



Response to Central Bank of Ireland Consultation Paper (CP88)

Overview

Tullamore Credit Union welcomes the opportunity to contribute to the consultation process initiated by the Central Bank of Ireland (CBOI) in its recent Consultation Paper (CP88). We hope that such consultation and interaction with the movement will help inform the Central Bank of the role that it can play in assisting credit unions into the future. Indeed without the understanding of the Central Bank of the supportive role that it must play there cannot and will not be the degree of change required to allow credit unions prosper in today's marketplace.

While accepting and supportive of the requirement for a robust regulatory framework for credit unions, our credit union remains seriously concerned that any proposed regulations should be appropriate to the needs of credit unions and enable credit unions to develop their business model, individually and collectively, to allow the movement grow and develop.

The proposals outlined in CP88 appear to focus entirely on the current position and business model, with little focus or understanding evident of the future business requirements of progressive credit unions. At present, many credit unions are experiencing some level of financial pressure, due primarily to current Loan/Asset Ratios in the region of 30%. To establish a sound financial footing for the future, Irish credit unions need to achieve Loan/Asset Ratios closer to 60% achieved in other jurisdictions. This process will require a fundamental change to our business model, which will only be achievable with the understanding and support of the regulatory authorities. Unfortunately these proposals give no evidence of accommodating necessary future change. This is demonstrated in the Regulatory Impact Analyses which focus directly on the current situation rather than the potential restrictive impact on credit unions future development.

General Commentary

We will comment on specific proposals elsewhere in this document, we must first address what we believe to be a fundamental flaw in the thinking behind the proposals.



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Tiered Regulation

This Consultation Paper seeks a response on a number of draft regulations which the Central Bank of Ireland proposes introducing to address various areas of legislation not yet commenced. At the outset it seeks to derive its legitimacy from the work of the Commission on Credit Unions, particularly in light of the response to the previous consultation paper on Tiered Regulation for Credit Unions (CP76). While it is a fact that the report of the Commission did indeed make a number of recommendations in respect of the regulatory framework for credit unions, and recommended that regulation making powers be delegated to the Central bank, this was in the context of recommendations for a tiered regulatory approach appropriate to, and supportive of, the needs of credit unions. It now appears to be the position of the Central Bank that, in responding to CP76, the credit union movement has rejected tiered regulation. Consequently the current proposals seek to introduce a single regulatory regime that ignores the scale, capabilities or business requirements of individual credit unions, to the detriment of the movement as a whole.

However it is our belief that the response to CP76 did not indicate a rejection of tiered regulation as an appropriate basis for future regulation of the movement, but represented two distinct messages to regulators and legislators:

1. Given the timing of CP 76, at a time when all credit unions were struggling with major legislative and regulatory changes as it was, further major change, at that time, was not considered appropriate. Given the progress made in the interim on implementation of these legislative and regulatory changes, and the proposed timeframe for implementation of the subject matter of CP88, this may no longer be as much of an issue.
2. The credit union movement did not reject Tiered Regulation, but, we believe, is supportive of appropriate tiered regulation as originally envisaged by the Commission in its report. What was rejected in CP 76 was a two tier system that sought to effect an initial worsening of the position of each credit union, with an option to apply for a return to their original status in time, but with no guarantee in this respect. In responding to Cp 76 we set out details of a proposed three tier regulatory system that, we believe, would be embraced by credit unions, and would allow each credit union develop a strategic position suitable to its long term development.

Unfortunately the response of the CBOI appears to be to initiate a single regulatory regime that does little to benefit strong, compliant, progressive credit unions or to assist in developing an appropriate business model for the future. Nor do we believe that it provides



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the most appropriate framework to assist credit unions that might favour a more traditional role.

Impact on Competitiveness

It is also appropriate to draw attention at this stage to the potential impact of these proposed regulatory changes on the competitiveness of credit unions in the future. Credit unions should not be singled out for unfair regulation that does not support a “level playing field” in terms of competition. Some of the current proposals may well constitute unfair state support for the commercial banking sector, and there may well be reason to refer some of the proposed provisions, for example the arbitrary cap on savings, to the Competition Authority, or indeed to Europe, for adjudication. In this context we would suggest that the Central Bank should take into consideration the comparative restrictions on commercial banks relative to the proposals now being set out for credit unions. This should be assessed under all eight headings as set out in page 4 of the document:

- Reserves
- Liquidity
- Lending
- Investments
- Savings
- Borrowings
- Systems & Controls
- Exempt Services

Specific Responses

1. Reserves

The assessment of an overall figure for Regulatory Reserve should be considered in the context of risk levels, and the regulatory reserve requirements for competitors in the marketplace. Credit unions should not be subject to additional Reserve Requirements that are anti competitive or inappropriate. TCU would consider it appropriate for the Board of Directors of each credit union to assess the need for additional reserves, on a risk weighted basis. We would also consider it appropriate for the Central Bank to give guidelines as to its expectations in this area. The Central bank should then give consideration to the overall strength of a credit union’s balance sheet in supporting the strategic or business objectives of any given credit union.



2. Liquidity

Once again, the proposals should be considered in light of the requirements imposed on competitors in the marketplace. The minimum level of 20% is considered appropriate, but the introduction of a short term liquidity warrants further examination.. However, there is some concern that the 20% may be seen by the Central bank as an absolute minimum and that there is an expectation that actual liquidity levels in credit unions would be significantly in excess of this figure. More clarity around this issue from the Central Bank would be useful.

The introduction of a short term liquidity ratio may not be an issue in the short term, given current interest rates, and yield curve. However, should markets improve in the future, this regulation could seriously undermine the ability of a credit union to manage its book in such a manner as to generate adequate return. On this basis we would be against the introduction of this additional ratio. At a minimum we would recommend that an annual RIA be undertaken to ensure that there is no undue adverse impact on credit unions income generation capacity.

The expansion of the definition of liquid assets is welcomed, on the basis that it does include Government and Commercial Bonds, provided that these are held by the credit union on its books at the lower of market, cost or par. Some further clarification around this might be also be beneficial.

3. Savings

The overall cap on savings is not acceptable for a number of reasons:

3.1 Restriction on Future Development of Business Model.

While it could be argued, given the current level of savings balances within credit unions, that the introduction of this requirement would have little immediate impact on the balance sheets of most credit unions, this particular proposal could have seriously detrimental consequences for the long term development of the movement. Due in major part to the current business model of credit unions, most credit unions now have a loan/asset ratio in the region of 30. Over time, credit unions in Ireland need to develop a business model that provides a loan/ asset ratios similar to that enjoyed by other movements, in the region of > 60%. This will involve the introduction of a greatly expanded range and complexity of



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lending products, allied to fundamental changes to the number and nature of savings products offered to members. While most credit unions have surplus savings at this time, movement to a more appropriate business model will increase our requirements for funds in the future, and the introduction of this cap on savings could seriously reduce our capacity in this regard.

3.2 Competitive Disadvantage

The proposal discriminates against credit unions in applying an arbitrary cap on all credit unions, irrespective of size or financial strength. Again this would appear to be directly anti competitive given the relative soundness of many credit unions currently, particularly when compared to the commercial banks.

We do not believe that the current inflow of savings to credit unions is driven by rates. For several years now the dividend policy of credit unions has been closely monitored by the CBOI. Our experience in TCU would indicate that other factors such as security, trust etc more directly influence deposit decisions by members.

No consideration appears to be given to the inherent right of each individual saver to decide on the most appropriate home for their savings. Many long term credit union members, with no business relationship with banks, may acquire funds through sale of dwelling house, redundancy, court settlement etc. To deprive such members of the services of their credit union, by insisting that the funds be placed elsewhere, may be distressing for elderly members.

3.3 Reputational Damage

This proposal will be interpreted by members, potential members and the media as a direct indication by the CBOI that credit unions, irrespective of financial strength individually, are considered a higher risk than banks.

4. Investments

Credit unions should be permitted to diversify investments across a range of asset classes if they can:

“ demonstrate to the Registrar of Credit Unions that they possess the skills and systems necessary to manage a more complex investment portfolio”

-Investment Guidance Note 2006



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An absolute ban on equity investments may be overkill. Long term it may seriously skew the balance of a portfolio, thereby increasing overall risk levels. In the short term, a limited opportunity to avail of equity investments, of 5% max, as envisaged in the 2006 Investment Guidance Note, might be appropriate.

The proposed limit on investments in other credit unions, and societies, is not considered significant.

We would consider the movement of maturity limits to full investment portfolio and not class, as appropriate, and addressing an anomaly in the system. The actual limits of 50% > 5 years, and 30% > 7 years are not considered unreasonable.

5. Borrowing

While not an issue at this time, this could become important should credit unions achieve a significant change to their business model in the future. The combined impact of this change and the cap on savings could seriously impact on ability to generate funds in the future. Again, the question of comparison with restrictions on competitors should be considered by the Central Bank in formulating its proposals.

6. Lending

Maximum lending term of 25 years could inhibit future business strategy & business model. This would possibly be more acceptable if there was clarity and transparency around the process and conditions for credit unions to be approved an extension. This should be provided "up front" as part of the proposed regulations.

While the maximum exposure levels are probably not unreasonable at this time, we would question the introduction of Regulatory Reserve as the benchmarking factor in determining the limit for each credit union. We believe that the level of overall reserves should be taken into account, particularly in light of the proposed introduction of an additional Operational Risk Reserve? We believe that a risk weighted approach, where individual credit unions would be allowed undertake initiatives provided they designate adequate Reserves to cover anticipated Risk levels should be explored. In developing such a framework, the level of provisions should also be incorporated into the considerations in respect of lending.

The introduction of new categories of loans, per se, is not seen as introducing unreasonable or onerous conditions, rather, it is the retention of Sec 35 limits, in conjunction with the current proposals, that poses a serious risk to credit unions development into a broad financial services provider in the future. We would consider it of utmost importance that the



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current provisions of Section 35 of the Credit Union Act 1997 (as amended) be fundamentally reviewed in tandem with the current proposals. The combination of the limits proposed and the restrictions already in place through Section 35 serve to significantly reduce the interest earning potential of credit unions, potentially to the point of non viability.

In respect of the proposed concentration limits, the issue raised above in respect of the appropriateness of the regulatory reserve as the benchmarking factor also applies. Other reserves should be included, particularly Operational Risk Reserves? In addition, a mechanism for exceptions for certain credit unions, again based on Reserves, should be considered. A clear and transparent process, with specified conditions for approval should be implemented..

The limits on loans to other credit unions and community loans do not appear unreasonable. However the limits on Commercial Loans could inhibit the growth and development of credit unions in the future.

7. Additional Services

The current regime for introducing new services is not fit for purpose. There should be a clearly defined, and time driven process for introduction of non exempt services. Credit unions should be aware at the commencement of the process what requirements are needed to obtain approval, and maximum CBOI response times for each part of the process should be clearly defined.

Similarly, in respect of exempt services, a clear, time driven, notification process should be defined, with the CBOI obliged to respond within certain defined timeframes, and with a clear understanding that CBOI approval is not required to proceed.