credit union development association

SUBMISSION FROM

THE CREDIT UNION DEVELOPMENT ASSOCIATION

IN RESPONSE TO

Department of Finance and Central Bank of Ireland
Joint Consultation Paper

Funding the Cost of Financial Regulation
CP95

25th September 2015

Introduction

CUDA (Credit Union Development Association) welcomes the opportunity to provide commentary in response to the Department of Finance and Central Bank of Ireland Joint Consultation Paper on funding the cost of financial regulation.

CUDA is a progressive representative & development association that was formed in 2003 by Ireland's most progressive and leading Credit Unions.

We have consulted with many credit unions in formulating a response to this Consultation Paper. The responses were in the most part consistent. Regulation is a requirement and respondents appreciate that there are unavoidable costs associated with administering regulation. Concerns were raised on a number of levels:

- value benefit
- seemingly spiralling costs associated with regulation
- appropriateness of the regulation being administered
- erosion of credit union ethos, both direct and indirect

We provide additional commentary on these concerns below and on other methods of recovering the costs of administering the regulatory function.

We also note the Consultation Paper proposes a move to a 50% funding of the cost of regulating credit unions over a period of 5 years. The Paper does not set out how levies will be determined for each credit union. The equity of a levy based on asset size, given the current restrictions placed on credit unions' business model, is regressive. What model does the Central Bank propose?

Meanwhile, we acknowledge as appropriate the separation of credit unions from other industry categories and the different funding approach adopted by the Central Bank. Of the 14 PRISM categories devised by the Central Bank, credit unions are the only industry that operates on a not-for-profit basis.

CUDA would be happy to elaborate further on any points made in this submission. Please do not hesitate to contact us in this regard. Contact details are listed at the end of this submission.

In responding to the Consultation Paper CUDA has grouped some questions together as responses overlap due to the nature in which some questions are posed.

1. Any change from the current funding arrangement would have to have due regard for the competitiveness of the industry. Do you consider that there are any particular competitiveness issues to be taken into consideration in revising the funding approach? Please state clearly your reasons for any such issues, their quantification and suggestions on how they may be addressed.

Due to common bond rules, credit unions do not have a significant part in the international stage of the Irish financial service sector. Therefore when addressing competitiveness we shall focus on the internal market. The taxpayer currently subsidises the cost of financial regulation yet consumers located both in Ireland and aboard benefit from such regulation. This is not true for the credit union sector.

Competitiveness for the credit union sector is an on-going concern. In 2003, CUDA was formed as a response to a more competitive and increasingly complex business environment. Credit unions need to evolve to be competitive, yet regulation is threatening the ability to evolve and thus compete. Whilst the Interim Report of the Commission on Credit Unions made strong recommendations for regulation and governance driven by the need to protect deposits, the Commission's Final Report stressed that prudence alone will not deliver sustainability if the rate of return on assets is suffering as a result of an unbalanced competitive environment[1].

Some industries, including banks, can pass on additional expense incurred by them as a result of the cost of regulation to customers by way of fees and charges. This is not true for the credit union sector[2]. Furthermore, as part of the Commission's research they noted that bank customers may buy a variety of loan products. It is therefore possible for banks to cross subsidise one product with another, i.e. to use a loss leader strategy. This could manifest itself in a number of ways. For example, the short-term personal loan market segment may attract "free banking". This provides a major competitive advantage for banks over credit unions.

As a result, therefore, with the introduction of a new levy structure it is important, to ensure that the conditions for balanced competition prevail following restructuring of the funding model.

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[1] Para 268, page 14 Report of the Commission on Credit Unions, March 2012

2 Section 38 of the Credit Union Act 1997 as amended places limitations on credit unions with regard to the scope of insert rates and charges

On a wider scale, it would be unfavourable should an increase of levies borne by industry force smaller stakeholders, for example self-employed or small financial intermediaries, out of business. Arguably, retaining taxpayer subsidies helps sustain a competitive market and helps prevent a curtailment of choice for the consumer.

More specifically for the credit union sector, an increase in the cost of regulation borne by the retail intermediary industry is likely to lead to a reduction of credit unions renewing their licenses to act as retail intermediaries. Annual returns by credit unions also authorised as retail intermediaries has shown that the return for the retail intermediary side of the business is marginal[3]. It is a concern that consumers would lose the diversity in accessing such services.

On a final note, many of our member credit unions raised a similar concern namely "is there no end to the cost of financial regulation". The Consultation Paper, itself, pointed to additional regulatory requirements on route that will give rise to further costs. Cleary, it is important nationally and internationally that we are perceived as competitive which is intrinsically linked with value benefit. It is encouraging that the Central Bank is undertaking international peer reviews of the performance of its regulatory functions, and that the first review, the "ICURN Report", recently conducted on the Registry of Credit Unions was in the most positive. There is a real opportunity to consider value benefit in conjunction with such reviews. In considering the manner in which the division performed their regulatory and supervisory functions, the ICURN Report provides no analysis of competitiveness or value benefit.

2. Any change from the current funding arrangement would have to have due regard to consumers and tax payers. Do you consider that there are any particular consumer or tax payer issues to be taken into consideration in revising the funding approach? Please state clearly your reasons for any such issues and suggestions on how they may be addressed

3. Do you consider it appropriate for taxpayers to continue to fund a significant proportion of the cost of financial regulation activity? If you disagree, what would you propose instead?

4. Do you consider it appropriate that industry be required to fully fund the cost of financial regulation activity? If you disagree, what would you propose instead?

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[3] Total income generated from fees and commissions by credit unions that are also authorised as retail intermediaries is reported as being less than 3% of income in each of these credit unions.
(Consultation Paper CP 83 Fitness and Probity regime for Credit Unions that are also authorised as Retail Intermediaries: Central Bank of Ireland, August 2014)

1. We have addressed some of these concerns at 1 above. An increase in the cost of regulation where directly borne by industry would have to be weighed against any possibility in a reduction in diversity.

2. Question 3 poses the question around the appropriateness for taxpayers to fund the cost of financial regulation. We would prefer to see more analysis and feedback on the pros of taxpayer contribution (*such as aiding diversity, greater accountability),* and the cons of taxpayer contribution (*such as the financial burden on the taxpayer)*. The Consultation Paper notes that some countries, such as Austria and Finland, make a contribution of €3.5m and 5% respectively. The amounts do not seem significant and probably could be absorbed by industry itself, so, why have such Authorities deemed it beneficial to continue to make contributions?

Perhaps a reduction in the requirement for a levy borne 100% by industry, due to a contribution by the Exchequer (ie the taxpayer), could be coupled with a cap on fees and charges that some industries pass on to the consumer. A combination of both may maximise the benefit for the consumer.

We also understand that 100% of the value of monetary penalties is directed to the Exchequer. Is there an argument to retain penalties and fines to offset against the overall cost of financial regulation?

5. Do you consider it appropriate that a move to full funding should commence in 2016? If you disagree, what would you propose instead?

6. Do you consider it appropriate that a move to full funding should take place in a single step in 2016? If you disagree, what would you propose instead?

For competitiveness reasons, we do not see a difficulty of a phased approach of 3 years across all industries not already contributing 100%. Whilst this may incur additional administrative costs, the cost to the Exchequer will reduce over time whilst the impact on industry will be less severe.

We agree with the Consultation Paper that the phased approach should be greater for credit union due to the financial increase being proposed.

7. Do you consider it appropriate that any revision in the proportion of funding provided by industry should continue to apply uniformly across all industry funding categories? If you disagree, what would you propose instead?

8. Do you consider that there are any particular industry funding categories which warrant a derogation or alternative funding approach? Please state clearly your reasons for such a view.

From our analysis on the 14 PRISM categories devised by the Central Bank, credit unions are the only industry that operates on a not-for-profit basis. All other industries categorised are driven by profit.

Credit unions are recognised in this State as being unique in the financial services' industry and we are satisfied to see that this has been reflected in the approach adopted in the Consultation Paper. They operate within the financial system but are unique to it. Minister Noonan acknowledged this uniqueness when he stated that "*the Government recognises the important role of credit unions as a volunteer co-operative movement and the distinction between them and other types of financial institutions"* (14th October 2011 on the Publication of the Interim Report on the Commission on Credit Unions).

Credit Unions have been in Ireland since 1958. They are financial co-operatives that operate on a not-for-profit basis and are managed by voluntary boards of directors elected from among their members. The sector has its own legislation since 1966, which recognises the distinction between credit unions and other financial service providers. Under the legislation a Regulator is established with statutory powers to regulate specifically for the sector.

Credit unions are well recognised for playing an integral part in combatting financial exclusion. Their objectives, set out in legislation include, the promotion of thrift among its members, the training and education of its members in the wise use of money, the education of its members in their economic, social and cultural well-being as members of the community, and the improvement of the well-being and spirit of the community. Support provided by credit unions and their commitment to social policy allows Government to advance initiatives such as financial inclusion and social housing.

Given the nature of the credit union movement, the public service it provides and the importance of maintaining the ethos of credit unions we agree that Exchequer funding is required.

Furthermore, should full funding apply to credit unions, considerable legislative and regulatory change would be required. Arguably credit unions would have to be afforded the opportunity to develop a business model that generates adequate ROA. Current legislative and, in particular, regulatory restrictions, preventing this would be removed thus permitting credit unions to utilise their assets to generate a reasonable return, similar to profit driven industries.

Currently, the proposed increase to 50% will see a 6 fold increase in the levy amount for a *medium high* credit union. The cumulative effect of this increase, when added to the other levies already being applied, will be significant, given the current interest rate environment and the effect it is having on ROA.

9. Are there any other considerations that you think should be taken into account in seeking to come to a decision on a move to full industry funding? If so, what are they?

1. The Consultation Paper proposes a move to a 50% funding of the cost of regulating credit unions over a period of 5 years. The Paper does not set out the mechanism is which the increase will be applied. Will the levy be based on asset size alone, as is the current operative model? CUDA has for some time regarded this approach as flawed. We would regard as progressive a levy calculation for credit unions based on a number of metrics, including member size, regulatory reserves and asset size.

2. In 2013, CUDA noted that for credit unions contributing towards the cost of administration of PRISM, there should be a greater sense that credit unions are benefitting from the supervisory approach. We cautioned against acting in a supervisory capacity without providing a guidance and supportive role[4]. The recent ICURN Report[5] supported this premise. It proposed a more hand-on supervisory approach, and whilst it acknowledged PRISM was an effective and valuable tool it recommended that the Central Bank should consider ways in which the PRISM framework could be better deployed to reflect the credit union model. The completion of this process in a manner that brings value benefit, and not merely additional regulatory and supervisory costs on the sector, should be taken into account before increasing the regulatory costs that will be borne by the credit union sector.

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[4] The approach to date experienced in the credit union sector is that this supervision is retrospectively applied – and that this in itself comes at a cost to a credit union. Examples include the application of Section 48 and the reactive approach adopted by the Central Bank to applying Restrictions on credit unions. We also stressed that the approach would be greatly assisted through the introduction of an advisory panel. (Submission from CUDA in Response to Consultation on Impact Based Levies and Other Levy Related Matters CP 61: Central Bank of Ireland 21st February 2013)

[5] Central Bank of Ireland Peer Review Report: Central Bank Performance of its Regulatory Functions in Relation to Credit Unions ICURN Credit Union Peer Review July 2015

We again thank the Central Bank and the Department of Finance for the opportunity to part-take in the consultation process and are happy to elaborate on any matters raised in our Response. As always, we are happy to meet with the Central Bank and/or the Department of Finance to communicate further on any issues, in particular those affecting credit unions.

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