Farranree Credit Union Ltd. Submission to Central Bank on Consultation Paper (CP76) on the introduction of a Tiered Regulatory Approach for Credit Unions

While acknowledging the commitment "the strengthened regulatory framework already recognises the nature, scale and complexity of individual credit unions" (Section 2.4 p.10), we wish to comment on the following matters:

Lending

- **Maximum loan repayment term of 15 years & possibility of limiting home loans to Category 2 credit unions.**

Many credit unions have successfully provided limited lending in relation to home loans over the past ten years. In many cases it was to facilitate long term tenants to purchase their homes from the local city council. Once strict lending criteria is set for home loans e.g.;

- Value of loan not to exceed 75% of the value of the property
- The total of the home loan repayment and any other loans not to exceed 35% of Member's income
- First legal charge on the property to cover existing and future liabilities

We do not see why this should be removed from all credit unions in category 1, when strict lending criteria for such loans will remove any regulatory concerns.

- **Loans to Restricted Persons (i.e. credit union Directors & the management team and their families) cannot exceed a total of the greater of €200,000 or 5% of our Regulatory Reserve i.e. €172,300.**

The Credit Union Act 2012 (Part 1-Preliminary & General) outlines that a ***"member of the family', in relation to any person, means that person's father, mother, grandfather, grandmother, father-in-law, mother-in-law, spouse or civil partner, cohabitant, son, daughter, grandson, granddaughter, brother, sister, half-brother, halfsister, uncle, aunt, nephew, niece, first cousin, step-son, step-daughter, step-brother, step-sister, son-in-law, daughter-in-law, brother-in-law or sister-in-law;"***

Management team' has the following meaning given by section 55(1)(*i*) of the Act;
"Identifying, in consultation with the manager, other officer positions within the credit union that—
(i) are essential to the proper management of the credit union,
(ii) are likely to enable the person holding the position to exercise significant influence on the conduct of the affairs of the credit union, and which, together with the manager and risk management officer of the credit union are referred to in this Act as the 'management team';"

We are requesting that the proposal to limit lending to Restricted Persons as outlined above would be reviewed by the Central Bank and replaced with a more measured and practical approach. The inclusion of the families of Directors and the Management team in the definition makes the existing proposal overly restrictive on community based credit unions. It creates the scenario of being obliged to refuse good loan applications (including loans within shares) for unjustifiable reasons e.g. a member's first cousin is on the board. Clearly the definition is too broad and a more proportionate one is required. We would advocate that the term "families" as defined by the Act would be excluded from this definition. We are also concerned that this proposal may have a parallel negative impact on the sourcing and retention of Directors, given that by joining the board they would effectively be re-categorising the membership status of their entire extended families, and restricting their ability to borrow from their own credit union. Similarly the monitoring of this limit would be overly complex, i.e. something as simple as a change of director may put a credit union over/under their limit. In our opinion the 5% of Regulatory Reserves is also too low, and should be increased to 10%-15%. The proposal does not address the area of net balances, which needs to be factored into this matter.

A more proportionate and practical solution to any regulatory concerns in this area is possible, while allowing credit unions to retain the ability to lend to their membership on an equal basis. We suggest that robust lending policies, a prudent approach to loan approvals and strict enforcement of the Code of Ethics/Conflicts of Interest Policy can alleviate and manage any Central Bank concerns in this area.

- **Commercial Loans (loans to fund an activity whose purpose is to make a profit (*new description*)) up to a maximum of 25% of our Regulatory Reserve**

We believe the definition is too broad, and requires clarity, as it appears to encapsulate both ends of the spectrum i.e. large scale commercial lending and a sole trader borrowing modest amounts are defined in the same manner. Proportionate commercial lending is an area credit unions could excel in, with proper parameters, certain limitations and clear processes. The movement has the funds available to lend and the reduction in credit union loan books in recent times coupled with the current reduced demand for new loans in our core personal lending market may provide a viable alternative lending option. While undoubtedly a more stable economic environment will promote confidence and subsequently personal loan demand from our members will increase, it is certainly important for credit unions to be permitted to pursue other avenues. We agree that lending in this area should be limited, but would advocate a higher figure than 25% of regulatory reserve for Category 1 Credit Unions; we feel 50% may be more appropriate in light of the proposed additional Central Bank guidelines in this area.

Investments

We have conducted an in-depth impact analysis on our investment portfolio with our investment advisors Davys and the implications of the proposals include:

- the very likely scenario of lower investment income
- diversifying into lower yielding asset classes
- lower yielding shorter term investments
- removal of collective investment schemes as an option
- reallocation of funds to other counterparties, outside of Ireland

The potential negative effects on credit union's investment portfolios as a result of the proposals are concerning. We wish to comment on other areas of the proposals on investments as follows:

- **Maximum maturity of 5 years and a maximum of 50% of total Investments can be investments with a maturity in excess of 3 years.**

We would suggest that the current maximum maturity term of 10 years is adequate and should be retained as the proposed lower limit of 5 years will severely restrict credit unions in the range of products they can invest in and the returns they can potentially achieve on their investments.
In relation to the proposals that a maximum of 50% of total Investments can be investments with a maturity in excess of 3 years, we would again suggest that the existing limits are adequate and should be retained, that is "**Not more that 50% of deposits shall be held in deposits maturing after 5 years and not more than 20% of deposits shall be held in deposits maturing after 7 years**" and "**Not more than 30% of a credit union's holding in Irish & EAA State Securities shall be held in Bonds maturing after 7 years and the total holding in such investments shall not exceed 70% of the total value of the credit union's investment portfolio".** The existing limits combined with the enhanced governance requirements within credit unions should provide rigorous adherence and alleviate any concerns in this area.

- **Value of total investments in a single Bank or EEA State cannot exceed 100% of a credit union's Regulatory Reserve**

We suggest that the existing limits would be retained (i.e. 25% counterparty limit and 70% of total investments in Government Securities) as this has served the credit union well during the unprecedented volatility of recent years and provides adequate protection for our Members Savings, particularly in light of the enhanced regulatory oversight of financial institutions. We agree with our investment advisors that counterparty and concentration limits should be expressed as a percentage of the investment portfolio rather than a percentage of the regulatory reserve, in addition this proposal may in fact lead to extremes in certain credit unions as illustrated in the Davy submission.

- **Investments to be limited to Bank Deposits, Irish & EEA State Securities (e.g. Government Bonds) and placing funds with other Credit Unions.**

We are requesting that the Central Bank would review this proposed amendment and include an option for credit unions to invest in Irish & EEA Senior Secured Bank Bonds and Senior Unsecured Bank Bonds to a certain limit, e.g. 20% of investment portfolio. We believe that they represent a viable alternative for credit unions to diversify their investment portfolio and an opportunity to source a product that may represent a potential for higher yields without increased risk. We concur with Davys assessment that Bank Bonds can also provide a contingency funding source in the event of unforeseen liquidity issues.

Savings

While not directly affected by this as our own internal limits already comply with the proposals, we would be concerned that category 2 credit unions, especially, may be restricted in their development due to this absolute limit irrespective of credit union size. It would appear that the rationale behind this figure relates to the deposit guarantee scheme, which is understandably comforting given the experience of recent events in Ireland; however we also must acknowledge it may restrict credit union growth into the future.

Liquidity

- **While the existing minimum liquidity requirement of 20% of unattached shares will continue, it is proposed that 10% of unattached shares would be kept up to seven days and 15% up to one month.**

A credit union's relatively predictable Annual Cash Flow requirements and the overall stability of Members Savings levels make these proposals overly onerous and indeed unnecessary. It may be appropriate to tie additional liquidity requirements to credit unions with higher percentages of their portfolios with a maturity in excess of 5 years for example. In line with our investment advisors we believe that the potential for a 100% cash deposit based collective investment scheme with its own separate and rigorous regulatory requirements may provide an alternative liquidity option, with the additional potential to mitigate some of the negative Basel III requirements while maintaining the objective of strengthening the investment framework.

Provisioning

It is difficult to comment effectively given the absence of specific detail with regards to some of the proposed changes to provisioning, and we look forward to future papers clarifying the detail. However we wish to make the following observations:

- We welcome the attempt to create a uniform and consistent approach to provisioning for the movement.
- We embrace a prudent approach to provisioning.
- The methodology used in the calculation of provisioning requirements must be clear, unambiguous, fully explained and transparent. This is essential in its correct implementation, and the attainment of consistency.
- While striving for best practice in this area it is imperative that any approach must be proportionate to the credit union lending model, scope and scale. Perspective must be attained on recent times, and any requirements in this area should not indefinitely tie credit unions to extra ordinary historical trends. While acknowledging that any provisioning proposals must take certain cognisance of recent events, it is essential that context is achieved and required levels must not be overly punitive for the future, and less volatile times.
- Any proposed model of provisioning must be implemented in conjunction with the movement.

Timeframe

We believe an elongation of the proposed timeframes is necessary to provide sufficient time for full deliberation and the accurate implementation of any subsequent requirements, given their potential scale and magnitude. This is in light of the significant level of change already on-going in the movement, the Restructuring process and the uncertainty regarding Basel III implications for credit union investments. It is also important to allow the enhanced functions i.e. Risk Management, Compliance, Internal Audit to be fully embedded and fulfil the purpose for which they were implemented, and indeed this may allay some of the concerns driving some of the proposals.

Overview

We share the Central Bank's strategic vision of "Strong Credit Unions in safe Hands". We agree with the view of the majority of community based credit unions and are too extremely concerned that some of the proposed changes outlined in the Consultation Paper may undermine our primary objective of the protection of our members' savings and concurrently may adversely impact upon credit unions ability to remain at the centre of the local community. It is imperative that the proposed tiered regulation encapsulates the spirit of the Credit Union Commission Report, and strikes the correct balance between regulation and development.

The proposed amendments on lending, investments and liquidity while designed to tighten regulation and reduce risk, will inadvertently have a substantial negative impact on credit union's potential income and consequently restrict our capacity to provide credit facilities to our Members in a prudent manner and at a reasonable rate of interest. The direct correlation between restrictions on credit union's ability to lend and an increase in moneylending is as stark, as it is concerning. Indeed we note the increased use of moneylenders is also a concern shared by the Department of Consumer Protection of the Central Bank from media reports in November 2013.

In conclusion, we hope that the Central Bank will take on board the suggestions and proposals which we have outlined in this submission. We look forward to the follow-up Consultation Paper and Regulatory Impact Analysis and trust that concerns raised during this initial consultation period will be addressed as part of that process.