“Introduction of a Tiered Regulatory Approach for Credit Unions”

Response to Consultation Paper from Ballincollig Credit Union Ltd Ballincollig Co Cork

A. Tiered Approach Section 4.8 (1)

As set out in the consultation paper the introduction of a “tiered regulatory approach” would follow on the introduction and embedding of a strengthened regulatory framework.

BCU makes the following comments:

1. The strengthened regulatory framework applies to all CU’s
2. The introduction of a tiered regulatory approach – with more stringent monitoring/regulation for Tier 2 CU’s –based on Asset size only and not taking into consideration any increased Risk – arising from the complexity/scale/scope of activities that the Tier 2 CU may or may not become involved in could cause confusion.
   A CU may apply and become a Tier 2 but may never become involved in additional activities – outside what a Tier 1 CU would be involved in – but attracts the more stringent regulation because of its Tiering.
3. CU’s should be allowed to develop either organically or through mergers & engagements – the tiering process is a “one or two hat/hats fits all approach. It should be refined to allow for a step by step individual approach - taking point 1 above into consideration. Bigger does not = better. The quality of decisions very often reflects the level of “education” in CU’s. Rather than having to apply for Tier 2 status CU’s should be assessed on their performance and level of activities.

B. Overview of Categories Section 5.12

BCU makes the following comments:

1. *Lending –*
   The proposals on “large exposures” will have more of an impact on smaller CU’s.

   In an ideal world “connected borrowers” would have no borrowing requirements but BCU feels that they should not be adversely impacted if the CU is their only source of borrowing.

   BCU does not understand the rationale behind the proposed restrictions on lending. Why are CU’s being treated differently to other Financial Institutions? BCU proposes that the lending criteria – presently in operation should continue – with the Regulator overseeing the operation and making whatever adjustments are necessary on an individual basis. Why should CU's who run a good operation be penalised?

Furthermore BCU is of the view that recent tightening up on lending e.g. ICB checks; mortgage checks in addition to revised lending policies and procedures provides sufficient risk cover and allows CU's to compete in the market place. Any additional restrictions as now proposed would leave CU's with at least one hand tied and in an unfair competitive position.

Concentration Limits.

The complexity that is being proposed here will make it more difficult in managing Loan Books.

Investments

At present a credit union can have up to 25% of its investments with any one bank counterparty. It is proposed that the new limit will be equal to each credit union's regulatory reserve. For most credit unions this will mean a reduction in the limit - a survey shows that on average, the regulatory reserve is around 15-20% of total investments.

Presumably the rationale behind this change is to ensure that if there is a default by any one counterparty, the losses to the credit union cannot exceed its reserves.

It is notable that these limits will apply to all counterparties, whether banks or governments. The Guidance Note of 2006 did not put a counterparty limit on individual governments.

Tier 1 Credit Unions (<€100m of assets)

It is proposed that Tier 1 credit unions' investments will be limited to deposits and government bonds. Bank bonds will no longer be an option.

It is also proposed that the maximum maturity will be 5 years for both deposits and government bonds. At current investment rates, this will impact on a credit union's ability to earn investment income. It is difficult at present to get a 5 year deposit above 2%, while a 5 year Irish Government bond (which is the highest yielding sovereign bond that a Tier 1 credit union could invest in) is currently trading at 1.70%.

The challenge to earn sufficient investment income will be made more difficult by the fact that at least 50% of a credit union's investment portfolio must mature within 3 years.

Tier 2 Credit Unions (assets >€100m)

Tier 2 credit unions will be allowed to make most of the same investments they have made up to now, with the possible exception of collective investment schemes (as discussed below).

The maximum maturity on deposits will be 7 years (10 years at present), and the maximum maturity on government bonds will be unchanged at 10 years. At least 50% of the total investment portfolio must mature within 5 years. We don't believe that these maturity limits will be overly restrictive.

Tier 2 credit unions can continue to invest in senior unsecured bank bonds up to a maximum maturity of 7 years (currently 10 years), but subject to a maximum total holding of 50% of the credit union's regulatory reserve. This means that bank bonds won't generally be able to make up more than 7.5-10% of the total portfolio.

By specifically mentioning senior unsecured bank bonds we are excluding subordinated bonds, which is no surprise, but it also excludes secured bonds which are a lower-risk form of bank bonds. *There is no logical reason why secured bonds should be excluded*.

Tier 2 credit unions will be able to invest in corporate bonds other than bank bonds, subject to a minimum A credit rating. Like with bank bonds, the maximum holding of these corporate bonds will be 50% of the credit union's regulatory reserve. The maximum maturity will be 7 years.

BCU believes that the inclusion of corporate bonds is a positive move in terms of enabling the credit union to have greater diversification within its portfolio.

Collective Investment Schemes & Equities

There is no mention in the document of collective investment schemes. The Guidance Note of 2006 allows credit unions to invest in collective investment schemes, as long as they are consistent with all the other investment classes and limits in the Guidance Note. It is unclear whether it is proposed to continue to include collective investment schemes, subject to the new classes and limits.

It is the view of BCU that collective investment schemes can be an efficient means of bringing diversification and liquidity to an investment portfolio, and it would be unfortunate if they were excluded.

Savings (Shares & Deposits)

BCU does not agree with the proposed limits – because of the competitive restrictions that this will place on CU's viz. other Financial Institutions. In addition the proposal - splitting shares & deposits -would introduce a level of complexity that is totally unnecessary.

Borrowing

BCU is in agreement with this proposal

Reserves

BCU does not understand the logic behind the imposition of an additional "operational risk reserve" particularly at this point in time in the re –structuring of the CU movement. Is this purely a mechanism to get to 12%? How do we know what type of a more sophisticated business model will develop? Surely this is something that should be introduced – only if it becomes apparent that there is a requirement for same.

Liquidity

BCU does not agree with the additional short term liquidity requirements that are being proposed and would argue – particularly in the present climate where unattached savings are high – that this requirement will impact significantly and negatively on the Investment Income earnings of CU's.

There is no evidence that the current Liquidity requirements are not adequate and the "Liquidity" across the CU movement is not an issue.

C. Additional Products.

BCU would like to see the introduction of (1) a revolving credit facility – type of overdraft (2) the introduction of mortgages – CU's to be approved on an individual basis.

D. Provisioning

The existing provisioning requirements are clear and in the opinion of BCU provide clarity in the manner in which CU's calculate their provisions.

The consultation document does not give too much clarity on the added value that would derive from the proposed Provisioning Framework. From the limited information available it is the view of BCU that the current provisioning requirements are adequate.

The challenge facing CU's is the active management of their loan books and the concentration of any available resources in this area – if this is done in a structured comprehensive manner – the requirement to make a provision or not for delinquent loans will quickly surface

E. Timing of Introduction.

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BCU is of the view that this is not the right time to introduce a tiered regulatory approach for CU's for the following reasons:

(1) The CU movement is presently going through a massive change programme- REBO restructuring , increased regulation, fitness and probity, etc,etc.….
(2) The economy is just coming out of recession and all CU's have suffered massive drops in Loan Books and now shrinking investment income. There should be a period of 2 years – to allow for the CU to stabilise and then a review /assessment could be made on the overall "fitness levels" of CU's – and the shape of the movement following mergers/engagements.

(3) As mentioned at 2 above – loan book income and investment income have dropped significantly. It is clear that if the proposals – specifically on Lending/Investments and Liquidity are now introduced – the health of the patient will be significantly challenged and there is a danger that the patient may die.

BCU acknowledges that the purpose of these proposals is to safeguard the Members Interests - but as mentioned earlier would be in favour of a more “measured approach” rather than the “sheep dip” or “2 Hats fit all” approach that is being proposed in this consultation paper.

Pat Moore

Secretary BCU Ltd