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

Submission from the Irish League of Credit Unions

Irish League of Credit Unions, March 2014

1. Introduction & Background

1.1 The Irish League of Credit Unions ("the League") welcomes the opportunity to make a submission on the Introduction of a Tiered Regulatory Approach for Credit Unions CP 76.

1.2 We wrote to our affiliated credit unions in January 2014 and consulted with them via a series of roadshows in March 2014. A summary of the feedback received is set out in Section 3 below.

1.3 The League is the principal trade and representative association for credit unions in Ireland. There are 376 credit unions in the Republic of Ireland affiliated to the League, with approximately 2.8 million members.

1.4 The credit union movement in Ireland dates from the 1950's and has had a beneficial impact socially and economically in enhancing the wellbeing of its members and in turn the wider community. The strength of the credit union movement is evidenced by the penetration rate of credit union membership. Over half of the adult population of the Republic of Ireland is a credit union member.

2. Summary

- The League approves of a differentiated approach to regulation of credit unions but not the model outlined in the Consultation Paper.
- The proposals are not in line with what the Final Report of the Commission on Credit Unions described as “a simple regulatory approach” for Category 1 credit unions.
- There is very little benefit to becoming a category 2 credit union in terms of additional services etc.
- The introduction of a Tiered Regulatory Approach for Credit Unions is being used as a method to further restrict credit unions.
- The League opposes in the strongest terms possible the proposal to create a category of “restricted persons” and place an arbitrary limit on lending to this category of member.
- The proposals around investments are more restrictive than the 2006 Guidance note. The proposals if implemented would have a massive detrimental impact on credit unions investment income.
- We believe credit unions should be able to invest in collective investment schemes as these type of investments enable credit unions to diversify their investment portfolio, meet liquidity requirements and could potentially be used as a method to invest in State projects.
- It is not appropriate to attempt to put such a substantially reduced limit on savings. It is anti-competitive, would hamper growth, and could potentially create the perception that credit unions are more risky than other institutions.
- Credit unions are already adequately reserved, therefore the proposals around reserves are excessive and unjustified.
- The proposal to increase liquidity requirements is unnecessary and will reduce credit unions future investment income.
- The proposed Tiered Regulatory Approach should not be introduced at this time, it would be sensible to allow the changes due to the Act to bed in and have ReBo complete its work before introducing the tiered regulatory approach.

3. Submission

(i) Do you agree with the proposed tiered regulatory approach for credit unions? If you have other suggestions please provide them along with supporting rationale.

The League has long called for a differentiated approach to the regulation of credit unions of different scales and complexity and therefore welcomes the introduction of a tiered regulatory approach for credit unions.

Two- Tier Regulation

The Final Report of the Commission on Credit Unions recommended that in light of the wide range of asset sizes of credit unions in Ireland, a tiered regulatory approach should be adopted. Under the Commission's proposal, credit unions that wish to operate a limited business model would be subject to a simpler regulatory regime and that those capable of offering a more sophisticated business model would be subject to a more intensive regulatory regime proportionate to the nature, scale and complexity of the credit union. The Final Report of the Commission on Credit Unions included three illustrative asset bands with three tiers of regulation corresponding to these bands. The Consultation Paper published by the Central Bank acknowledges the suggested three tiers but opts instead for two tiers of regulation, namely Category 1 and 2. The main argument advanced for a two-tier approach is that given the strengthened regulatory framework, smaller credit unions can be given the flexibility to operate a model which is more like the one that they currently have rather than being forced to adopt a simpler model. The benefits for smaller credit unions under this proposed approach would be that they would not be subject to the severe limits on lending and investments as outlined in the Final Report of the Commission (page 96). However, the Consultation Paper further notes that the regulation of credit unions is governed by the Credit Union Act 1997 (as amended) which contains requirements that apply to all credit unions. These requirements include a risk management system, a compliance programme and an internal audit function.

As outlined above, the proposed two tiered approach deviates from the three tiered approach recommended by the Commission. The League would like to take this opportunity to formally seek a more detailed rationale for this deviation, including detailed evidence of the success of this approach in other jurisdictions etc.

Possible Implications of two-tier Regulation

The proposals in the Consultation Paper effectively remove any expectations that existed of what the Commission called "a simple regulatory approach" for Category 1 credit unions. The credit union movement is already subject to a high degree of regulation and the PRISM regime has recently been rolled out for credit unions. With this is mind it was expected that any proposed tiered regulatory approach would at worst mean maintaining the status quo. However, what is proposed is far more restrictive and onerous in nature. The new regulatory requirements from the Credit Union Act will apply in full to all credit unions. The table on page 21 of the Consultation Paper which provides a summary of the proposed two tier approach clearly shows that category 1 regulation will not be simple as that envisaged by the Commission.

Credit unions of a smaller size, particularly those with assets below a threshold of €10 million will feel the weight of regulation on their ordinary business model. This is likely to incentivise a greater level of amalgamation among credit unions. Post ReBo there will still be a substantial number of small credit unions which will find the basic level of regulation extremely onerous. In addition, the Central Bank now has in place what it refers to as a "strengthened regulatory framework" which includes a fitness and probity regime, as well as significant governance and prudential requirements. These provisions are due to be implemented across the credit union movement in the Republic of Ireland.

A cursory examination of the table on page 21 shows that credit unions in category 2 will be treated as sophisticated financial institutions which could be subject to a range of regulations in addition to those already in place. Thus, the very slightly enhanced level of freedom in lending and investments will attract a far greater level of regulation and supervision. As regards governance, fitness and probity, reserves and liquidity, it is proposed that category 2 credit unions will also have additional requirements.

With regards to the application process to become a Category 2 credit union, we would make the following observations. The Consultation Paper states that "in general, credit unions that apply to become category 2 credit unions will have assets close to or above €100m". The League believes it would be preferable to operate a model similar to that pertaining in Northern Ireland where there is no prescribed limit on the asset size of a credit union becoming a type 2 credit union i.e. even smaller credit unions can become Type 2 credit unions provided that they prove that they are capable of handling the consequent more complex regulatory regime. Furthermore the application process needs to be clear and straightforward, and should avoid "stumbling blocks" being put in front of strong credit unions making applications to become category 2 credit unions.

Regarding the two tiered approach and the size and scale of credit unions, the Consultation Paper references the jurisdictions in the UK and Ontario, Canada. It should be noted that in the UK, credit unions are generally smaller than those in the Republic of Ireland, and credit unions applying for Version 2 status vary significantly in size. There is also no indicative minimum asset size or indeed asset size requirement of any type for making an application. Credit unions as small as £20 million in assets have successfully applied for Version 2 status (equivalent of category 2 status). The League believes that it must not be a requirement for credit unions to have assets of more than €100 million in order to apply for category 2 status.

In Canada, the average assets of credit unions affiliated to Credit Union Central of Canada is approximately $465 million. Therefore, the scale of credit unions is very different to those here in Ireland (the average assets of League affiliated credit union was €33 million in 2013). We see no merit therefore in setting an indicative asset value at €100 million for Category 2 credit unions. Credit unions should be allowed to apply for Category 2 status once they have reasonable scale and can meet other requirements.

5.12 (i) Do you agree with the proposals for the operation of the two category approach for credit unions set out in section 5.1 – 5.11? if you have other suggestions, please provide them along with supporting rationale. It should be noted that tiering is possible where regulation making powers are available to the Central Bank. Where requirements are set out in the 1997 Act they apply to all credit unions and cannot be tiered.

Section 5 sets out rules and limits on credit unions' operations in areas such as lending, investments, savings etc. The view of the League and the overwhelming feedback at the recent roadshows is that the proposals in these areas stray way beyond tiered regulation and are in effect an attempt to 'micro-manage' credit unions. It is completely inappropriate that a tiered regulatory approach would set out such detailed rules in relation to limits which are in effect an effort to simply restrict rather than regulate credit union activities.

Despite the fundamental flaws in these proposals, it was deemed judicious to still respond to the proposals contained within the Consultation Paper and this feedback is included below.

5.2 Lending

It would appear that the revised lending limits will offer the Registry of Credit Unions the scope to operate a more calibrated system and move away from the inflexible system of lending restrictions currently being applied by the Central Bank. The League would welcome any movement in this regard but much more detail than that contained within the Consultation Paper

is required. The League understands that greater detail will be contained in this regard in the next phase of consultation.

From our analysis, some smaller credit unions with lower than average reserves will have a significantly lower limit on loans, while larger credit unions will not be impacted as the 1.5% of assets limit was often largely irrelevant to those credit unions as they would very rarely if ever have advanced loans of 1.5% of total assets. For example a small credit union with assets of €7 million and a reserve ratio of 10.5% would have an upper limit of €105,000 under the 1.5% of assets rule. However, under the proposed revised requirements this would reduce significantly to €73,500.

In some ways linking lending limits to reserves makes good sense and arguably mitigates risk. However, it would therefore be helpful to know as part of the consultation process how lending restrictions will apply in the future, i.e. will the Registry of Credit Unions still impose additional restrictions similar to, and as widespread as, those in place now, on top of the percentage of reserves lending limit? If the number of ad-hoc lending limits is not greatly reduced or completely removed, the proposed lending limits will be rendered largely redundant.

The proposals around concentration limits are a further effort to micro manage credit unions and their lending. Limits such as those proposed in the consultation paper have the potential to cause extreme difficulty to certain credit unions. The proposed limits would create an administrative workload as credit unions would have to constantly monitor their lending to ensure they would not breach what are ultimately rather arbitrary limits.

Overall, the proposed concentration limits are simply too low i.e. the proposed limits on commercial lending would cause issues in terms of limiting loans to self-employed members e.g. sole traders, farmers, publicans, shopkeepers etc. Furthermore the proposed limits on

community lending are also too low. Community lending is an integral part of the ethos of credit unions and it is therefore inappropriate to attempt to place a cap on this type of lending under the guise of introducing a tiered regulatory approach. Indeed a recurring theme at the recent roadshows held by the League was that the introduction of a tiered regulatory approach is being used as a method of implementing further restrictions on the credit union movement.

5.2.3 Maturity Limits

Given that there are already limits on loan terms contained within Section 35(2) of the Credit Union Act 1997 the proposals in this area are unnecessary i.e. there is no need for the proposed maturity limit of 15 years. We also note that the Consultation Paper makes reference to considering a homeloan product for Category 2 credit unions. However, as with many of the proposals contained within the Consultation Paper, the piece on homeloans is not tiered regulation but micro management. It is not appropriate for the Central Bank to seek to be so prescriptive in this area.

5.2.4 Restricted Person Limits

The League opposes in the strongest terms possible the proposal to create a category of "restricted persons" and place an arbitrary limit on lending to this category of member. We query the rationale and justification for these proposals related to restricted persons. There is no provision in the Credit Union Act, 1997 (as amended by the 2012 Act) nor in the Final Report of the Commission to support the imposition of lending limits on a specified category of members, i.e. restricted persons.

This proposal creates a second tier membership in the credit union and is a discriminatory imposition on a particular category of member based on their position in the credit union or based on their relationship with a person who holds a particular position in the credit union. The

definition of *"member of the family"* in the Act is extremely wide and therefore has the potential to impact on a large number of members.

The Act specifically provides that *"the ability of the loan applicant to repay shall be the primary consideration in the underwriting process of the credit union"*. However, the proposal directly contradicts this as an arbitrary (and extremely low) cap is being placed on all loans to "restricted persons" without any regard to the ability of the particular individual to repay.

The League supports the position that controls should be in place with respect to loans to directors and the management team. This is already in place as loans to officers are required to be approved by a special committee and reporting on loans to officers etc. is more onerous. It would also be prudent that additional monitoring is in place with respect to loans to officers and loans to those who have close relationships to officers. However, the imposition of the proposed limit on lending is without justification and given the definition of family to be used, it is completely impractical and unworkable. It would be a particular issue for credit unions with a smaller common bond/membership base as it would completely decimate their ability to lend.

5.3 Investments

The proposals for the classes of investment instruments and the limits for both Category 1 and 2 credit unions are much more restrictive than those outlined in the 2006 Guidance Note on Investments. The League is dismayed to see that there is no mention of social investments/ investments in State projects being permitted despite the fact that these type of investments were allowed for in the Credit Union Act. Under the proposals contained within the Consultation Paper credit unions' ability to invest in collective investment schemes would also appear to be removed. It is likely that this proposal would deny credit unions the opportunity to invest in state projects, social housing etc. on a movement-wide basis. We believe that credit unions should be permitted to invest in collective investment schemes to facilitate these type of investments and indeed other types of investments such as those used for liquidity requirements. Furthermore, the proposed limits on maximum terms would also appear to preclude investment in State projects as these would typically have a longer investment term.

In recent years, many credit unions have suffered significant reductions in their loan interest income. This is due to falling loan demand, as well as the impact of the imposition of lending restrictions, Section 35 and the prudent lending circular of February 2013. It has therefore been the strong returns on investments which have enabled credit unions to generate sufficient surpluses to maintain their reserves and bad debt provisions and still provide a return to their members. If implemented, the proposed restrictions would have a significant detrimental impact on credit unions' income and future earning potential. As long as the reduced lending conditions continue, any proposals that reduce investment income will have a consequent effect on credit unions ability to survive.

Therefore, the League would request that the 2006 Guidance Note would be the starting point for both Categories of credit unions and Category 2 credit unions should also be permitted to invest in Corporate Bonds to the same limits as laid down for bank bonds in the 2006 Guidance Note.

Included below are some of the more significant details for each category.

Category 1 - Investments

The proposals contained within this section of the Consultation Paper would, if implemented, restrict category 1 credit unions to investments in bank deposits, Government bonds and other credit unions. The ability to invest in bank bonds, in equities (up to 5%) and, it appears, in collective investment schemes is removed.

The maximum term would be reduced from 10 years to 5 years and half the total investments would have to be under 3 years. This will have a detrimental impact on credit unions investment income and as mentioned above would also all but preclude credit unions from investing in State projects as envisaged by the Commission and permitted by the Act.

The minimum number of counterparties is increased from 4 to 6/7, by restricting the maximum permitted to be held in a single counterparty to the amount of the Regulatory Reserve. This proposal may well force credit unions to invest much more significant funds in institutions outside of the State which is not something they would wish to do; and this would also likely have a negative impact on investment income.

Category 2 - Investments

The proposals contained within this section of the Consultation Paper would if implemented restrict category 2 credit unions to investments in bank deposits, Government/Senior Bank and Corporate bonds and other credit unions. The ability to invest in bank bonds, in equities (up to 5%) and, it appears, in collective investment schemes is removed.

It is also proposed to reduce the maximum term from 10 years down to 7 years for all investments with the exception of Government bonds. Similar to the proposals for category 1 credit unions, the effect of the proposals would also be to increase the minimum number of counterparties from 4 to 6/7, by restricting the maximum allowed in a single counterparty to the amount of the Regulatory Reserve.

Although in theory Category 2 credit unions are being allowed to invest in Corporate Bonds (which are not allowed under the 2006 Guidance Note), by restricting the total combined amount allowable in bank and corporate bonds to the amount of the Regulatory Reserve, this significantly reduces any positive impact their inclusion may have on investment income.

This restriction on the bank/corporate bonds total will mean that only approximately 15% of a Category 2 credit unions total investments will be allowed to be in bank/corporate bonds. Therefore the rest, circa 85% will have to be in bank deposits and Government Bonds which is a much more restrictive position than the 2006 Guidance Note.

Possible impacts of investment requirements

The proposals around investments have the potential to have a massive financial impact on credit unions. League affiliated credit unions generated €662 million in income for the year to September 2013, with a total surplus of €240 million. Total investment income was €254 million, which represented a yield of approximately 3% on investments. This yield was partly due to longer term investments delivering reasonable returns in 2013, but investment rates are now declining sharply.

From the latest information available, the average rate available from Irish banks for deposits of 3 years duration has fallen to 1.73%, while the average rate available from Irish banks for deposits of 5 years duration has fallen to 1.93%.

The deposit interest rates available from counterparties other than Irish banks are likely to be lower than the figures outlined above. All of these factors mean that these additional proposed requirements would drive down investment income, at a time when credit union loan books and loan income are declining. While credit unions are making every effort to turn this lending trend around, this will take some time, and credit unions remain massively dependent on investment income.

Therefore as mentioned above we believe that at worst the 2006 Guidance Note on investments should be the starting point for both Categories and also Category 2 credit unions should be permitted to invest in Corporate Bonds to the same limits as laid down for bank bonds in the 2006 Guidance Note. Further restrictions are not required and would massively impact credit unions ability to generate income at this time.

5.4 Savings

The current limits on savings are:

(*a*) €100,000 on deposit; and

(*b*) €200,000 or 1 per cent of the total assets of the credit union, whichever is the greater for aggregate of shares and deposits.

The proposed limits on savings are:

Category 1 – the lower of €100,000 or 1% of the credit union's assets

Category 2 – maximum of €100,000

Therefore the proposed limits on savings are substantially reduced from the current position. The proposal is clearly linking the limit on savings to the limit protected under the Government Deposit Guarantee Scheme. Although it would appear prudent for an individual to limit savings in any institution to €100,000, it could be argued that a regulatory imposed restriction of this nature could potentially send the wrong message that there is a greater risk to members' savings in a credit union as there is no similar limit on savings in banks. Furthermore, such a limit may hamper growth in the credit union in the future and it is anti-competitive as these limits do not apply to other financial institutions.

Introducing a savings limit of €100,000 or 1% of assets for category 1, or €100,000 for category 2, could be a significant issue for a number of credit unions. Out of a total 2.8 million members, there are currently 2,860 members with balances over €100,000, and there are some credit unions with very large savings balances, mainly industrial credit unions. Savings in League affiliated credit unions increased by €110 million in 2013, and the potential flight of funds brought about by this new limit (if members with balances above €100,000 were to withdraw all their savings) would more than wipe out that growth. No similar limit is applied to bank customers, therefore the League does not see the need to impose this limit on credit unions.

Secondly, there are currently 95 League affiliated credit unions with assets below €10 million. These credit unions would have a savings limit **below** €100,000 if the 1% of assets rule comes

into force. The limit would be as low as €10,000 for the smallest credit unions. This proposal is therefore completely unacceptable.

Of the smallest credit unions, some examples:

- A credit union with assets of €1 million - Savings maximum set at 1% of assets would be €10,000. The largest share balance is €34,450 and all five of the top five member balances reported are > €10,000.

Of slightly larger credit unions, still with assets < €10 million some examples:

- A credit union with assets of €2.5 million - Savings maximum at 1% of assets would be €25,000. The largest share balance is €38,924 and all five of the top five member share balances reported > €25,000.
- A credit union with assets of €5 million - Savings maximum at 1% would be €50,000. The largest share balance is €91,135 and the CU has two members > €50,000.

Finally, the League would question the proposals to limit aggregate deposits to a percentage of shares. The Final Report of the Commission on Credit Unions made reference to "mature" credit union movements and in these movements savings are overwhelming held in the form of deposits. Deposits have a number of advantages over shares in terms of asset liability management, in that credit unions could offer term deposits or notice accounts which would reduce the amount of liquidity they would potentially need to hold.

5.5 Borrowing

As the Consultation Paper acknowledges, credit unions do not engage in borrowing to any significant extent therefore it would appear that proposals in this regard are largely irrelevant and therefore unnecessary.

5.6 Additional Services

This section of the Consultation Paper is seeking views on the further additional services that credit unions may wish to provide to their members. The League would recommend that the list of services be broad so that credit unions are facilitated to offer as wide a range of services as possible to their members. The League also believes that these additional services should be available to all credit unions. Suggestions would include the following:

- Debit cards
- Credit Cards
- Mobile banking
- Certain long-term savings products on agency basis

5.7 Governance

One of the proposals contained within the paper in relation to Category 2 credit unions is "that an external evaluation of the performance of the board of directors every three years". The League would make the following observations in relation to this proposal.

The requirement for Category 2 credit unions to undertake an external review of the performance of the board every three years is overly onerous. This is not necessary for credit unions as it is already the on-going function of the Board Oversight Committee. Questions also arise as to who would make the decision regarding the carrying out of this review and would the review be required to be submitted to the Central Bank. Furthermore, the Corporate Governance Code for Credit Institutions and Insurance Undertakings imposes a similar requirement only on *"major institutions"* and we would argue that Category 2 credit unions are not comparable to *"major institutions"* under this Code.

5.9 Reserves

The proposed operational risk reserve is excessive and therefore unjustified. At year end September 2013 200 League affiliated credit unions have Reserves above 15% so there is an extremely high level of capital already in the sector. The Central Bank suggests that this separate reserve would cover "other operational risk" not linked to loans such as investment losses (where a credit union may be allowed invest in wider range of investments) and other possible losses with more use of electronic payments EFT and other services. We believe current capital levels should cover this without the need for additional reserving.

It is further proposed that category 2 credit unions will be required to maintain a minimum operational risk reserve. Consideration is being given as to whether this will be based on (a) the Basel Basic Indicator Approach adapted for credit unions, which is likely to be 15% of gross income or (b) an additional specified percentage of assets, e.g. 2%.

It remains to be seen if other reserves could be transferred into this new operational reserve. The League feels that this additional reserving is totally unnecessary. If the 2% of assets operational reserve was applied to all credit unions, the total cost would be approximately €250 million. This figure almost matches the total surplus generated by League affiliated credit unions in 2013. If the 15% of income operation risk reserve was applied to all credit unions, the total cost would be €99 million based on 2013 income levels.

It is proposed that an operational risk reserve would apply to category 2 credit unions. There are currently 20 League affiliated credit unions with assets >€100 million. If the 2% of assets operational reserve was applied to those 20 credit unions with assets above €100 million in assets, the total cost would be in excess of €65 million (the largest individual cost for a credit union would be almost €6.5 million).

If the 15% of income operational reserve was applied to all ILCU credit unions above €100 million in assets the total cost would be almost €25 million (the largest individual cost would be €2.2 million).

Other institutions that hold capital on the basis of risk weighted reserving may have to hold an operational risk reserve. However, it is inappropriate to force credit unions to hold a Regulatory Reserve Ratio based on a percentage of assets and then compel them to also hold an additional operational reserve. The Regulatory Reserve Ratio is already higher than reserves held by other institutions on a risk weighted basis (even including any operational risk reserves they might hold) so it is therefore unfair and anti-competitive to force credit unions to hold excessive capital.

The League has previously proposed that it would be more appropriate for credit unions to reserve on the basis of risk weighted reserving e.g. Basel as opposed to the Regulatory Reserve Ratio. If an additional operational risk reserve is to form part of credit unions reserves then all of their reserves should be calculated based on risk weighted reserving. The proposed mix and match of a reserve based on a percentage of assets plus an additional risk weighted reserve is not appropriate.

The League believes it is timely and appropriate for the Registry of Credit Unions to completely reassess the basis for credit unions reserves. The Regulatory Reserve Ratio is a crude and blunt instrument which does not take any account of the risks faced by credit unions; i.e. it is a one size fits all approach. A credit union with a higher risk profile does not have to hold higher level of reserves than a credit union with a low risk profile. However, the League capital policy proposals which were overwhelmingly passed by the credit union movement at a League Annual General Meeting were based on Basel and designed to promote risk aversion as credit unions with riskier assets would have to reserve more. It is arguable that the Regulatory Reserve Ratio

can promote risk as credit unions are forced to chase income/return in order to build up and maintain large regulatory reserves.

As mentioned above the League's proposed approach was based on best international practice as developed by the Bank of International Settlements and also on how other credit union movements calculate reserve requirements. At the time of the introduction of the Regulatory Reserve requirements, the Registry did not provide any rationale to back up the Regulatory Reserve Ratio, nor does there seem to be any rationale other than a vague suggestion that this is what WOCCU advocate. In the past the Registry said that WOCCU requires reserves at 10% of total assets but this is only partly accurate. WOCCU suggests reserves at 10% for developing, unsophisticated credit union movements, but for more developed and mature movements such as in the Republic of Ireland, WOCCU feels that risk weighted reserving is appropriate.

5.10 Liquidity

The definition of liquid assets as included in the consultation is to be welcomed and is certainly helpful to those credit unions which hold investments of that nature. However, the proposal to increase liquidity requirements is unwarranted and, similar to the proposals around investments, will have a detrimental impact on credit unions' ability to generate investment income. Credit unions already hold high levels of a liquidity and while it may be prudent for certain credit unions to be requested to hold higher levels of liquid investments at certain times, there is no need for these requirements to be extended to the entire movement.

Also the apparent removal of Collective Investment Schemes in the investment proposals will make it much more difficult to implement both existing and any amended liquidity requirements.

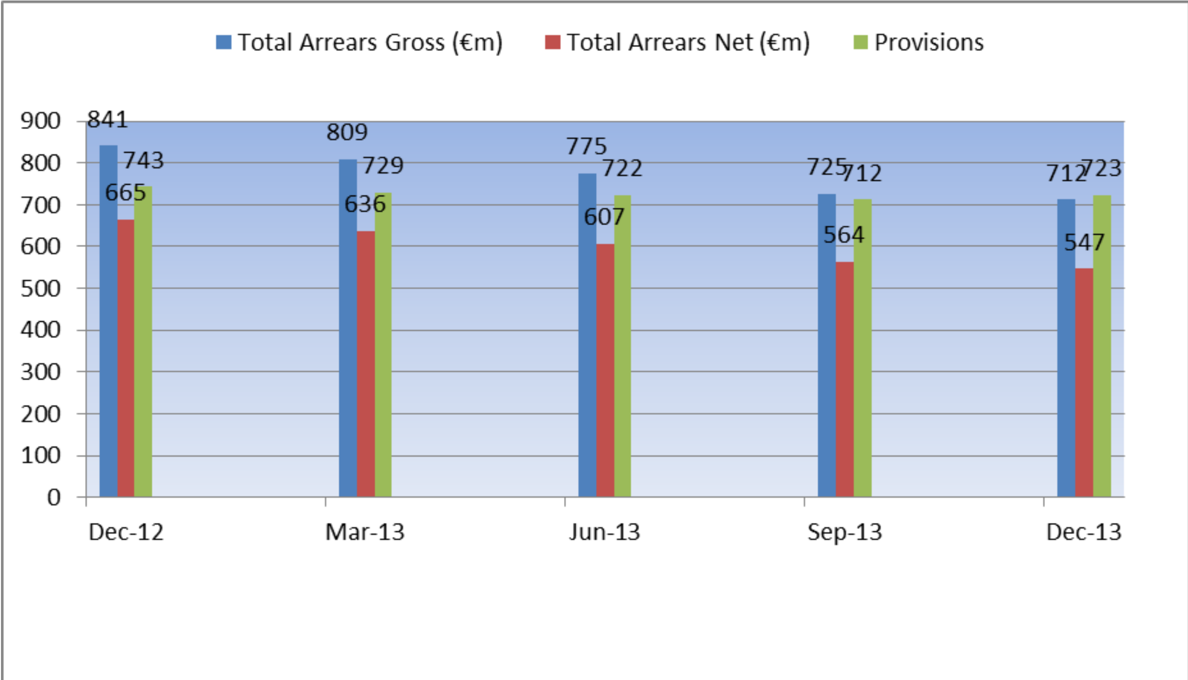
6.3 (i) Provisioning

Do you agree that a provisioning framework should be developed for credit unions as proposed in section 6.2? if you have additional proposals please provide them along with supporting rationale.

There is not enough information in the document to estimate potential costs or impacts of provisioning. The League expects that there will be much greater detail around the proposals relating to provisioning in the second consultation paper and the accompanying Regulatory Impact Analysis. However, the broad thrust indicates that Section 6 Provisioning may be an issue for credit unions. It states *"The Central Bank is also considering setting a requirement for credit unions to provide in full for a loan that has been delinquent for a specified period*". If this means 25 weeks +, that would be a significant issue, as this is how the roll rate methodology applies provisions. 100% provisions at the 25 weeks arrears point is not suitable for credit unions. The immediate impact would be additional provisions of in excess of €42 million based on September 2013 data. Any additional "roll rate" type provisioning proposals would have a much greater impact than this initial additional cost.

It should be borne in mind that credit unions are currently extremely well provisioned (detail below). The table below shows that from the very latest December 2013 quarterly data total loan provisions among League affiliated credit unions now exceed total gross loan arrears (provisions of €723 million which is above the gross loan arrears of €712 million). Regarding net loan arrears, there is now a buffer of loan provisions of €176 million above total net loans (provisions of €723 million which is above the net loans arrears of €547 million). It is also worth noting that total gross loan arrears are down €213 million from the peak arrears reported in December 2011 when gross loan arrears hit €925 million.

In light of the above therefore it is clear that no new provisioning requirements, or new factors applied to provisioning calculations, are necessary at this time.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7.2 Timeline

(i) Do you agree that the tiered regulatory approach should be introduced at this time? If you consider that alternative timing is more appropriate, please provide suggestions, along with the supporting rationale.

A general consensus emerged at the roadshows that the tiered regulatory approach should not be introduced at this time. The League would share this view and indeed it is recognised in the Consultation Paper that credit unions are currently undergoing significant change in implementing the requirements of the Credit Union and Co-operation with Overseas Regulators Act 2012. We would suggest that it would be sensible to allow the changes due to the Act to bed in and have ReBo complete its work before introducing the tiered regulatory approach. At this point, the League does not have a precise alternative timeframe in mind but this can be considered and decided upon during the course of the consultation process.

If it is considered that the tiered regulatory approach should be introduced at this time, do you agree with the proposed timelines for the introduction of the tiered regulatory approach set out in section 7.1, in particular the transitional period proposed between the publication and commencement of the regulations? If you have other suggestions please provide them, along with supporting rationale.

As outlined above, the League does not think that the tiered regulatory approach should be introduced at this time. However, whenever the tiered regulatory approach is introduced, the League would also expect that the transitional arrangements would allow credit unions to hold investments to maturity even if they are outside the parameters of the new proposals should they come into effect. Likewise, if the proposed savings limit comes into effect, the League would expect that members with balances above the revised limits would be able to retain those balances i.e. they would not be forced to withdraw funds above the revised limit.

4. Summary of feedback received from credit unions

As the Registry of Credit Unions is aware, the League held a series of six regional meetings for credit unions regarding the Consultation Paper on a Tiered Regulatory Approach for Credit Unions. There were two primary purposes for holding these meetings. Firstly, the League outlined to credit unions the most important aspects and recommendations contained within the Consultation Paper and secondly, feedback was sought from credit unions on the proposals.

All six meetings held were extremely well attended and much valuable feedback was received from credit unions. There were a number of recurring themes/issues that arose at each of the meetings and in some cases from many speakers present on the night. The issues raised are summarised below:

- Views were put forward that the entire approach is fundamentally flawed i.e. the Central Bank has gone way beyond its remit in that the Consultation Paper is not about tiered regulation but is instead about micro-managing credit unions. For example, the CBI is attempting to set rules for all credit unions but this amounts to micro management and should be fought by all credit unions.

- Feedback was also received that the proposals amount to an attempt to "restrict the life" out of credit unions. This was referred to as suffocating supervision at a time when revenue is decreasing, costs rising and it will directly affect the service to members, dividends and interest rebates. The proposals are also an attempt to restrict the supply of future volunteers and with all this increased regulation and standards who would become a volunteer?

- Many credit unions felt that the introduction of a tiered regulatory approach is being used by the Central Bank as a method of implementing further restrictions on the credit union movement.

- It was also widely felt that the tiered regulatory approach proposals do not implement tiered regulation as credit unions would have expected or indeed the Commission envisaged. It was anticipated that smaller credit unions with simpler business models would be subject to simpler regulation but that is clearly not the case under these proposals.

- It was highlighted that the aim of the Commission and the view of stakeholders and the Department of Finance was that tiered regulation should be a positive, and that smaller simpler credit unions would have simpler less intrusive regulation. Credit unions are already tightly regulated as it is, for example the PRISM framework is in place now. The Commission envisaged that the majority of credit unions would be in the lower tier and they should expect the current "status quo" level of regulation, not additional levels of regulation. There should be no confusion on what was agreed at the Commission and the Consultation Paper is not what was agreed by the Commission. The CBI has misinterpreted what tiered regulation should be about, and takes no account of the changing landscape for credit unions.

- It was observed that Section 35 was brought in some time ago, and is still causing issues and it is difficult to get this changed. When something new comes in, one can only see if it works at some time in the future. If the proposals contained within the Consultation Paper do not work, will it be possible to change them? Will the Central Bank stonewall the credit union movement when change is requested?

- It was also suggested that if there is to be a new model for bad debt provisioning then this should be driven by the representative bodies and not the Central Bank.

- The question also arose as to "Why would a credit union want to move to category 2 status? as they would need dedicated Internal Audit, Risk and Compliance functions and board reviews would take place. Why would a credit union apply for category 2 when they are not allowed offer much in additional services? There are some allowances for commercial lending and longer term mortgage type lending, but credit unions do not, in the main, partake in this".

- The view was expressed that the focus should be on the long term viability of the credit union movement, the Consultation Paper seems instead to be aimed at shrinking the movement. For example the proposed savings limit will have the impact of shrinking credit unions. The limits on credit unions in general are being tightened and tightened.

- Comments were made querying why the Central bank is requesting supporting rationale for the views from credit unions when much of the Consultation Paper provides no rationale for the proposals contained within it.

- It was stated that the introduction of Internal Audit, Risk and Compliance, Fitness and Probity etc. illustrates that the Central Bank anticipates the need for further checks in these areas to limit, reduce or curtail risks. If that is the case then why is all that is proposed within the Consultation Paper necessary regarding further regulations, greater reserves etc.? Does the Central Bank feel that Internal Audit, Risk and Compliance etc. will not in fact do their jobs and therefore further reserves will be required?

- With regards to proposals on lending, credit unions expressed the view that the concentration limits on commercial and community lending are unnecessary and unworkable. The view was also expressed that the definition of commercial lending should be split to define commercial, covering small business/sole trader, versus large scale commercial lending.

- Credit unions also expect that any new lending limits that come into effect as part of the introduction of a tiered regulatory regime will mean an end to the ad-hoc imposition of lending restrictions on credit unions.

- Credit unions object in the strongest possible terms to the proposals around the creation of restricted persons limits under lending. It was felt this is a very important issue that will affect boards, staff and family members hugely. Why should good members be penalised for no good reason? It was also felt that this proposal would make it more difficult to attract volunteers for the board of directors. The definition of family is so broad as to make the proposal completely unworkable especially for smaller credit unions.

- It was emphasised that this requirement would create a "2nd class" of membership, it was acknowledged there is a need for additional controls for officers' loans, but the current controls regarding loans to officers etc. are fit for purpose.

- Many credit unions had huge concerns about the proposals on investments. It is widely felt that the proposals will have a significant effect on the returns that credit unions will be able to generate on their investments. The effect in some cases could even threaten the viability of the credit union.

- Specifically, credit unions stated that the proposal to link the amount held in any counterparty to Regulatory Reserves would mean that credit unions would have to hold investments with six or more counterparties as opposed to the current number of four. Credit unions are unhappy with this proposal on two fronts, firstly it will force them to

invest funds outside of Ireland which they would not wish to do and secondly it will potentially have a negative impact on their return on investments.

- Credit unions should be permitted to invest in collective investment schemes, particularly as this would facilitate investment in State projects as envisaged by the Commission.

- Credit unions are also unhappy with the proposed limits for Category 1 credit unions in particular i.e. the proposals to reduce the maximum investment term from 10 years down to 5 and also the proposed requirement to half total investments under 3 years.

- Likewise it was stressed that the proposals to increase the liquidity requirements will impact negatively on credit unions investment income.

- The overwhelming responses received are that the proposed savings limit of €100,000 per member would be very restrictive and affect a lot of members. It was also felt that this is another example of the Central Bank trying to damage or restrict credit unions and it was time credit unions stood up and were counted.

- Credit unions are also not be in favour of the proposed restrictions on deposits for members. Among the reasons advanced was that savings are more commonly held by way of deposits in mature credit union movements. Also deposits potentially can counteract the raised levels of unattached savings currently held by credit unions as a result of lower borrowing levels as credit unions could offer fixed term deposit accounts/notice deposit accounts etc.

- Much concern was also expressed at the proposed requirement that each credit union will have to maintain an additional reserve that it has assessed is required for operational risk having regard to the nature, scale and complexity of the credit union. Feedback in this

regard was that credit unions are already extremely well reserved (better than other financial institutions) and therefore this proposed reserve is unnecessary. Concern was also expressed that credit unions will be unable to pay a dividend if all of their surplus has to go to reserves and that members would then begin to move their savings out of credit unions in search of a return.

- A number of credit unions expressed concern that the timeline for implementation of the proposed tiered regulatory approach is too short given all of the other changes that credit unions are having to deal with as a result of the implementation of the Credit Union and Co-operation with Overseas Regulators Act. A suitable period of time should be allowed for credit unions to bed in these changes before having to understand and prepare for a tiered regulatory system.

5. Further Information

The League will be happy to provide additional information if required. Contact details for the purposes of this submission are:

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