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ONE BIG FAMILY

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Submission from St Patrick's Credit Union (ESB Staff) Ltd in response to CP95

The Department of Finance and the Central Bank of Ireland's Joint Public Consultation Paper -

Funding the Cost of Financial Regulation.

The following paper is submitted on behalf of St Patrick's Credit Union (ESB Staff) Ltd.

Having reviewed the Consultation Paper it is clear that much of the content is not directly applicable to the Credit Union sector. Therefore, whilst initially making some broader commentary in line with the opinions sought in CP95, our submission focuses on funding the cost of regulation primarily as it pertains to the Credit Union sector.

This submission contends:

Regulation (broad)

- That regulation should be funded by the beneficiaries of the regulation

Credit Unions (specific)

Under the proposals, Credit Unions are to carry further costs of regulation.

- If so, this should be done by linking costs to a percentage of the loan book - not the total assets
- Linkage to the Loan Book where growth is a priority provides a potential win-win scenario for both the Registry of Credit Unions (RCU) and the sector
- If the Credit Union sector becomes "fully lent", the cost of the regulating the sector would be 100% covered by credit unions
- The accountabilities of RCU should be clear and the funders of the regulation should have an input into agreeing those accountabilities.

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Broad Commentary:

Funding regulation – A public service or a cost to the actual consumer?

When one considers a business – and regulation in Ireland is a business – one needs to consider income received, the sources thereof and the costs incurred by the regulatory office in fulfilling its remit.

What should be the source of income for the regulatory body?

If regulation is theoretically for the protection of the public, then is it not a matter for the public to pay? And if this is the case, the following questions are relevant:

- How much regulation does the public actually want?

  and

- How much are the public willing to pay for it?

Answers to these questions are difficult to establish and of course, the alternative argument – that regulation should be paid for by the industry - may also be legitimately posited. This latter approach appears a 'neater' solution because in practice, the industry will likely recoup the cost of regulation through charges to the *actual consumers* of those services, rather than the public at large.

However, as outlined in the consultation paper, a further consideration appears:

"Whereas the Irish taxpayer currently subsidises the cost of financial regulation, the consumers of these services are located both here and abroad. (pg 4, CP95).

So, we now have three categories of 'beneficiaries' of regulation: the Irish public (taxpayer); the Irish consumer (of financial services) and the overseas consumer.

The primary objective of the Central Bank is that of price stability and the Bank also has five other specific remits as outlined in its 2014 Annual Report (see Table 1). In order to ascertain who should pay for regulation, surely it is appropriate to consider both who benefits from the specific remit and the precise extent to which each party benefits.

Such information should be accessible from the CBI's Annual reports. However, on examination, whilst the Annual Report of the Central Bank is extremely detailed, it is fair to say that the average consumer or member of the public would have great difficulty in making much sense of it. Or indeed in identifying where regulation actually provides benefit to him or her other than in the broadest sense. Nor is it apparent, even to industry professionals, as to the extent to which each category benefits.

As with any institution that has multiple 'remits', it would be instructive to have an outline of where income is allocated and the costs incurred duly apportioned in an open and transparent way. By way of example which we will return to later, the budgeted costs for Credit Union regulation is €14m but there is no way of ascertaining where the direct benefit of this is to the members of credit unions, who in theory, are the principal beneficiaries such regulation.

We would suggest that in order to decide on an equitable funding model, it is appropriate to identify the specific CBI remit, the beneficiaries of that remit, the extent to which they benefit and the costs associated with regulation in relation to that specific remit. From that, it should be a relatively straightforward exercise in identifying the appropriate funder(s) for the costs incurred.

Table 1 outlines a draft matrix that would help identify the appropriate funders of each of the CBI's remit. It is not intended to be comprehensive, rather an indication of the type of analysis that should be conducted before deciding on how best to fund regulation.

Table 1: Draft matrix for identifying an equitable approach to funding Financial Services.

	CBI Remit	**Beneficiaries**	**Extent to which they benefit**	**Cost associated with regulation**	**Appropriate Funder**
		Taxpayer Consumer Overseas Other	Should be quantifiable in financial terms	CBI to provide information on costs breakdown	Taxpayer Consumer EU Other
1	Price Stability				
2	Stability of the financial system				
3	Proper and effective regulation of financial institutions and markets, while ensuring that consumers of financial services are protected				
4	Efficient and effective operation of payment and settlement systems				
5	Resolution of financial difficulties in credit institutions				
6	Provision of analysis and comment to support national economic policy development.				

From the Consultation Paper it appears that the process is that the Central Bank will draw up the budget that it feels is required and then simply levy the industry accordingly. This is not how a normal business operates. Concerns in this regard are further raised by the levels of profit generated by the Bank in recent years i.e. over €2 billion for the year ended 2014 and over €1.5 billion for the year ended 2013 and it is against this backdrop that the Bank intends to increase the levies due from credit unions fivefold to €7 million per annum.

Funding the Regulation of Credit Unions:

The consultation paper outlines that the budgeted costs associated with RCU for 2014 were €14m. In the context of funding regulation, it is interesting to note that this cost is greater than the annual costs of any one individual credit union.

Each year, all credit unions are obliged to publish annual accounts through an Annual Report. In those accounts, there are Reports from the Board, Reports from various committees, notes from Chairmen, Auditor opinions and so forth. There are also detailed breakdowns of specific costs and little is left unsaid with members of each credit union provided with as much information as required to understand the running of their financial institution. This is further supported by the holding of AGMs where members can question the Board and management on the governance, strategy and operations of the credit union. In short, accountability.

Unfortunately, when reading the Central Bank's Annual Report, it is hard to ascertain the precise nature of how and where costs are allocated in the Registry of Credit Unions (RCU) with much of the financial costs associated aggregated into the broader 'grouped' costs. Whilst there is some welcome qualitative commentary around PRISM inspections and so forth, there is little way of knowing if €14m is too much, too little or just the right amount to be spent on regulation of the sector. There is also no way of knowing if the public, the vast majority of who are credit union members, are receiving value for money.

The Consultation Paper makes it is clear that the Central Bank intends to progress the policy to phase in 50% of the cost of regulating credit unions over a period of 5 years commencing in 2016.

Under the proposals, Credit Unions will see:

- An increase of 525% in funding (a jump from 8% to 50%)
- An increase in costs to Credit Unions from €1.4m to €7m

As credit unions are not-for-profit financial co-operatives that redistribute any surplus available to their members, any increase in the cost of regulation directly impacts these members negatively.

Currently the amount payable by credit unions is capped at 0.01% of their total assets and we believe that the principle of a cap should be retained to recognize the societal benefit of credit unions. However, this cap should not be linked to a percentage of the total assets. Rather, it should be linked to a percentage of the loan book because this is the one asset that credit unions have the direct ability to adjust income from.

Currently, the credit union sector has approximately €14bn in assets. Of this, approximately €3.5bn is lent. The cost of running RCU is c.€14m annually. The average loan rate in the sector is c.10%. If the cost of funding regulation in the sector was based upon a percentage of the loan book, credit unions would need to increase lending by 2% (i.e. charge an average of 10.20%) to find the €7m required to meet the proposed 50% target. This seems onerous in current market conditions.

SPCU would propose the following approach that will bring fairness and equity to all sides. The funding charged should be the equivalent of 0.1% of the loan book, which would mean that on average, credit unions would charge 10.10% (a 1% increase). Under the current situation, this would raise €3.5m in funding. Going forward, as credit union loan books increase, the funding to the Regulator will increase in line with any increase. If credit unions were "fully lent", the attendant funding sum raised would approximately equate to the current costs of RCU (€14bn X 0.1% = €14m).

If, as we are regularly reminded, credit unions loan books need to increase to ensure viability, such an approach would inextricably link the viability of the RCU unit to the viability of the sector. This would ensure that all parties were working towards a future viable business model for credit unions and would also ensure that credit unions were sustainable and self-sufficient from a regulatory stand-point – a situation that is in the interests of all stakeholders.

Under the Credit Union Act 1997, (" the 1997 Act") the functions of the Registrar of Credit Unions are "to regulate Credit Unions with a view to the protection by each Credit Union of the funds of its members; and the maintenance of the financial stability and wellbeing of Credit Unions generally". Whilst *"the maintenance of the financial stability and wellbeing of Credit Unions generally"* is not a discussion for this paper, it is certainly not obvious as to how RCU have contributed to credit unions wellbeing. By way of example, the newly published regulations for credit unions will see the sector lose potential income that would approximate to the full cost of regulation but regrettably, the rationale for the implementation of the proposed regulations remain unclear.

Table 2 outlines a similar draft matrix to funding credit union regulation as Table 1 does but with an added column which should establish accountabilities for RCU through Key Performance Indicators (KPIs) that are open and transparent. These should be agreed with the funders of the office.

Table 2: Draft Matrix for Funding Credit Union Regulation

	RCU Remit	**RCU KPIs**	**Beneficiaries**	**Extent to which they benefit**	**Cost associated with regulation**	**Appropriate Funder**
		Open Transparent	Taxpayer Member Other	Should be quantifiable in financial terms	CBI to provide information on costs breakdown	Taxpayer Consumer Other
1	The protection by each Credit Union of the funds of its members;	How is this assessed?				
2	The maintenance of the financial stability and wellbeing of Credit Unions generally	How accountable is RCU for this?				

As mentioned above, the costs and benefits associated with financial regulation should be spelt out in plain and simple terms. Each unit within the regulator's office should have its own Income and Expenditure accounts that are available for inspection by the funders of the unit. Where costs are shared cross-functionally, these can be apportioned. In this way, the activities and the value the Registry of Credit Unions (RCU) brings to regulation and the sector will be visible to all parties.

Whilst volunteer Directors of Credit Unions are fully accountable and maintain the burden of fiduciary duties associated with holding a Directorship of a Financial Institution, the RCU appears to have little accountability to the sector it serves. If increased regulatory costs are to be phased in for credit unions, then it should only be in conjunction with a clear, open and transparent set of accountabilities such that the Credit Union sector can have confidence that the RCU will deliver on its remit, in particular, *"the maintenance of the financial stability and wellbeing of Credit Unions generally"*. It should also be phased in in conjunction with a progressive approach to credit union loan book growth. In such circumstances, credit unions and their members could maintain confidence in the regulator and the approach it takes.

In summary:

Broad Regulation:

- Regulation should be funded by the beneficiaries of the regulation

Credit Unions (specific):

Under the proposals, Credit Unions are to carry further costs of regulation.

- If so, this should be done by linking costs to a percentage of the loan book - not the total assets
- Linkage to the Loan Book where growth is a priority provides a potential win-win scenario for the Registry of Credit Unions (RCU) and the sector
- If the Credit Union sector becomes "fully lent", the cost of the regulating the sector would be 100% covered by credit unions
- The accountabilities of RCU should be clear and the funders of the regulation should have an input into agreeing those accountabilities.

At the recent debate on credit unions, Dáil member Pat Rabbitte expressed the following sentiment:

"I question the appropriateness of credit unions being regulated by the Central Bank at all, notwithstanding the separate arrangement that is there. I am not sure the Central Bank understands the culture of the credit union movement." (Pat Rabbitte, Dail Debate on Credit Unions, 24/6/2015).

Adopting the approach outlined in this submission would be an excellent start in ensuring that such a statement is unlikely to be heard again.

Robert Cooper

CEO.