that lending takes account of the credit union's ability to absorb any losses that may arise from credit risk*". This use of "*a percentage of reserves*" is also the approach detailed in CP88 under 'concentration limits' where it is proposed that a credit union may make commercial loans up to 50% of its regulatory reserve; community loans up to a maximum of 25% and loans to other credit unions up to a maximum of 12.5% of its regulatory reserve.

Strong risk management policies and procedures and the application of such ensure that losses arising from credit risk are kept to a minimum. Absorbing the actual losses that arise from credit risk are the function of bad debts provisioning. Whilst it is appropriate for financial institutions such as banks and credit unions to maintain strong reserves, it is hard to understand how imposing regulatory limits on lending *based upon a percentage of reserves* is the appropriate approach in the asset and liability management of a credit union.

From SPCU's perspective, as the rule stands, currently we could lend c.€4.7m and be within the limit. Imposing the rule would see that limit reduce by c.€1.5m to c. €3.2m. Whilst providing such credit at this level to a "large exposure" is outside our current risk appetite and therefore, the practicality of such a proposal being enacted has little material effect currently, the principle of linking loan limits to a percentage of reserves is not the optimal approach.

If limits are to be imposed, good loan portfolio management practice would suggest that these limits be a percentage of the portfolio (for example 5%) and where a large exposure was greater than a specific percentage of the portfolio, a percentage provision should be made. So, in a loan portfolio of €50m, with a large exposure limit of 5% of the loan portfolio, the cap would be €2.5m. This could be further strengthened by ensuring that on any exposures greater than a set percentage (say 2.5%), a specific provision (say 20%) should apply.

Therefore, using an example with the numbers outlined, a credit union with a portfolio of €50m could have a large exposure of up to €2.5m and on a loan for that amount, it would need to set aside a provision of €0.5m. There could also be a limit to the number of 'large exposures' each portfolio could have, again, probably a percentage of the portfolio (eg. "Large exposures should not constitute an amount greater than 25% of the portfolio").

Whilst some of the specifics of the suggested approach here may cause further debate (which is to be welcomed), the principle is more appropriately rooted in strong asset and liability management than that proposed in CP88.

Section 7.2.4 Maturity of lending

Maturity of lending is an area where it was suggested under CP76 that credit unions might be able to look at mortgages over a 25 year period.

Under section 7.2.4, the proposed regulations outline that the limits on lending over 10 years of 10% (up to 15% in certain cases, subject to CBI approval) of the loan book can be lent up to a maximum of 25 years.

For SPCU, if we offered a 'full' mortgage product, we would be in a position to issue a mere 25 mortgages of €250,000 each after which we would have to stop. The largest lent loan book in the sector could only issue approximately 50. The entire sector could issue, on average, less than three mortgages per credit union, in an economy that saw 44,000 house sales last year in a still depressed market and saw €1.3bn of lending for mortgages in Q4 alone. It would be difficult to visualise that credit unions could credibly 'launch' a full mortgage-product offering with such constrained capacity.

As SPCU outlined in our CP76 submission, the lending profile of more mature international credit union models reflects that the large majority of their lending portfolio is for mortgages (eg. over 70% in Canada). If only 15% of the loan book can be outstanding for more than 10 years, this is not reflective of a more mature model. Nor does it address and support the type of borrowing that is most in demand in the Irish market-place.

There is a competitive constraint on growth in a credit union's loan book that obtains through the lack of ability to issue the one lending product that has seen any significant demand in the Irish market.

Therefore SPCU believes that the proposed amendments to limits will not:

- sufficiently address the current imbalance in the sectors' loan to asset ratio
- support a truly viable 'credit' model for the credit union sector,
- address the current needs and demands of the members.

The limits on lending over 10 years of 10% (albeit 15% in certain cases) and the extra imposition of a 25-year maximum is both constraining and, in our opinion, anti-competitive. We would request that the regulator engages with those credit unions with expertise in these areas before enacting this proposal.

Section 8 Investments:

Under the October 2006 Guidance note on Investments by Credit Unions issued by the regulator, the following is stated under 'Obligations':

> ***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.***
> *Credit Unions that wish to avail of this provision are required to make a written application to the Registrar for approval. Such application should set out the reasons in support of such a request.*
> *Nothing in this guidance note shall be interpreted so as to restrict a credit union from providing social finance for community related projects, approved by the Registrar of Credit Unions, in accordance with Section 44 of the Credit Union Act, 1997 (as amended).*
> *investing any of its funds in the shares of, or deposits with, or loans to a credit union, in accordance with Section 43 of the Credit Union Act, 1997 (as amended).*
> ***Credit unions will be subject to inspection from time to time to check their compliance with this guidance note.***

Irrespective of the specific investments contained in the "List of Authorised Investments for Credit Unions" in the Guidance note, which we deal with below, SPCU questions what is wrong with the approach as outlined in the Regulator's existing guidance above?

The regulations as proposed in CP88, do not allow for "*those credit unions that can demonstrate to the Registrar of Credit Unions that they possess the skills and systems necessary to manage a more complex investment portfolio*". Once again, this is reflective of the limitations of the 'one size fits all' approach to regulation that CP88 adopts.

Under the existing guidance note, the Regulator outlines that credit unions would be subject to inspection to check their compliance with the guidelines. If, as CP88 indicates, the regulator believes that guidance should be turned into regulation, this infers that some credit unions did not adhere to the guidance. If this is the case, the regulator had the imprimatur to 'inspect compliance' and deal with any issues as a result of non-compliance. Imposing the regulations as proposed therefore serves to punish the competent in order to discipline the incompetent.

It needs to be noted that as we write, many A-rated institutions are currently offering negative interest rates. If markets continue on this path, and the current signs are not positive, credit unions will be faced with a scenario where we cannot invest in any counterparty under the Guidance because we will be in breach of the 'capital guarantee' rules. The regulations as proposed would not appear to factor in such a scenario.

8.2.1 Classes of Investments:

Although SPCU has not historically invested in equities, some credit unions believe that equities provide an important element of generating returns for members over the investment cycle. Whilst we may not currently invest in them, we would argue that if a credit union can demonstrate the "skills and systems necessary to manage a more complex investment portfolio" – including equities - it should not be precluded from equity investing. Equity investments may have significant volatility in the returns over the cycle but can also form an important element of return as a small proportion of an overall managed portfolio.

Equities can provide a diversification of returns and may have a role to play for some credit unions, particularly at the moment given the low level of return likely on "safer" assets over the next few years. A relatively modest weighting in equities of say 5% seems reasonable for those credit unions that can show they understand the risks involved and have the appropriate systems in place to manage their exposure, particularly when one considers the level of reserves in the credit unions with those abilities.

Under Classes of Investments, there are limits introduced for 'Investments in Other credit Unions" (12.5% of Regulatory reserve) and 'Investments in Societies' (12.5% of Regulatory reserve) with the rationale that "...less than 1% of credit unions have exposure to either of these investment types'. This is not a sufficiently robust rationale. Whilst a credit union may not hold such an investment type currently, this does not mean that it may not become attractive at some point in the future.

SPCU propose that in relation to investments, guidance rather than regulation should be considered as an appropriate way forward and that as many asset classes as possible should be available to credit

unions to consider as ways to maximise the return on assets and best utilise the strengths of its balance sheet.

SPCU has the skills, systems and controls in place as demonstrated by its successfully management of the scale and complexity of the largest investment portfolio in the sector. There are other credit unions that are similarly capable. Again, the regulation proposed serves to penalise the competent.

SPCU contended in our submission to CP76 that an 'expert group' be established to address the investment element of regulation. The proposed regulatory changes fully indicate that such an approach is a necessity.

Section 9 Savings:

9.2.2 Maximum Savings

CP88 proposes that individual members in credit unions may only hold a maximum of €100,000 in savings. The argument is that:

> *"...while c. 55% credit unions would not comply with these requirements, less than 0.11% of credit union members currently have savings that would not comply with these requirements. In addition, less than 1.2% of members' savings would not comply with the new limit. The draft savings regulations will impact on credit unions that do not comply with the requirements, as these credit unions will be required to return savings to members who currently hold savings in excess of €100,000 to bring their savings into line with the requirements." (RIA CP88, pg 18)*

The RIA outlines that "*..less than 0.11% of credit union members currently have savings that would not comply with these requirements*". Although it is difficult to be exact, the numbers suggest that this regulation will impact approximately 3,300 members. Given that SPCU probably has the largest level of savings of any credit union in the country it is unsurprising that approximately twelve per cent of those impacted are SPCU members.

We therefore suggest that the following issues in relation to this point are given the level of attention and import that are proportionate to the level of impact such a regulation has.

This proposal on Savings contains at least 5 negative impacts on the credit union sector.

1. **Potential for a 'run':**

Requesting a credit union to return deposits of over €100k to members could be misconstrued as being a problem with either a specific credit union or worse again, a problem with the sector.

SPCU currently has over 400 members who retain savings greater than €100,000 with the total of their savings equating to c.62m or approximately one quarter of SPCU's member savings balances. Adhering to the proposal as outlined has significant potential to create a run on SPCU which would not be contained to those members with over €100,000 alone.

Across the sector, those 0.11% of members alone withdrawing ***all*** of their funds (a not unlikely scenario when someone is asked to withdraw *some* of their funds), would potentially create a 'run' on credit unions that would see **approximately €450million in funds exit the sector**. Naturally, such a large outflow of money from the sector would precipitate an even broader 'run' as it is unlikely that such an event would be contained to just €450million.

As this is not mentioned in the RIA, one can only assume that this was not considered, as surely such a potential outcome is anathema to any robust regulation.

2. **Income Loss**

Without access to the information that RCU have across the sector, it is difficult for SPCU to measure precisely the loss of income to the movement that would come from this proposal. However, we can use some robust estimates. SPCU manage the largest investment portfolio in the sector. We adopt a conservative, low-risk strategy to managing our portfolio. Even in the current low-rate market, a well-managed, balanced, well-spread, low-risk portfolio would comfortably obtain a yield of 1.5% per annum. (It is worth noting that this is below the yield forecast in SPCU's figures this year).

Using a 1.5% yield per annum as a proxy and given SPCU numbers as outlined in point 1, 'returning savings to members' as proposed would equate to **a loss of at least €330,000 in income annually** to SPCU alone. To make up for that loss, SPCU would need to grow its loan book within the year by approximately 15% in a market that is, at best, static (note: investment income is 'passive'; increasing loan income significantly incurs extra costs).

However, this figure as the potential quantum of impact is understated. As seen in point 1, it is a more likely behaviour that, when asked to withdraw some of their funds, people are very likely to withdraw ***all*** of their funds. In such a scenario, SPCU would see an outflow of some €62m. This would result in **a loss of income to SPCU alone of over €930,000 annually**. For the sector, a flight of €450m would conservatively equate to **a loss of approximately €6.75m in income annually**.

In times of decreasing income and low demand for core products, one can only assume that this is not the intention of the proposed regulation.

3. Sectoral Reputation

Regulation of this type could be construed as inferring that the credit union sector is not to be trusted with members' savings.

Enacting regulations that limits every member to holding savings that are fully covered by the Deposit Guarantee Scheme has the potential to send out the message that credit unions are not capable of managing members' funds. We find this regulatory approach difficult to understand given that credit unions are actually the only segment of the financial sector that managed to survive without any significant government intervention either nationally or globally.

4. Anti-competitive issues:

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

5. Freedom of Choice for Members

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

Any of these five points is reason enough not to enact such a proposal. It is difficult to understand how the Regulatory Impact Analysis failed to mention even one of them.

As with much of CP88, it is unclear to us why there is a concern about the 0.11% of credit union members that currently prefer to keep funds with their local credit union as opposed to their local bank. The credit union movement as a whole has a strong balance sheet and has a significantly lower loan to deposit ratio than the banks which therefore means, it has lower liquidity risks. Credit unions do not use leverage in the way banks do. At a 10% reserve, credit unions can demonstrate higher capital balances than most traditional banks – capital that is acquired in a robust 'banking' model.

A little over two years ago, SPCU brought in a local rule that restricted members bringing 'new savings' to over €80,000. This was in response to an ESB redundancy initiative that given previous experiences could have seen an inflow of funds of anywhere up to €50m. Given the nature of the loan-to-asset ratio and the small returns available in the market, these were considered funds that SPCU did not require at that time. This was an example of good governance and good management.

Bringing a cap in on savings at a local level may make sense at certain times but enacting this as a 'one-size fits all' regulation is not acceptable.

Section 14: Regulatory Impact Analysis (RIA):

In line with the Consultation Protocol for Credit Unions, it is incumbent upon the CBI to publish a Regulatory Impact Analysis (RIA) in conjunction with any proposed regulatory changes. We wish to make comment on this under a number of headings.

1. **Rationale for proposed changes:**

There is little in the way of substantive rationale for many of the proposed changes.

On a number of occasions, the analysis outlines a change that is proposed using the rationale that the proposed regulation has little current impact on the sector. For example, CP88 justifies the proposal that individual members would only have savings up to €100,000 as it impacts "*... less than 0.11% of credit union members*" and further outlines that "*...less than 1.2% of members savings would not comply with the new limit*".

As seen above, this analysis is superficial and the RIA does not identify any of the risks associated with such a proposal. Unfortunately, there is no way of knowing if that is an oversight or a lack of understanding of the risks associated.

One other rationale for change to regulation as expressed appears to be that if a criteria, that is held in either regulation or guidelines, is not currently being utilised or maximised across the credit union sector, it is appropriate to regulate it out of existence. This reasoning is questionable.

One example is as follows: Under the analysis on Investments, the RIA states that:

> *"Data provided by credit unions in the June 2014 Prudential Return indicates that 56% of credit union investments have maturities of less than 1 year while only 6% of investments have maturities of more than 5 years. Based on the June 2014 Prudential Return no credit unions currently hold more than 50% of their investment portfolio in investments maturing after 5 years.(RIA, CP88 pg17).*

It then proceeds to state that:

> *Based on this analysis, the introduction of the maturity limits in the draft investment regulations will not have any significant impact on credit unions. (RIA, CP88 pg17).*

The recent volatility of markets has made decision-making in the area of investments decidedly difficult. Therefore, there are good reasons why credit unions have favoured some shorter-term investments than may not have been the case in a different market environment. For instance, it is worth noting that there is a counter-intuitive phenomenon in the market at present where unusually, on-call rates are providing similar or better yields than longer term rates. But this is a point-in-time phenomenon.

CP88 is suggesting that the CBI should enact regulations based upon the sector's ***current*** profile and that this should then form the basis of how the sector is regulated for the future. There are risks inherent in proposing future regulation by merely extrapolating information from a point-in-time market situation that has been subject to tenuous analysis. Times change and markets change quicker. The rapidly changing nature of markets means that it is not always possible for regulation to keep pace. This is not a sound rationale to make good regulation.

2. Level of Analysis:

It is disappointing to observe that the RIA for CP88 does not contain a level of analysis that one would expect from a set of proposals that collectively, can only impact negatively on credit unions' income and that have the capacity to constrain the sector's potential growth in a time when both of these issues (declining income and lack of growth) are two of the largest that credit unions face.

In the RIA, the CBI outlines that it had access to all of the credit unions prudential returns, the final financial statements at year-end, and information provided by a '*representative sample of 31 credit unions*' where '*relevant data was not available*'. The set of regulations as proposed:

(a) Has the ability to extract over €16 million in income from the sector
(b) Will definitively see €120 million of funds leave the sector; Contains a high risk of €450 million leaving the sector; And which may not stop there if, in a not unlikely scenario, it precipitates a 'run'.

Despite access to all of the information outlined and despite the potential impact associated, there is not one piece of analysis in the 21-page Regulatory Impact Analysis document that calculates a euro amount on the impact of any of the proposed regulations. That the analysis does not is unacceptable.

3. Language:

We are concerned at the wording of some of the proposals. As some of the examples already used in this submission attest, (eg. *less than 0.11% of credit union members*" and "…*less than 1.2% of members savings would not comply*") the language serves to suggest that it is only inconsequential numbers that are involved. As outlined in this submission, this completely underplays the risks and consequences attached. Such language is disingenuous and not befitting a robust impact analysis.

4. Business Model viability:

The RIA does not address the potential impact the proposed regulations have on the viability of the credit union sector business model. For instance, the level of analysis contained within the section on Investments is wholly insufficient. As outlined below, it is a function of the credit-cycle that the credit union business model relies on investment income. Credit Unions need to be free to maximise the assets on their balance sheet for the good of their members. They must do that in a prudent, well-governed, well-managed way. Regulation should not restrict authorised investment classes in a way that CP88 proposes particularly when there is insufficient analysis conducted to outline the impact the changes have and there are no sound arguments presented that would justify the changes.

The CBI are well aware that many credit unions have viability challenges – some short-term, some medium-term and some long-term. Enacting these proposals has the potential to directly move even well-run large-scale individual credit unions down the scale and may cause them to consider winding up. This may be an unintended consequence of the regulations but it is a not insignificant risk.

Given all of the above, we would view the level of analysis contained in the RIA, both for many of the individual regulations and the overall impact of the entire proposal as not being sufficiently robust.

Regulation and the Credit Union Business Model:

Development, growth and restructuring are crucial to ensure that the credit union sector remains viable and sustainable and continues to play a substantial rule in providing financing and deposit-taking opportunities in local communities and society. (A.M.McKiernan CUDA 3/1/15)

The Credit Union business model is challenged. Although credit unions were established to provide sources of finance that members could not access elsewhere – and that remains a core part of our *raison d'etre*, - the change in the membership profile needs to be acknowledged. A sector that collectively has €14 billion in assets with only €4bn of lending certainly needs loan growth.

But this mantra masks the real demand of our members that consistently goes unarticulated. It needs to be acknowledged that currently, the overwhelming demand from our members is for credit unions to provide a 'safe environment' for their savings. Demands for new lending and returns, by way of dividends, particularly in a low-return environment, are secondary to the majority of members. This is a fact that needs to be recognised and addressed.

The recent behaviour of Irish society is for people to pay down debt and borrow less. The demand for the type of lending traditionally on offer from credit unions remains low and CP88 does nothing to encourage credit unions to broaden out lending offerings. In fact, it serves only to constrain it.

Over the last couple of years, the Registry of Credit Unions has consistently stated that it will look favourably on progressive proposals for new products but CP88 provides little light in the way in which credit unions can engage with the regulator to create forward momentum in these areas.

The approach outlined in CP76 appeared at least somewhat supportive of a well-structured, well-defined CU Sector, placing more 'structure' on individual credit unions and allowing 'larger' more-ambitious credit unions to grow. Unfortunately, with CP88, the CBI has not only abandoned the tiered regulatory approach at this time but is also proposing to enact specific regulations that will actually have the effect of constraining larger credit unions from significant growth.

Whilst no one can argue that a '*strong*' or even "*strengthened regulatory framework*" is not in the sector's and indeed economy's interests, the nature of the strengthened framework as proposed in CP88 appears to encourage the demise, rather than the strengthening, of the sector itself.

Conclusion:

It has been stated that RCU's focus, when putting regulatory requirements in place, is to protect the funds of our members and the stability of our sector. In our view, CP88 does not provide a regulatory framework that allows credit unions to substantially set about addressing deficiencies in the current business model.

As shown in our submission, SPCU could lose €1.2m (15%) of annual income if these proposals are enacted. Further, we would definitively lose over 22m in savings (c.10%) with a high risk of losing over 62m (c.25%). Extrapolating these numbers out, the sector will potentially lose €16.75m in income annually and there is a direct risk for the flight of €450m in capital from the sector.

These along with the other issues outlined in our submission imply that it is not scare-mongering to suggest that the proposals contained in CP88 are the biggest threat the credit union sector has faced in recent times. **For SPCU's part, CP88 is now one of the top risks on our 'risk register'**.

SPCU supports the idea of a strong regulatory framework that can underpin the real, sustainable and viable growth of the credit union sector. On a number of occasions, representatives of SPCU have been supportive of the thrust of the regulator's approach, even when we were in the minority and many of our credit union colleagues were exercised by our stance.

In this instance however, given the scale of the issues identified in this submission, SPCU's considered view is that the regulations as proposed under CP88 are not fit for purpose. We would respectfully suggest that the entirety of these proposals be revisited with any future proposals underpinned by a robust impact analysis that can withstand challenge. We outline in Appendix 1 how this might be achieved.

Yours sincerely,

Robert Cooper,
CEO.

Appendix 1: In relation to Section 13: SPCU would like to suggest the following next steps:

The proposals in CP88 be 'parked'.

A working group be established and that group to contain members of the expert (eg. Top 20) credit unions to work in unison with the CBI to examine the specific details of the regulatory approach that will underpin a viable and vibrant credit union model for the future. The following areas should be the key ones considered with robust analysis underpinning any proposals that are forthcoming:

1. **Tiered regulatory structure**
   Examine and identify a **proper robust tiered regulatory structure** with **appropriate and proportionate regulation for each tier**
2. **Reserves (Section 5 of CP88)**
   Identify a correct minimum reserve requirement, taking into consideration a risk weighted approach to reserving (which exists in other credit union movements). This is more appropriate than a blanket approach of 10% across all credit unions.
3. **Liquidity, Investments and Savings (Sections 6,8 & 9)**
   These three sections need to be considered collectively given the impact they have on the sector's ability to generate income. It is likely that external expertise will be required to support the Group in modelling a desired state for credit unions to operate within. The appropriate regulation should fall out of this model.
4. **Lending & Borrowing (Sections 7 & 10)**
   Again, the areas under 'Lending' all need to be reviewed collectively with consideration given to what lending models are appropriate, not just the sector as a whole but rather the tiers within the sector. In this way, well-managed progressive credit unions are provided with the framework to explore and execute new approaches to the credit union lending model.
5. **Regulatory Impact Analysis (RIA) & Timelines**
   A forensic analysis of the impact of all proposed changes on all tiers be conducted and circulated with any future proposals. Timelines be agreed and published.

Finally, given the nature of a tiered approach, it will be appropriate to include well-run progressive credit unions from each tier at various stages in order to ensure inclusivity of approach.

Given the seriousness of these proposals, we sincerely trust that you will strongly consider this collaborative approach for the sake of the future of the credit union sector in this country.