Submission from

C.U.M.A.

The Credit Union Managers Association

In Response To

Review of the Code of Conduct for Business Lending to Small and Medium Enterprises

13th April 2015

Introduction

The Credit Union Managers Association (CUMA) is the professional representative association for managers of credit unions in Ireland. CUMA provides professional development training and assistance to its members and engages with a wide range of stakeholders and industry bodies in its pursuit of excellence in professional standards in credit union management.

CUMA welcomes the opportunity to provide feedback in response to proposed changes to the existing regime of business lending to small and medium enterprises (SMEs).

There are over 380 independent credit unions in the Republic of Ireland today. Each is a separate legal entity. The Board of each of these independent legal entities is charged with the responsibility for taking due care of the moneys invested in the credit union by the members, including lending it wisely. Directors of each credit union are subject to a very vigorous governance framework and regulatory regime, arising from the reforms necessarily brought about by the Credit Union and Co-operation with Overseas Regulators Act, 2012.

A key strategic challenge for Credit Unions is the fact that their balance sheets are under lent, and there exists a very high level of savings in Credit Unions against lower than required loan portfolios. Credit Unions have money to lend but urgently need to identify opportunities to grow their loan books in accordance with the risk appetite of their boards. Each credit union board must take its' own decisions on their particular loans policy, and how they will achieve that growth.

Day-to-day Risk and Compliance

The members of CUMA oversee the day-to-day lending decisions in credit unions, operating within legislative, regulatory, compliance and risk management frameworks.

Credit Unions are, by their nature, co-operatives that lend only to their members. The vast majority of credit unions are Small to Medium enterprises, typically employing between three and thirty people.

Our primary market, for lending purposes, is personal unsecured member borrowers.

Because we are largely based in geographically-defined communities, we see, on a daily basis, the impact that the economic down-turn has had on our members and on our towns and villages. Many of our members – most often the employees of SMEs – lost their jobs or emigrated. Many more of our members – self-employed trades people and micro-business entrepreneurs – saw their businesses fold. In a more limited number of cases, a number of credit unions that had made loans for business purposes saw many of these loans become delinquent during the down-turn.

Credit Unions have been challenged in the economic down-turn, with increased arrears, increased provisioning and, reduced dividends to our members. There has also been a very significant decrease in loan demand due to depressed consumer confidence, depressed income and increased taxation.

It is incumbent on our Directors and Management to learn from our experiences over the last decade.

The Enterprise – Lending Experience

Credit Unions already provide significant support to the SME sector and are lenders for the SME owners' personal financial needs. In some cases this may also extend to small capital or even working capital loans to our members for equipment or vehicles.

Credit Unions have, in a limited number of cases, engaged in SME and micro-credit lending during the last decade. The manner in which these enterprise-type loans have been addressed has varied very considerably. A number of Credit Unions have defined a specific amount or percentage available for business lending. A small number of credit unions have engaged in start-up business lending in association with local enterprise boards. For example, in Kilkenny, one of the larger credit unions considered loan applications that had already been assesses by the local enterprise board to determine the likelihood of success of the enterprise in question. In Dundrum, a similar situation exists, with a relationship existing between the Dundrum

Credit Union and the local enterprise board. In Waterford, a relationship existed between a number of credit unions and the Waterford City Enterprise Board, but was subsequently cancelled due to business lending restrictions placed on some of the participating credit unions.

Many of our Manager Colleagues are familiar with a more common form of lending to self-employed members. Increasingly, as the banks seek to repair their balance sheets, they are withdrawing over-draft facilities to small business-persons. Our members see increasing demand for credit to address this deficit. We are well aware of applications for credit to match local enterprise board grants. We are also aware of loans for enterprises not supported by Enterprise Boards. Many derived their initial loans from local credit unions.

In all cases, the final decision, on whether to grant a loan application or not, rests with the Credit Committee or Loans Officer as determined by board approved policy and procedure. The Credit Committee or Loans Officer must ensure that he/ she or they lend wisely, and do not burden the borrower with unsustainable debt. We have all seen, and suffered the consequences of unsustainable debt burdens in recent times. Recent Personal Insolvency legislation is also a factor, affording the borrower greater capacity to unburden him or herself of debt, and making lending more risky, and therefore less attractive.

Concerns

CUMA is concerned that credit unions who refuse a credit application on the grounds of insufficient expertise to assess a loan application or because the loan is outside their risk appetite may face difficulties with the Credit Review Office.

CUMA believes that credit unions may require additional or different credit agreements and pre-contractual information to comply with this code. Many credit unions may not welcome this and may simply avoid self-employed or business lending.

CUMA would question the practicality of the relationship between the credit union and the credit review office, and consider that further detail would be required and further engagement required with the sector on this matter.

In conclusion, CUMA welcomes the consultation, and believes that further, structured engagement would facilitate the emergence of realistic solutions.

Question 1

Do you have comments on the attached draft regulations? In your response, please quote the number of the specific provision (s) which give rise to your concerns and, if possible, suggest alternative drafting or solutions.

General

The below references are to Appendix 1 paragraphs.

The three months or 90 days qualifying period for “Financial Difficulties” status is over-long.

7 (a) is clearly untrue for a credit union offering SME loans at 12.68% APR.

7 (c) will only be true if the interest only arrangement is made before the first principal payment is made.

9 (2) (q) puts no limit on the number of times such a request can be made, and could be used for mischievous purposes.

11(f) This is not reasonable. Government should provide a single point of information publicly for people.

12(4) This could better be expressed in terms that the lender may only impose a charge to the extent of the proposed borrowing and interest and charges thereon.

12(5) This should also warn the prospective guarantor of possible negative impacts on his or her credit ratings in the event of default.

15(3) Twenty working days does not encourage timely engagement – Ten working days would be more realistic.

16(2) Some credit unions do not have a website.

17 (1) (d) How is this to be achieved if the borrower refuses contact?

21(4) Credit Union Directors are non-executive directors. There is a requirement in the Act for a clear and documented separation of function to exist. Unless a credit union trains sufficient, alternative staff or volunteers in SME lending, this will be very difficult to implement for small to medium credit unions.

Cognisance needs to be taken in relation to expanding the appeals committee remit of the voluntary/board structure of credit unions, should Central Bank seek to include credit union members under this protection.

Question 2

Are there specific areas that you feel should be expanded on? If so, please provide details and, if possible, drafting suggestions or proposed solutions.

Borrowers should be warned that they are entering into a legally enforceable contract. Borrowers should also be warned that their arrears will keep mounting while these various consultation periods are running. The avoidance of moral hazard arising from the proposed guidelines should be given very serious consideration by the Central Bank. Lessons should be learned.

There are inherent contradictions between the Credit Review Office approach to lending and what is prescribed in Registry of Credit Unions Prudent Lending letter of February 2013.

The following excerpt from the Credit Review Office Reference Document states the following;-

> *"In the event that the Credit Review Office's opinion is that the lending could have been made within acceptable risk boundaries, the bank will be required to comply with the recommendation or explain to the Credit Review Office why they will not do so".*

This could be seen to place significant pressure on a credit union to engage in a lending practice that is outside of its risk appetite.

Question 3

Do you have any suggestions for further reform, e.g., are there any gaps or areas omitted from the protections proposed? If so, please set out your proposals.

European assistance in the areas of micro-credit should be explained, and extended to credit unions.

CUMA would suggest three ways that SME lending could be facilitated in Credit Unions:

- Consideration should be given to extending a partial guarantee for enterprise-based lending to individual credit unions with the assessment capacity to undertake such lending, within their policy and risk appetite parameters. Credit Unions with the scale and capacity to undertake such lending would need to consider obtaining or acquiring the necessary underwriting skills.
- Consideration could also be given to the development of a cooperative organisation with the resources, systems and skills necessary to consider and underwrite SME lending. The cooperative would have a state guarantee and the funding could be sourced from Credit Unions. The State has invested considerable resources to establish Microfinance Ireland. A relatively small additional expenditure to establish a co-operative to co-ordinate CU business lending might be a very effective use of scarce funds.
- On a more widely applicable level, government should consider raising an Enterprise Bond that Credit Unions could invest in, for onward-lending by a state Enterprise Bank. This latter would probably have the most immediate and country-wide application.

The three options would need further development and CUMA would welcome engagement on the development of these opportunities and accessing the necessary support from Government to enable Credit Unions to provide SME support on a structured and considered rationale.

Working with local enterprise boards has, for a number of credit unions, been a positive experience. However, it is not a total solution. Enterprise Boards are excellent at what they do, encouraging enterprise. Enterprise, by it's nature, involves risk-taking. As stated already, the final decision on whether to grant a loan application or not, based upon the risks presenting, rests with the Credit Committee or Loans Officer. A very significant number of Credit Unions do not possess the resources to undertake a full assessment of a business-start-up proposal, at this point. Nor will it be easy for those Credit Union to acquire those resources. Herein lies a very real barrier to expansion in lending for enterprise promotion purposes.

Question 4

Do you agree that SMEs dealing with credit unions should have the same level as protection as when dealing with other lenders? If you do not agree, please outline the reasons why.

Credit Unions are different from banks, in that we make loans only to our own members. Furthermore, we are of an entirely different scale as to what is envisaged in the proposed requirements. The requirements, as proposed, are designed to address the lending and staffing capacities of large institutions, such as banks. They are not scaled to meet the realities of much smaller entities, credit unions, which are SMEs themselves in most cases. They may, as presented, force many credit unions to eschew SME lending altogether as a matter of policy.

The difference between the self-employed and "micro" businesses is not defined in the code and could cause problems for credit unions.

Question 5

Do you agree that 'Smaller Enterprises' provisions in the current SME Code should be extended to all SMEs? If not, please set out the reasons why.

CUMA does not agree that 'Smaller Enterprises' provisions in the current SME Code should be extended to all SMEs as the definition of 'Smaller Enterprises' potentially embraces all personal lending to self-employed individuals.

CUMA suggests that the Central Bank take a lead from CP88 and exclude any credit union business loans under €25,000 from the provisions of the code.

There should be a limit for business lending for credit unions (similar to what is proposed in CP88) i.e., loans up to €25k may be considered as personal lending and not subject to strict SME lending rules. This would cater for 'bread and butter' credit union business loans such as loans for taxis, very small businesses etc.

Question 6

Do you agree that business credit cards should be included in the scope of the regulations that are proposed to replace the SME Code for all SMEs? Please explain why you think this approach is appropriate. If you do not agree, please set out the reasons why.

CUMA does not agree that business credit cards should be included in the scope of the regulations that are proposed to replace the SME Code for all SMEs. This is because business cards are typically used as a payment method and paid off monthly. Using the current financial crisis where certain arrears or repayment difficulties have arisen is not an adequate justification. As structured, business cards are not a business credit product in the same way as negotiated lending is.

Question 7

Do you agree that multi-lender credit, including syndicated, club or other multi-lender transactions, and special purpose vehicles should continue to be excluded from the scope of the regulations? If so, please provide the reasons for your view. If you do not agree, please set out the types of multi-lender credit or special purpose vehicles you think should be included and explain why the protections proposed would be appropriate or necessary for these borrowers.

CUMA agrees with the approach proposed here in that these borrowers should be excluded from scope.

Question 8

Do you agree that the introduction of a concept of 'not co-operating' is useful in an SME context? If so, do you have any comments on the proposed provisions?

Please see comments already made in response to Question 1 above.