Collaborative Finance CLG

Central Bank review of the lending framework for credit unions

Submission in relation to the Regulatory Limit on Business Lending of 5% of Total Assets for Credit Unions under €100m

Summary
Collaborative Finance ("CF") recommends that the Central Bank of Ireland ("CBI") amends the 2019 Regulations in one specific respect: removal of the requirement that a credit union must have assets of at least €100 million ("€100m threshold") in order to apply to the CBI for a concentration limit of 15% for mortgage and business lending combined.

This recommendation is based in the main on the following key points:

- The €100m threshold is contained in regulation. This contrasts with the position regarding the requirements for the provision of current accounts, which are not set in regulation and are therefore more dynamic and responsive to an evolving environment. Because the €100m threshold is set in regulation, affected credit unions have no pathway to apply for a higher limit.
- Through its concept of "earned flexibility", the CBI can (where deemed appropriate) support credit unions to deliver a broader range of products than is currently provided for in legislation or regulation. Using its statutory and regulation-making powers, the CBI can facilitate changes to the credit union business model where prudentially justified. The CBI has indicated that use of the concept of "earned flexibility" is contingent on credit unions taking ownership of their business model development.
- The CBI has linked the concept of "earned flexibility" to "sectoral collaboration through a shared services approach", which the CBI has stated "can offer the benefits of access to scale and cost economies, unattainable for individual credit unions".
- In less than five years, Cultivate has established itself as the national credit union farm loan brand. It has demonstrated to the farming establishment and the farming community that it is a real alternative to traditional banks for the provision of farm finance. It has been warmly welcomed and is taken seriously in the farming industry, which is the backbone of rural Ireland.
- Cultivate has achieved this by means of "sectoral collaboration through a shared services approach". It has achieved for its participating credit unions "the benefits of access to scale and cost economies, unattainable for individual credit unions".
- Due to the success of this collaborative venture, some Cultivate Credit Unions that are below the €100m threshold are approaching the 5% Limit. We do not yet have the data to confirm exact numbers, but we can confirm the following:

    - At least a handful of credit unions are materially affected by the 5% Limit, such that they have had to restrict access to or promotion of Cultivate farm loans. These credit unions now face reputational damage in their communities as a result of having raised expectations that they cannot now meet. This is in addition to the negative financial and business consequences for the credit unions of restricting lending in a growing new market.
    - There are a number of credit unions not offering Cultivate farm loans who we understand are approaching or are affected by the 5% Limit. These credit unions have no incentive to join Cultivate because they have no capacity to grow their business loan books. As a consequence, these credit unions remain outside Collaborative Finance and are deprived the benefits of access to scale and cost economies that participation in a shared-services structure entails.

- It requires a significant commitment of resources of all types (human, financial, time, technological) for a credit union to enter a new lending market such as agri-lending. When assessing the business case for entering this new market, a credit union less than €100m in assets must take into account the regulatory restriction which limits its exposure to this new market to 5% of total assets. Anecdotally, we know of credit unions that have decided not to join Cultivate and offer farm loans because of the 5% Limit.

5% Limit is a barrier to loan growth and diversification

We are currently gathering data on the Cultivate loan books of member credit unions. Once it is compiled we will send a report to the CBI. We know that for at least some credit unions the 5% Limit is a real and material impediment to further loan-book growth and diversification. CF acknowledges that a small number of credit unions is not material in the context of sector-wide performance or sector-wide averages. But adopting only a macro-approach to reviewing the extent of business lending among the country's credit unions is to ignore the reality that we don't operate in a world of averages. And that different credit unions will adopt different strategies to business model development and loan-book diversification.

The 5% Limit is a barrier to loan growth and diversification for the credit unions that have put in the systems, practices and hard work to grow their agricultural/business loan book. These credit unions are now victims of their own success. They are restricting their lending in a market that they have carefully cultivated over the past five years, through the business model that Cultivate provides and enables. After investing in their systems, capabilities, IT environment and staff (training and in some cases recruitment), these credit unions now face the reputational damage in their communities of having raised expectations that they cannot meet. And they face the negative financial and business consequences of having to restrict lending in a growing new market where they have established a foothold and a reputation.

Cultivate in Brief

- Launched in 2017 as an initiative of four Co. Galway credit unions
- Within two years, by March 2019, there were 26 credit unions offering Cultivate farm loans
- Growth in numbers stalled during the first year or so of Covid-19 and resumed in late 2021
- By December 2023, Cultivate's profile was as follows:

    - 51 credit unions offering Cultivate loans
    - Though a network of over 150 credit union offices
    - In 23 of the 26 counties in the Republic of Ireland
    - Over €100 million lent in Cultivate loans
    - Combined assets of the 51 credit unions amount to €7.1 billion

Collaborative Finance CLG

Collaborative Finance Company Limited by Guarantee ("CF") is a collaborative structure through which participating credit unions collaborate in the development, delivery and marketing of loan products and brands. Its best-known brand is Cultivate, which is now recognised as the national credit union farm loan brand. Further information on Collaborative Finance is provided later in the submission.

Regulatory Lending Limits

The Credit Union Act 1997 (Regulatory Requirements) (Amendment) Regulations 2019 ("2019 Regulations"), as implemented in January 2020, prescribed a limit for credit unions in respect of their combined total amount outstanding in relation to house loans and business loans as a percentage of a credit union's assets.

The prescribed limits in the 2019 Regulations in respect of all credit unions is a concentration limit of 7.5% of total assets (7.5% Limit). For credit unions meeting specified objective criteria a limit of 10%

of the credit union’s total assets may apply (10% Limit). Within both the 7.5% Limit and the 10% Limit, no more than 5% of total assets can be in respect of business loans. In addition to the 7.5% Limit and the 10% Limit, credit unions having total assets of at least €100m may apply to the Central Bank of Ireland (“CBI”) for a concentration limit of 15% of total assets (15% Limit), under which there is no inner limit.

Review of the lending framework for credit unions

The Central Bank is undertaking a review of the lending framework for credit unions, as committed to in its Feedback Statement on CP125. The purpose of this review is to analysis and assess the impact which the changes introduced in 2020 have had on credit union lending and to inform on the need for future changes.

Focus of this submission

This submission from CF focuses solely on the business lending limits that apply to credit unions with assets less than €100m, for the following reasons:

- Cultivate has no role in house loans. Cultivate is confined to business lending to farmer members of credit unions.
- Cultivate credit unions with assets greater than €100m can apply to the CBI for the 15% Limit, under which there is no inner limit on business or house loans.
- However, Cultivate Credit Unions with assets less than €100m have a strict upper limit of 5% of assets for business lending. This 5% Limit is set by CBI regulation and no pathway is open to affected credit unions to apply for a higher limit.

Earned flexibility

Speaking at the CUMA Spring Conference in April 2018, the Registrar of Credit Unions, Patrick Casey, outlined and explained the concept of “earned flexibility”. At the outset of his address, he stated that one of the four key areas he would focus on in sharing his perspective on “addressing sector sustainability” was “earned flexibility”.

Under the heading “**Taking ownership of your business model development**”, the Registrar stated:

“Responsible business model change requires clear ownership by you of the development of your business model, and where necessary, regulatory support by us through an earned flexibility approach.”

The Registrar elaborated on this concept of “earned flexibility” as follows:

“Under our statutory and regulation making powers, we can facilitate changes to the credit union business model and balance sheet where prudentially justified. These powers enable us to set and amend prudential limits, and exempt low risk initiatives from needing approval. They also allow us to approve new services through our additional services framework for those credit unions with the capabilities and financial strength. We call this earned flexibility, which means facilitating strong credit unions in safe hands to develop their business models and transform their balance sheets.”

The Registrar explained how the CBI can use the approach of earned flexibility to facilitate prudent development in credit unions that demonstrate “a clear vision and the capability to successfully implement that vision”:

“We can further enhance this approach by facilitating prudent development in those credit unions that can demonstrate a clear vision and the capability to successfully implement that vision. As mentioned earlier, this approach of earned flexibility supports those stronger credit unions to deliver a broader range of products than is currently provided for in legislation or regulation.”

Still on the subject of “Taking ownership of your business model development”, the Registrar stated:

“Sectoral collaboration through a shared services approach can offer the benefits of access to scale and cost economies, unattainable for individual credit unions.”

Regulation versus Guidance

Note: We acknowledge that the comments in this section require further elaboration.

The lending limits that apply to credit unions are set in regulation, specifically the 2019 Regulations. In contrast, the requirements regarding the MPCAS offering are set out in RCU guidance. Originally, the CBI’s expectation was that the provision of current accounts would be confined to credit unions with a minimum of €75m in assets and a membership of at least 15,000. Within a relatively short space of time, this expectation evolved in response to MPCAS applications from credit unions below these thresholds. If the minimum thresholds for applying for MPCAS had been set in regulations, the CBI would not have been able to respond to a dynamic situation as it evolved. Because the €100m threshold for business lending is set in regulation, the CBI is not able to respond in the flexible, responsive manner that it did in relation to MPCAS.

The case for “necessary, appropriate and prudent adjustments”

The changes brought about by the CBI’s extensive review of the lending framework for credit unions in 2018, that resulted in the 2019 Regulations, were at the time very welcome. The 2019 Regulations aided credit unions in engaging in new areas of lending and increased exposure to longer term lending. This facilitated credit unions in moving away from an overconcentration in the traditional personal loan base to a more balanced loan portfolio with increased lending, while doing so in a prudent way. To this end the Regulations have served the sector well, as can be evidenced in the positive development of the loan-books of Cultivate Credit Unions.

However the CBI, in permitting only credit unions having total assets of at least €100m apply for an increased concentration limit of 15%, precludes credit unions under 100m from making an application to allow them to lend out more than 5% in business lending. Collaborative Finance requests the CBI to review this, and in doing so, is mindful that at the time of the implementation of the 2019 Regulations the CBI advised in the Feedback Statement on CP125 - Consultation on Potential Changes to the Lending Framework for Credit Unions (“CP125 Feedback Statement”) that “the significant and fundamental structural changes being made to the framework lay the groundwork for potential future changes”.

The CBI stated that it was “*of the view that a gradual stepped approach to providing additional capacity to credit unions for house and commercial lending is appropriate. Where conditions in the sector are such that there is an evidence basis to adjust capacity in the future, this could be achieved by amending the level of the limits.”* The CBI elaborated:

“Such conditions would include clearly articulated strategies, sustained delivery of viable house and/or commercial lending business lines, demonstrated alignment of credit unions’ risk appetites with business model strategies, highly developed competence and capability, fully embedded governance and risk management frameworks, well established and operationalised shared service type structures and financial resilience.”

Finally, the CBI stated: *“In this regard, we remain committed to re-evaluating the capacity provided for house and commercial lending as the sector evolves and to making any necessary, appropriate and prudent adjustments”.*

As stated in the Summary above, CF recommends that the CBI amends the 2019 Regulations in one specific respect: removal of the requirement that a credit union must have assets of at least €100 million in order to apply to the CBI for a concentration limit of 15% for mortgage and business lending combined

In making the case for this change, the remainder of this submission will address each of the conditions stipulated by the CBI in the CP125 Feedback Statement. Our purpose is to show that the evidence basis exists to warrant adjusting capacity in respect of the 5% Limit by removing the €100m threshold.

Conditions stipulated in CP125 Feedback Statement

1. Clearly articulated strategies

Cultivate's main strategic objectives are to expand on the existing range of loan products for the farming sector and to grow the loan-books of participating credit unions. Cultivate believes that (i) this can be achieved by offering an outstanding experience to the farmer credit union member, and (ii) by working collaboratively together credit unions are in a in a stronger position to achieve this aim and develop the credit union model.

Central to Cultivate's success is that, while it is a standardised and commonly branded offering to meet the specific defined credit needs of the farming community, it is not static. Cultivate continues to grow and be shaped by its own success. As more credit unions join Cultivate they bring new lifeblood into the group, and together the participating credit unions continuously collaborate on the model, development, marketing and delivery of the agri-financial services offering. This process ensures that Cultivate remains relevant and viable.

The most recent manifestation of this process of business model development was the introduction of a secured farm loan offering in 2023. Named Cultivate Secured, this new product was developed by a working group of Cultivate Credit Union CEOs and senior lending managers, many of whom had previous experience of secured agri-lending. It is being rolled out incrementally in response to the demand of member credit unions. It provides finance for large-scale capital expenditure including land purchase and farm infrastructure up to a maximum of €300,000 and a duration limit of 30 years.

Cultivate's strategy is set out in the template Business Case each participating credit union must complete prior to joining Cultivate. This detailed business analysis includes a rigorous analysis of the potential for farm lending in the credit union's common bond as well as setting out how Cultivate will enhance the credit union's business model.

2. Sustained delivery of viable house and/or commercial lending business lines

The introduction of the new lending rules for credit unions under the 2019 Regulations has enabled credit unions to achieve greater diversification in their loan-books and increase their business lending portfolios. Cultivate has been a major contributing factor in the growth of business lending credit unions. Cultivate has appealed to two cohorts of credit unions:

- Those who were not offering farm loans at all, for various reasons including lack of expertise and experience: For these credit unions, Cultivate has been the gateway into and vehicle for delivering farm loans to their members.
- Those who were offering farm loans on an independent basis: These credit unions have joined Cultivate for two main reasons: (i) the importance of being part of the evolving national credit union brand for farm lending; and (ii) the operational, risk management and other benefits of being part of group of credit unions that are offering a standardised, established, robust loan offering.

The sustained, upward trajectory of Cultivate from its origins in 2017 with four credit unions in Co. Galway is confirmation of the success of Cultivate and its role in the sustained delivery of viable commercial business lines over the past six years.

3. Demonstrated alignment of credit unions' risk appetites with business model strategies

In the first instance Cultivate as a farm business loan helps credit unions address the traditional lack of business lending in their loan portfolio. Credit unions have traditionally focused on personal lending. Prior to the inception of Cultivate, while individually credit unions had experience of providing loans for agricultural purposes, lending to farmers had not been significant in the sector. The Cultivate initiative had at its genesis the need for credit unions to develop their business models and a desire by credit unions to meet the growing needs of current and potential members. Following an initial analysis of common bonds and detailed market research, it was identified that a significant cohort was not being served and that many of them did not regard credit unions as an option for farm lending.

From its initial conception as a pilot project by four Galway credit unions, Cultivate has seen the success of having a standardised and commonly branded offering to meet the credit needs of the farming community. A single, standardised and tailor-made farm loan offering with a high-quality member experience has proven attractive to farmers. In turn the popularity of Cultivate with farmers has enabled Cultivate Credit Unions to diversify and grow their loan-books in a prudent way.

In addition, through Cultivate it became clear to participating credit unions that by working together they could provide more credit solutions than by working individually. The Cultivate model has since been used to develop Greenify, which is a standardised loan offering for home energy upgrade loans. This remains a central tenet of Cultivate – Collaboration in Action. There is strength in numbers and in working together.

In order for a credit union to join Cultivate it must first engage in a thorough knowledge-gathering process. Cultivate deem it essential that a credit union understands the business of farming, the credit needs of farmers, and the strengths and weaknesses of existing competitor offerings. Each credit union must identify the key stakeholders in their area and conduct a comprehensive consultation process with them. This collaborative process happens before the launch of the loan product and continues post-launch as a way of retaining engagement with and relevancy to the farm loan market. This stakeholder engagement is a key part of Cultivate Business Case prepared by each Cultivate Credit Union. The Business Case requires Cultivate Credit Unions to have completed a thorough appraisal of the initiative, considered the inherent risks, the costs and the benefits, prior to joining Cultivate.

This strong emphasis by Cultivate on comprehensive business case assessment means that for Cultivate Credit Unions their desire to grow their loan-book through participation in Cultivate requires them to thoroughly assess their risk appetite for farm business lending in a very calibrated and strategic manner to ensure that it is aligned with the Cultivate loan product. This alignment of risk appetite for business lending and offering the Cultivate loan product begins for credit unions prior to joining Cultivate and continues as part of their participation in Cultivate, which maintains as a core goal prudent credit union business model development.

4. Highly developed competence and capability

Since its inception, Cultivate has put a strong emphasis on developing the farm knowledge and agri-lending underwriting skills of participating credit unions. As part of the onboarding process, new credit unions must participate in a bespoke Farm and Farm Finance Course that was developed by Teagasc in conjunction with and solely for use by Cultivate. Teagasc – the Agriculture and Food Development Authority – is Ireland's national body providing integrated research, advisory and training services to

the agriculture and food industry and rural communities. This foundation course is supplemented on an ongoing basis by refresher courses, online webinars and industry-relevant information sessions.

Also since its inception, Cultivate has had the benefit of the services of a single Project Manager who is a highly experienced and senior agri professional. A retired Regional Manager of Teagasc, the Project Manager has overseen the onboarding of all 51 credit unions that currently offer Cultivate. Due to Cultivate's growth and mindful of the risk of "key person dependency", in early 2023 this Project Manager was joined on the Project Management Team by a second person, who is also a former Teagasc Regional Manager. This Project Management Team provides ongoing support services to all Cultivate Credit Unions.

A key factor in the success of Cultivate has been our relationship with Visualyse, which is an end-to-end loan assessment system. As part of the onboarding process, new credit unions must adopt Visualyse and use it as part of their credit underwriting and loan assessment process for Cultivate loan applications. The excellent performance of Cultivate loans from an arrears perspective is due in part to Visualyse.

5. Fully embedded governance and risk management frameworks

As explained under items (1) and (3) above, each credit union must prepare a Business Case as part of the onboarding process. The Business Case is a detailed and comprehensive document that covers all the relevant areas including: financial analysis; farm statistics; market research and analysis; project costs; cost-benefit analysis; stakeholder engagement; project plan; data protection; loan underwriting; risk assessment and risk management; lending policy and credit management policy; training and marketing.

The Board of Directors of each credit union approves the participation of their credit union in Cultivate by adopting the Business Case and executing the documentation regarding membership of CF.

The risk management, compliance and internal audit functions of participating credit unions monitor the Cultivate loan offering and the performance of the Cultivate loan-book, either on an ongoing or ad-hoc basis.

As stated under item (3) above:

"This strong emphasis by Cultivate on comprehensive business case assessment means that for Cultivate Credit Unions their desire to grow their loan-book through participation in Cultivate requires them to thoroughly assess their risk appetite for farm business lending in a very calibrated and strategic manner to ensure that it is aligned with the Cultivate loan product. This alignment of risk appetite for business lending and offering the Cultivate loan product begins for credit unions prior to joining Cultivate and continues as part of their participation in Cultivate, which maintains as a core goal prudent credit union business model development."

6. Well-established and operationalised shared service type structures

Cultivate is based on a shared service structure. Cultivate is generally acknowledged as one of the success stories of the Irish credit union sector in the past decade, and this success is based on the collaborative nature of the venture.

All Cultivate Credit Unions are members of Collaborative Finance. Incorporated on 3 September 2018, CF is a not-for-profit company in which each credit union is an equal shareholder with equal voting rights. Member credit unions are divided into three geographical regions. Each region elects two senior credit union officials to the Board of Directors. Five of these six member-elected directors are credit union CEOs. The independent Chairperson of the Board of Directors is Joe Healy, former President of the Irish Farmers' Association and one of the most influential people in Irish agriculture.

The purpose of CF is to provide marketing and associated support services to its member credit unions. From the outset, the emphasis in CF/Cultivate has been on Collaboration in Action. In other words, ***operationalised shared services.*** To date, two loan brands have been developed and delivered: Cultivate (including the sub-brand Cultivate Secured) and Greenify. A key principle at work in the operation of CF's activities is: "Centrally Designed, Locally Delivered". CF has well-established working relationships with its three main third-party service providers in the areas of Project Management, Marketing and Financial Administration. Through tight controls and streamlined operations, CF delivers excellent products and services to its member credit unions in a cost-effective way in which the emphasis is always on delivery.

CF's business model uses economies of scale and sound business acumen to achieve results collectively that would not be possible for individual credit unions, no matter how big.

To illustrate this point, until the past few years the farming sector in Ireland did not regard credit unions as being relevant to their industry. Farmers and their representative bodies thought only of traditional banks when thinking about finance and credit. The credit union was somewhere that their children put their First Holy Communion money. Cultivate Credit Unions began their first joint marketing campaign with a modest budget in July 2019. By March 2021, less than two years later, Cultivate was being recognised by the farming sector as part of the consideration set when it came to thinking about farm finance. That is the power of collaboration. The power of **well-established and operationalised shared service type structures.**

7. Financial resilience

Cultivate is contributing to the financial resilience of member credit unions. A number of member credit unions have stated that, without Cultivate, they probably would not now exist as independent credit unions.

There are a number of measures and metrics that confirm the contribution of Cultivate to the financial resilience of member credit unions. Among these are:

- Diversification of loan book – reduction in concentration on traditional personal lending market.
- Growing loan book – in the main, business lending including agri-lending is a new market for credit unions. It has contributed to the recent growth in credit union lending.
- Income generation – stating the obvious, a growing loan book results in an increase in loan interest.
- Improving loan to asset ratio – again stating the obvious, growth in this new market of business lending is contributing to the improvement in the overall loan to asset ratio of credit unions that engage in business lending.
- Increase in size of average loan – the size of the average Cultivate loan is three times the size of the average credit union loan. This is an important contributor to reducing the churning of credit union loan books and thereby to the financial resilience of credit unions.

Not all Cultivate Credit Unions are achieving the same results. And it would be unrealistic to expect that they would. It is important to remember that the model is based on the principle of "Centrally Designed, Locally Delivered". During the onboarding process for every new member credit union, the Project Management and Marketing Teams emphasise that "The real work begins now". In other words, the success or otherwise of the loan brand (Cultivate or Greenify) will depend on the credit union's own efforts and commitment. CF's services are enablers – it is up to each individual credit union to use these enablers to deliver the desired outcome: a growing, diversifying, sustainable, well-performing loan-book.