Submission to the Central Bank of Ireland in respect of Consultation Paper CP88 on behalf of Mitchelstown Credit Union Limited.

27TH February 2015

Introduction

While we would agree that there are a lot of positives in the CP88 document 'Consultation on Regulation', we do have a number of areas of concern, particularly in relation to the proposed lending limits, and we will go through these in this submission. Mitchelstown Credit Union accepts that certain sections of the 2012 Act have not yet commenced, specifically those in relation to the Regulation making powers of the Central Bank in respect of Reserves, Investments, Liquidity, Borrowings, Loans and Savings and we welcomes this consultation process in relation to these key areas of Credit Union Business.

Mitchelstown Credit Union fully accepts that key prudential limits must be in place. However, we also believes that it is crucial that new regulations introduced are proportionate and fair and to not stifle a credit unions growth potential.

The 'Consultation Protocol for Credit Unions', issued on 27 November 2012, states that a regulatory impact analysis ("RIA"), which will contain an examination of the impacts of new regulations and consideration of alternative options, will be carried out by the Central Bank, where practicable, when consulting on new regulations.

The Central Bank sought the views of a sample of 31 credit unions to provide, on a voluntary basis, certain information required to conduct the RIA. There are currently 385 credit unions registered in the Republic of Ireland with total members reported to be in the region of 3.1 million. We are concerned that the 31 credit unions chosen by the Central Bank for the RIA, represents, in number terms, only 8% of the total number of Credit Unions, which to us appears very low and not a true representative sample of the wider movement. The proposed regulations and limits have far reaching implications for the Credit Union movement going forward and Mitchelstown Credit Union is of the view that a larger number of Credit Unions should have been involved in the RIA in order to ensure that differing views, stages of development, products and services offered, member demographics, were taken into account when drafting the proposed regulations.

While Mitchelstown Credit Union agrees with many of the proposals, it has serious concerns on the existing and proposed lending proposals, lending limits and future restrictions on credit union loan growth. Mitchelstown Credit Union is of the view that more work needs to be done to predict what the effect the proposed regulations in relation to loans will have on all credit unions in the future.

Reserves

Mitchelstown Credit Union agrees with a Minimum Regulatory Reserve of 10% of Gross Assets. However, we would recommend that the required regulatory reserve of a Credit Union should be calculated on a **Risk Weighting of Assets approach**, with a Minimum Regulatory Reserve Requirement of 10%

In line with having a Risk Weighting of Asset approach we believe that the requirement of transferring 10% of surplus to the Statutory Reserve should be removed if the reserves are high enough.

We do not see a need for the introduction of an 'Operational Reserve' for new Credit Unions. This is likely to make it impossible to establish new credit unions in future, because the reserve requirement is so onerous and subjective.

Liquidity

Mitchelstown Credit Union agrees with a Minimum Liquidity Rate of 20% on unattached Savings (or 30% in respect of S35 approved Central Bank Extension limits in respect of 40% lending over 5 years)

Mitchelstown Credit Union Ltd. does not agree with the proposed new Short Term (Less 7 Days) Liquidity requirement of 10% of unattached or unpledged Savings. We believe this 10% requirement is too high as

1. It will result in a Credit Union losing further Investment Income, and a Credit Union could end up paying a Bank to hold its short term funds
2. It is contrary to the principles of a Credit Union to 'protect member savings', when it could cost members money to hold funds short term
3. Having funds available short term in Bank Current Accounts does not mean a Credit Union can 'physically' gain access to these funds on demand, should the need arise. Mitchelstown Credit Union with €56.4 million in unpledged Savings, is required to hold liquidity of €11.28 million short term (3 months or less), which will include, under the new proposals, €5.65 million (or 10%) for 7 days or less. There is no way that the local retail banks would have access to €5.65 million cash on demand, should our members require it. Mitchelstown Credit Union would have to order cash of this magnitude from the Banks, and considering it takes 7 days to get 50k in cash from the bank it would take a considerable amount of time to get this amount in cash. Credit Unions can sometimes have severe difficulty getting cash from Banks, particularly around Christmas time. Members, of course, can have funds transferred immediately by EFT, but many still prefer cash.
4. We welcomes the changes in the definition of 'Liquidity', to include Bank Current Accounts. However, where funds are held long term, Banks can be very reluctant to confirm, in writing, that a certain portion of funds can be available on demand, if required. In addition, banks have ceased to offer term deposit accounts with access at particular intervals.
5. Mitchelstown Credit Union strongly believes that **Irish Government Gilts should be included in the definition of Liquid Assets**, as these are very tradable instruments and can be sold quickly. We do accept that these Gilts will then have to be accounted for or a 'mark-to-

market' basis. The Draft Regulations are silent on this issue and Mitchelstown Credit Union would like clarification from the Central Bank in respect of the proposed treatment of Government gilts.

Lending

1. Mitchelstown Credit Union agrees with the proposal to reduce the loan large exposure limit to 10% of its Regulatory Reserve. Clarification is needed to confirm whether this 10% of the Regulatory Reserve relates to the 10% Minimum Regulatory Reserve Requirement or the actual Regulator Reserve held by a Credit Union, which could be say, 15%.
2. Mitchelstown Credit Union is strongly of the view that the Current Limits on Lending (30% or 40% over 5 Years, 10% or 15% over 10 years) are too restrictive, very damaging to a credit union's loan growth potential, and will have serious financial consequences for credit unions in the medium to long term. Mitchelstown Credit Union does not agree with the proposed concentration limits for categories of loans.
1. The consultation paper does not make clear how the Central Bank consider that this is a "*proportionate*" approach to Regulation making (as required by Section 84A[1] of the Act)

A credit union which currently has a low loan to asset ratio (Say 25%, or less) will find it very difficult to grow its loan book up to say 50% of its assets, even with the current lending limits in place. It will find it harder again if the proposed new limits are introduced.

For example: Credit Union A, with €100 million in gross Assets, if 25% lent out, will currently have a loan book of €25 million. Credit Union B, with a €100 million in gross assets, if 50% lent will currently have a loan book of €50 million.

If allowed to lend 30% over 5 years, then Credit Union A can have loans outstanding to a maximum of €7.5 million over 5 years, and Credit Union B can have loans outstanding over 5 years to a maximum of €15 million. (If allowed to lend 40% over 5 years, Credit Union A can lend a maximum of €10 million, and Credit Union B, €20 million). The only way Credit Union A can grow its loan book up to Credit Union B's level is to lend quality business over 5 years for Commercial / Business loans; Home Loans; Secured loans, or other long term structured products. It is not going to grow its loan book significantly if it has to rely on small ticket, personal loans, with a duration of 5 years or less. The proposed lending regulations say that a credit union can only lend 50% of its Regulatory Reserve for Commercial Loans. In the example above, the €100 million credit union will have a Minimum Regulatory Reserve of €10 million (10%), of which its maximum exposure to Commercial Loans is €5 million (50% of Regulatory Reserve). So even if credit union A above lends an additional €5 million in Commercial Loan business, it will not come close to what Credit Union B *has currently lent out*. Credit Union B can lend €15 million over 5 years, but again will be restricted to a maximum commercial loan book of

€5 million, which it probably has currently exceeded, so its potential for growth in this area is zero, more likely negative

The situation becomes more critical for lending over 10 years. Currently, only 30% is allowed over 5 years, of which 10% is allowed in loans over 10 years (if 40% over 5 years, then 15% over 10 years). Thus in the example above, credit union A can have loans outstanding above of only €2.5 million, and credit union B, €5 million. If 40% extension allowed, then credit union A is allowed 15% over 10 years, i.e., €3.75 million, and Credit Union B, €7.5 million. As most loans over 10 years are for Commercial Mortgages, or Home loans, then the capacity to lend into this market is very restricted under current and proposed new regulations. Credit Union A, which is currently under lent, can only lend a maximum of €2.5 million in Commercial or Home Loan Mortgage business. Again, it will not get close to what credit union B is even currently achieving in its lending over 10 years. Credit Union B is allowed to lend €5 million over 10 years. It is more than likely close to this figure at present, so its scope for future growth is limited, and in effect, 'capped'.

We also feel that the proposals on lending to related parties are not fair to the volunteers who work in credit unions, and are even more unfair to their families who will suffer an entirely separate evaluation of their own borrowing at each loan application. This provision should only apply to the person who volunteers in the credit union.

To give Credit Unions scope to expand their business, Mitchelstown Credit Union recommends;

- Lending over 5 years should be calculated as a % of a Credit Unions Regulatory Reserve. We **recommend that lending over 5 years should be 200% of a Credit Unions Regulatory Reserve**. Thus, a Credit Union with Assets of €100 million will have a Minimum Regulatory Reserve of €10 million and thus could lend €20 million over 5 years (200% of its Regulatory Reserve). If the Credit Union above is currently 35% lent out, i.e. €35 million, with loans over 5 years of 40% (€14 million), it has the scope under our proposal to increase its lending by up to €20 million over 5 years.
- **Lending over 10 years should be 100% of a Credit Unions Regulator Reserve**. In the example above, a credit Union with €10 million in Regulatory Reserve, could lend €20 million over 5 years, of which €10 million would be allowed over 10 years.
- We recommend that the concentration limits for Categories of loans should be calculated as a % of a Credit Unions Regulatory Reserve
- We recommend that the proposed introduction of a 25 year maximum term of any loan should be extended to 35 years.

Investments

Mitchelstown Credit Union acknowledges the need for cohesive asset liability management by credit unions but queries the mismatch between the 25 year maximum on loans and 10 year maximum on investments.

Mitchelstown Credit Union recommend that the maximum term on investments should be extended to 15 years.

Savings

Mitchelstown Credit Union does not agree to entering 'absolute' figures into credit union Regulation, such as the proposed €100,000 restriction on what a member can save. The value of this €100,000 would become eroded over time, due to inflation.

Mitchelstown Credit Union believes the figure of €100,000 per member is too low. It is not unusual for some members to save this amount, and over. The requirement that credit unions **only** would be required to go to their members to ask them to withdraw any savings in excess of €100,00 and place them in some other institution is discriminatory and anti- competitive. In addition, it sends a very clear message that RCU has no faith in the ability of boards and management to manage the affairs of credit unions in a prudent manner.

Mitchelstown Credit Union does believe that there should be a limit on an individual member's savings, and as all other proposals / limits in CP88 are based on % of Regulatory Reserves, it believes that the limit on savings should be calculated as a % of a credit unions Regulatory Reserve.

Mitchelstown Credit Union recommends that the maximum a member can save in a Credit Union should be €200,000 or 5% of the Minimum Regulatory Reserve, whichever is higher.

Borrowing

Mitchelstown Credit Union has no issue with the draft proposals in this area

Systems, Controls.

Mitchelstown Credit Union has no issue with the draft proposals in this area

Proposed Timelines

Mitchelstown Credit Union has no substantial issue with the proposed timelines

Review

Personal Insolvency Act 2012:

S.141.— *(1) The Minister shall, in consultation with the Minister for Finance, not later than 3 years after the commencement of this Part, commence a review of its operation.*

> *(2) A review under subsection (1) shall be completed not later than one year after its commencement.*
>
> *(3) Having completed the review the Minister in consultation with the Minister for Finance shall prepare a report setting out the assessment arrived at and the reasons for that assessment.*
>
> *(4) The Minister shall lay a copy of a report prepared under subsection(3) before each House of the Oireachtas as soon as reasonably practicable after it has been completed.*

In circumstances where the financial services system in the Republic of Ireland continues to operate with ongoing uncertainty and concern, it is vitally important that the Regulations make clear provision for review within a designated period.

To that end, we believe that it is wholly in line with its statutory mandate in respect of credit unions that the following provision be included in the Regulations:

(1) *The Bank shall, in consultation with the credit union sector, not later than 2 years after the commencement of these Regulations, commence a review of their operation.*

(2) *A review under subsection (1) shall be completed not later than six months after its commencement.*

(3) *Having completed the review the Bank shall prepare a report setting out the assessment arrived at and the reasons for that assessment.*

(4) *A copy of a report prepared under subsection(3) shall be provided to each credit union registered in the State and to such other bodies as appear to the Bank to be expert or knowledgeable in matters relating to credit unions as soon as reasonably practicable after it has been completed.*

In conclusion we wish to state that we believe that the proposed regulations constitute a barrier to competition in the financial services in the marketplace and may well be in breach of EU competition law.

Yours faithfully.

Dermot Long
CEO
Mitchelstown Credit Union Ltd.

For and on Behalf of the Board of Directors of Mitchelstown Credit Union Limited

Section 84A states that "*In making regulations under this Act, the Bank shall have regard to the need to ensure that the requirements imposed by the regulations so made are effective and proportionate having regard to the nature, scale and complexity of credit unions, or the category or categories of credit unions, to which the regulations will apply*".