Gurranabraher Credit Union Ltd.

Submission on CP 76

Consultation on the Introduction of a Tiered Regulatory Approach for Credit Unions.

February 2014.

Introduction

The approach to the formulation of this submission on CP 76 by Gurranabraher Credit Union Ltd (GCU) has been to attempt to directly answer the questions as posed by the consultation paper in the first instance, and then to provide additional comment where Gurranabraher Credit Union has a view or a suggestion in particular areas.

Context of GCU Submission

Gurranabraher Credit Union Ltd has approx 15k members, total assets of €86m, savings of €72m, loans of €29.5m, has 2 offices and 21 staff.

Central Bank Questions.

1. Do you agree with the proposed regulatory approach for credit unions?

The Commission for Credit Unions recommended a three tier regulatory approach for Credit Unions based on asset size. The Central Bank has approached the issues from a different perspective, proposing to regulate Credit Union based on their 'nature, scale and complexity' as opposed to simply on their size. In principal, GCU agrees with the approach of the Central Bank, in that we believe it is more appropriate and suitable for the regulation of individual Credit Unions to be based on the strategy and model of operation that the Credit Union wishes to adopt, as opposed to simply the asset size of the Credit Union. In theory, this approach should allow for a more flexible approach for individual Credit Unions to determine their own strategy and model and then to be regulated accordingly.

However, we believe that the reality of the proposed approach by the Central Bank is that the vast majority of Credit Unions will remain as category 1 Credit Unions, with only a small number of larger Credit Unions being able to achieve category 2 status. This will mean that in practice tiered regulation will have little or no impact, or provide no service or regulatory flexibility, for most Credit Unions. We would also further contend that the overall approach being applied to category 1 Credit Unions is too broad and too onerous in its approach, and actually does **not** take into account the 'nature, scale and complexity' of most Credit Unions.

We believe that the impact of this approach will be two-fold as follows:

- Smaller Credit Unions will find it difficult to meet the regulatory requirements as laid down for Category 1 Credit Union;
- Larger Credit Unions who remain as category 1 Credit Unions will find the regulatory restrictions proposed will significantly curtail their business.

We believe that the approach by the Central Bank is based on the correct principal, but the level of tiering being proposed essentially means that the tiering will have no bearing on most Credit Unions and will have a significantly negative impact on many Credit Unions.

2. If you have other suggestions please provide them with the supporting rationale.

The principal of regulating Credit Unions based on their nature, scale and complexity is a good principle. However, even though CP 76 aspires in its approach to achieve this, in reality what it delivers is an overly restrictive, largely standardised, across the board single regulatory approach.

We would contend that some of the restrictions, for example around lending, investments and savings, should have a broader range of regulatory tiering applied individually to them, and have specific regulations within the specific areas. It would seem a relatively straightforward task to put in place tiered regulatory requirements across a range of areas, so for example if a Credit Union would like to provide secured home loans a set of pre-determined regulatory requirements apply or if a Credit Union would like to have longer term investments, then a different set of pre-determined regulatory requirements would apply.

The Central Bank should have a menu of regulatory requirements, and the regulatory requirements in a particular area should be selected based on the strategy and model being adopted by a Credit Union in that area. The current approach being proposed deals with every aspect of a Credit Union as one issue, and you either have all of the additional service and product functionality and regulation of category 2 or you have none of the additional service and product functionality and regulation of category 2.

3. Feed back is sought on any further additional services credit unions wish to provide to their members

We believe that there is a clear need for the expansion of additional services available to Credit Unions, and a change in how the Central Bank approach the issue of dealing with both additional services and also already exempted services.

Credit Unions are under increasingly significant income pressure, with loan portfolios down considerably and the return on investments reduced dramatically. At the same time costs are at best holding steady, and in a lot of cases increasing. We believe that these pressures mean that Credit Unions will have to consider their income streams and seek to supplement these income streams with income from other sources, or consider the recovery of costs relating to current services.

Specifically, in relation to additional services we make the following points:

- We refer to page 28 of CP 76, which deals with additional services. We note with some interest that footnote 37 refers to two statutory instruments when dealing with exempt additional services. However, our understanding is that there are three statutory instruments dealing with exempt additional services, and wish to query why S.I. 838 2007 is not referenced in footnote 37;
- Lending is and should continue to be the key income source in Credit Unions. However, Credit Unions are now largely dealing in the very restricted and reduced market of un-secured personal lending. We believe that this market has

changed significantly and it is now questionable as to whether a reasonable sized Credit Union can actually be sustainable into the long term future when only providing personal un-secured credit. To this end, we would like to see Credit Union being allowed to extend their lending products, to include such products as secured home loans and credit cards. We would contend that if a Credit Union cannot lend in these areas going forward, particularly secured home loan, that it will be very difficult to maintain loan portfolios and thus income levels. We note with interest that the lending section of CP 76 states that Credit Unions are not actually prohibited from providing home loans to members, however, in reality many Credit Unions have lending restrictions which means that they cannot provide home loans.

(We further note here that we submitted a proposal to the Central Bank in relation to GCU providing home loans to members in April 2013 and we are still awaiting a response to same)

CP 76 makes reference to the regulatory model in operation in other jurisdictions. If ones looks at the operation of Credit Unions in some of these areas, such as Canada, USA or Australia, secured lending is a significant element of the Credit Unions business.

- We believe that Credit Unions should have the flexibility to be able to provide a range of services that are complementary to lending, with a view to generating income from same;
- Technologies are changing rapidly in the world today, and Credit Unions need to be able to respond to these changes quickly and provide delivery mechanisms and services that are appropriate to the technologies of the day. In our view, the regulatory regime applied to Credit Unions needs to be more flexible in this regard and allow Credit Unions to adopt new technologies faster in order to keep up to date with the provision of services to members. The reality in some cases, for example in the provision of debit cards to members, is that the regulatory requirements are excessively onerous and slow even in allowing Credit Unions to provide services that are already classified as exempt additional services.

On an overall level, we believe that additional service with appropriate regulation should be embraced by the regulatory regime, as it ultimately strengthens the service offering to members and supports the sustainability of Credit Unions into the future. However, we believe that this should be applied on a ‘voluntary’ basis, in that if a Credit Union wishes to provide an additional service, a set of pre-defined regulatory requirements applies, and if a Credit Union does not wish to provide this service, then these regulatory requirements do not apply.

4. Do you agree with the proposals for the operation of the two category approach for credit unions as set out in sections 5.1 to 5.11

We would like to make a number of observations of specific proposals within the sections 5.1 to 5.11.

5.2 Lending

- Category 1 commercial lending limits are too restrictive;
- A restriction on the maturity of loans to 15 years is too restrictive. This will have a negative impact on loan portfolios that are already under pressure;
- Both categories of Credit Unions should be allowed to provide home loans, and specific regulatory requirements could be applied in this area. In relation to the specific details on home loans in CP 76, we would contend that having a loan to value restriction at 80% is excessively onerous and outside of current market norms (say 90%), and that the term restriction should be 30 years as opposed to 25 years. We again come back to the point that if Credit Unions are not permitted to provide secured home loans, it will become increasingly difficult to be sustainable into the future;
- The restricted persons loan limits is a major issue, and we would implore the Central Bank to consider the implications of such a proposal carefully, as we believe it will have a significant and detrimental affect on Credit Unions. The definition of a member of a family is extensive, and in the case of GCU this restriction would mean that overall lending in this category could not exceed 5% of regulatory reserve ratio, which is approx €435k. We believe this level would be exceeded on an on-going and continuous basis. This restriction will apply to hundreds of members, and will mean in reality that the first cousin of a Director will come into the Credit Union for a loan and we will have to tell that member that we cannot provide the loan as they are the first cousin to a Director of the Credit Union. This broad level of restriction extending to the defined family member makes no sense (we accept that the principal of the restriction is valid for close family members such as spouses or dependent children), is totally and utterly un-workable and we would ask the Central Bank, in the strongest terms, to give serious considerations to the implications of this restriction and the impact it will have on the ground. We believe that the ultimate impact of this proposed restriction is that Directors will resign from the Board and/or not run for the Board.

5.3 Investments

- The category 1 term restriction to 5 years is far too restrictive, and will have a negative impact on the ability of Credit Unions to even maintain, never mind improve, their return on investments;
- Reducing the counterparty restriction to the level of Regulatory Reserve means that the counterparty restriction in GCU would be approx 15%. From a risk diversification perspective this seems like a good principal, however, in reality there are not enough banks operating within the state to meet this requirement. Investment returns are already under serious pressure from dramatically reduced interest rates and yields on bonds. Introducing this restriction will mean that funds will have to be placed in institutions that operate outside of the state and will in our view lead to a further reduction in returns.

5.4 Savings

Our reading of the proposals is that savings in both category 1 and category 2 Credit Unions will be restricted to €100k (subject to the 1% of total assets limit in category 1 Credit Unions).

It is un-clear from the proposals as to whether this limit is inclusive of deposits or exclusive of deposits ie shares only, and is a matter that the Central Bank could clarify.

On an overall basis, we believe that a savings limit of €100k per member is too restrictive, and while we appreciate that it aligns with the Deposit Guarantee Scheme, we do not believe this is sufficient reason to introduce an overall limit on savings of €100k per member. In addition, we would query how this would be implemented, as many Credit Unions already have significant amounts of members that have in excess of €100k in savings.

5.5 Borrowing

No comment.

5.6 Additional Services

See answer to question above in relation to additional services.

5.7 Governance

From the perspective of GCU, we would see that proposal of having a ‘dedicated’ risk management officer and compliance officer as being a significant issue that would prohibit GCU from becoming a category 2 Credit Union.

We would contend that there should not be a requirement to have a dedicated risk management officer and compliance officer, as long as the risk management system and compliance system are operating in an appropriate manner. To put in place dedicated personnel for these roles can involve significant cost for Credit Unions, and will put further pressure on already decreasing margins. In addition, we believe that this is one of the main requirements that will lead to only a small number of very large Credit Unions achieving category 2 status.

5.8 Fitness & Probity

No comment.

5.9 Reserves

No issues.

5.10 Liquidity

No issues.

5. Are there any areas where credit unions could provide new additional services to their members? Should these be available to category 1 and category 2 credit unions or only category 2 credit unions.

As per Additional Services question above.

These additional services should be open to both category 1 and category 2 Credit Unions to provide, and regulation should be specific to each individual area.

For example, if a Credit Union wishes to provide home loans, they should be able to do so regardless of category, and specific regulations in relation to the provision of home loans should apply.

6. Do you agree that a provisioning framework should be developed for credit unions as proposed in section 6.2

On an overall basis, we do not have any major issue with the provisioning proposals. The one comment we would make is that it is very important for the Central Bank to recognise that most of the current lending in a Credit Union such as GCU is top up lending, and any proposals around provisioning should take into account that this is the nature of lending in such Credit Unions. So, for example, it is not practical to propose that all tops up loans are individually reviewed each quarter, as this is essentially means that the entire loan portfolio is reviewed on an individual loan by loan basis each quarter.

7. Do you agree that a tiered regulatory approach should be introduced at this time?

Yes

8. Do you agree with the proposed timelines for the introduction of the tiered regulatory approach as set out in CP 76?

Yes

Conclusion

The view of GCU in relation to appropriate regulation is that it can strengthen and support the prudent operation of a Credit Union. Having regulation based on the *nature, scale and complexity* of Credit Union is in our view a very good principal, and allows the development of individual Credit Unions in a planned and carefully manner. However, we believe that many of the proposals in CP76 do not in fact recognise the *nature, scale and complexity* of individual Credit Unions, and overly onerous regulation could ultimately have a detrimental impact on the long term future of the Credit Union movement.