THE LOUGH Credit Union

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The Lough Credit Union Limited,
100-103 Bandon Road,
Cork.
26/02/2015

RE: Consultation on Regulations for Credit Unions on the commencement of the remaining sections of the 2012 Act.

General Comment

We welcome that The Central Bank has taken on board the concerns highlighted by credit unions during the consultation process for CP-76 and that the draft regulations in CP-88 reflect some of the changes requested by the movement at that time. However, it is our view that the draft regulations, if introduced as proposed, would lead to the imposition of some very unfair and unworkable requirements on a sector that has been subject to an unprecedented level of regulatory change in the past couple of years.

We believe that the credit union movement in this country has proven very strong throughout the financial collapse that devastated the finances of this state and its citizens. We would also respectfully suggest that there has been little acknowledgement of this fact by the regulatory authorities, either through public pronouncements or through a more balance approach to regulatory change, which has continued unabated.

Given the huge downturn in our economy it is important to note that to-date there has only been four credit unions subject to resolution or enforced transfer of engagements. By our reckoning, given that there were nearly 400 credit unions at the beginning of the crisis, this amounts to a failure rate of around 1%. Taking account of the massive surge in unemployment, the effects of austerity and cuts to pay over the past seven years, credit unions should be acknowledged for showing such resilience whilst maintaining their ethos. While the banks have been closing branches in communities the length and breadth of the country credit unions have done all they can to maintain service levels for the ordinary people suffering the worst effects of the collapse.

Indeed, it seems to get lost in the haze of the current environment that it was not the credit union movement that indebted the Irish people to the tune of €64 billion, on which the interest payments alone amount to €1 billion per annum. Over 90% of credit unions are meeting the 10% regulatory reserve requirements, most credit unions are paying dividends to members and arrears have fallen considerably in recent years - all indicators that the sector is not as weak as certain interests would suggest.

Whilst there undoubtedly exists a wide range of challenges for credit unions, the current regulatory approach is heavy handed and not conducive to business development and loan book growth, the main challenges facing Irish credit unions today.

(i) Do you have any comments on the draft reserves regulations? If you have suggestions please provide them along with the supporting rationale.

We would seek the Central Bank to review the current reserve requirements imposed on Irish credit unions with a view to introducing a risk-weighted approach in line with international best practice.

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The underlying rationale for a standardised 10% regulatory reserve requirement (RRR) has not been communicated to credit unions and is a regulation peculiar in the Irish financial services sector to credit unions

We would also call upon the Central Bank to reconsider introducing section 45(5) of the Act. There does not appear to be any rationale for the introduction of an undetermined operational risk reserve in addition to an RRR that is already set at a challenging level. Whilst additional capital buffers are important in the current operating environment – indeed the sector currently has over €700 million in additional reserves - it seems unnecessarily restrictive to require credit unions to maintain a blanket 10% RRR **and** another reserve to absorb operational risk.

Additionally, the new governance framework introduced under Part IV of the Act proscribes a comprehensive model that provides for the effective and robust management of operational risk.

(ii) Do you have any comments on the draft liquidity regulations? If you have suggestions please provide them along with the supporting rationale.

We welcome the broadening of the definition of liquidity to facilitate the inclusion of deposits and investments for which a credit union can get a written acknowledgement from the bank that funds can be accessed on shorter notice subject to certain penalties and fees.

The short-term liquidity ratio is achievable for The Lough Credit Union, and we would assume for many credit unions presently, but we would argue that this is not the time to be introducing such a ratio. Credit unions are currently overly dependent on investments and deposits to generate an income given the huge deterioration of loan books and the continuing stagnation in demand for personal credit. Introducing additional limitations on credit unions' capacity to invest would only exacerbate the challenge to generate income and put further pressure on struggling credit unions that need the required breathing room to trade out of their current positions through loan book growth, or where necessary through restructuring.

(iii) Do you have any comments on the draft lending regulations? If you have suggestions please provide them along with the supporting rationale.

We welcome the decision to define particular categories of lending but we do not believe that the draft lending regulations are an appropriate or proportionate means of supervising credit unions. We believe that the framework proposed would amount to the micro management of credit union lending by the Central Bank. It would be more beneficial for regulatory authorities to work with the 58% of credit unions that are reportedly subject to lending restrictions and ensure weaknesses are remedied rather than introducing a standardised, limiting set of regulations for all.

We also believe that the draft lending regulations, and in particular the proposed category concentration limits, would usurp individual credit union boards of directors of their autonomy and independence, thus resulting in the micro management of credit unions by the Central Bank. The regulations as currently formulated would also strip credit unions of the potential that exists in a shared-service approach to riskier areas of lending such as commercial or mortgage lending. As the number of credit unions shrink through consolidation it would seem that larger credit unions will

have the capacity to develop more robust governance and risk systems, enabling them to enter into markets that credit unions in other jurisdictions successfully compete with banks in.

For the credit unions that remain as stand-alone entities there exists an opportunity to access expertise and underwriting capabilities through arrangements with other stand-alone credit unions, piggy-back arrangements with the new larger credit unions or through organisations like the ILCU[1]; all options that might be able to provide the necessary scale to facilitate the maturing of the product and service offerings of credit unions thus safeguarding the future business model of the sector, an objective that the Central Bank, government and credit unions should all share.

Below we have summarised our sentiments on particular aspects of the draft lending regulations but overall we believe the current proposed approach is far too limiting and restrictive and would only compound the business challenges faced by the sector as a whole. We would call upon the Central Bank to look beyond the current challenges to the future and put in place a regulatory regime that facilitates growth rather than one that hamstrings innovation and development.

Categories of Lending & Concentration Limits

We welcome the introduction of definitions for different categories of lending even though we disagree with the attaching concentration limits. We believe that it should be in the purview of credit union boards of directors to develop their credit unions in line with the intricacies of their individual common bonds and determined risk appetites. We do not believe that any regulator is in a position to determine standardised concentration limits for independent local lenders that are applied indiscriminately across the board without reference to an individual credit union's common bond or management and governance capabilities.

In relation to particular category definitions:

- House Loans

We take issue with the proposal to include the improvement or renovation of a house on a property that is already used as a principal residence in the definition for house loans. This leaves an unnecessary grey area in the draft regulations between personal and house loans that should be removed.

We also have difficulty with the proposal to require credit unions to hold a first legal charge over a property for loans classified as house loans. This requirement would put considerable limitations on credit unions in this market given the impossibility of securing a legal charge over a property already subject to a mortgage.

Furthermore, the inclusion of a 25 year term limit on loans will shut credit unions out of a considerable portion of the mortgage market. This is something we would ask the Central Bank to reconsider.

If credit unions are willing to develop the required capacity to engage in mortgage lending through the acquisition or development of internal expertise to underwrite such lending then it seems logical that there should be a level playing field with banks. After all, the mortgage crisis that currently exists in Ireland was not caused by the credit risk management of credit unions but rather by so-

[1] The Irish League of Credit Unions is already successfully offering sector-wide shared solutions for member credit unions in the areas of stability (the SPS fund), electronic payments (CUSOP) and insurances (ECCU).

called pillar banks that were supposed to have the necessary scale and commercial capabilities to engage in such activities. If credit unions wish to compete with banks in local markets for mortgages they are as well placed to do so as the centralised for-profit banks.

- Commercial & Community Loans

In relation to commercial lending we take note and welcome that loans with a value below €25,000 will not be subject to the calculation of the concentration limit but would suggest that the concentration limit for commercial lending is set at an arbitrarily low level of 50% of the regulatory reserve, particularly if credit unions are not permitted to increase their reserves to increase the amount of money that they can lend in this category, which is not clear from the consultation paper.

As with house loans, or any other category of lending, where a credit union is willing to invest in the personnel and systems to facilitate a particular type of lending that credit union's board should have the authority to set concentration limits rather than limits being predetermined by way of regulation. Indeed, it is also worth noting that the Central Bank's supervisory powers have been so greatly enhanced over the past number of years that were a credit union to overextend itself in a particular category of lending then the Central Bank would be more than capable of taking the necessary enforcement action to remedy the situation.

Credit unions could play an important social and economic role by providing SME's and community groups with access to credit. While banks see such organisations only through the prism of profit, credit unions are also community stakeholders and best-place to assist small and medium sized businesses and groups in developing and contributing to local economies.

Related party lending

This proposal along with the proposal to cap savings at €100,000 is the greatest concern to us as a local community lender.

To our knowledge in no other walk of life does there exist a regulation that penalises and restricts access to services to people because of the simple reason that they happen to be related to a person working or volunteering in a non-profit, community organisation. This proposal flies in the face of natural justice and we would call on the Central Bank to drop what can only be described as an attack on the ethos of credit unions.

Part IV of the Act coupled with the PRISM supervisory framework provide more than enough protection to ensure that credit unions do not engage in wayward lending to related parties. The introduction of a process that would be embarrassing for credit union staff and volunteers does not in our view enhance the governance of such loans in any way but rather damages the attractiveness of both volunteering and borrowing from a credit union.

(iv) Do you have any comments on the draft investments regulations? If you have suggestions please provide them along with the supporting rationale.

We welcome that there is no plans to introduce excessive limitations placed on credit unions with regards to the types of investments a credit union may hold. Given the balance sheet mismatch that currently exists in credit unions it is important that there is no further external intervention further reducing options for income. Credit unions are rightly focusing on loan book recovery and should be allowed to retain access to as many investment options as is prudent for the sake of income stability.

We also welcome the proposal to apply maturity limits to credit union investment portfolios rather than individual investment classes and the expansion of permitted state securities to include EEA state securities.

We do not, however, agree with the proposed introduction of an 8-day short-term liquidity requirement as we do not believe it can fulfil what is already being catered for by existing liquidity requirements, and may, in the future further hinder credit unions in generating investment income. This proposed regulation is another example of a prudential requirement applying only to credit unions, calling into question the fairness, equality and competitiveness of the proposed regulations.

Notwithstanding these welcome developments we do believe that there is greater scope for the Central Bank to put in place an environment that will allow for innovation and diversification of investment portfolios in line with the movement's ethos and we would be in agreement with the ILCU that the draft regulations be amended to include the following:

(g) Centralised lending [e.g. mortgage, SMEs etc.]
(h) Social housing
(i) State guaranteed projects, and;
(j) or otherwise as may be approved by the bank

Finally, from an asset-liability management point of view we cannot understand the proposal to introduce a 25 year term limit on loans but a 10 year maximum term limit on investments. This proposed 10 year limit would constrict the movement's ability to establish risk reducing investment schemes such as the centralised lending model currently being explored by the Irish League of Credit Unions.

(v) Do you have any comments with the draft savings regulations? If you have suggestions please provide them along with the supporting rationale.

We have the following concerns in relation to the proposed savings limit:

- It is a competitive restriction on credit unions. No other institutions covered by the deposit guarantee scheme are limited in such a manner.
- It would restrict future balance sheet growth. While the sector is currently under lent this will not always be the case so limiting the ability of credit unions to attract large deposits to fund lending activities would amount to a considerable obstacle to growth.
- It is impracticable. Despite it only effecting a small number of accounts at The Lough Credit Union, the introduction of this would be very difficult to execute, and even more difficult to execute retrospectively:

• If we ask members to take out the difference between the cap and their level of savings the likely response would be for the member to withdraw the full amount.

• Monitoring accounts near the cap would prove burdensome given the application of dividends and the potential for lump sum lodgements such as on retirement

- The reputational effect of such a requirement would be considerable, particularly with unbanked members or members who have conscientiously ended their relationships with their banks. It would also be construed as a pronouncement by the regulator that credit unions are inherently risky, which is not the case, and could increase the risk of a drain on liquidity possibly effecting the financial stability of credit unions and therefore members' savings.
- Other financial institutions have closed their doors in many communities and very often credit unions offer the only solution for people who want to lodge money. This regulation could prevent them from lodging their money in a local financial institution which will provide them with ready access to their funds. Online options may not provide a solution for everyone with cash to deposit and not having access to somewhere to save may encourage people to keep cash at home with potentially dangerous consequences.

(viii) Do you have any suggestions on additions, amendments or deletions to the services and related conditions that are included in the draft regulations?

We believe that debit cards should be included in the draft regulations as an exempt service. It beggars belief that credit unions in Australia have been offering members debit card solutions since 1983, and here Irish credit unions are in 2015 still struggling to introduce such an old technology, but one that is vital to offering members a genuine co-operative based banking solution that is an alternative to the commercial banks who see their customers as nothing but cash cows to be milked and exploited.

(ix) Do you agree with the proposed timelines for the introduction of the draft regulations set out in this consultation paper, in particular the transition period proposed between the publication and commencement of the regulations? If you have other suggestions please provide them, along with the supporting rationale.

No, the scale and pace of change for credit unions over the past number of years has been monumental. In the interest of facilitating the maturing of strategic plans and the new governance framework, we would call upon the Central Bank to postpone the introduction of the current proposals for one full financial year. This will give credit union balance sheets time to recover as well as allowing for the development of restructuring within the movement and a more centralised approach to the sectoral challenges.

Additionally, the timelines to meet the proposed requirements regarding liquidity and investments may force credit unions to dispose of existing investments that are earning a higher return than what is currently available in the market. This will further hinder a credit union's ability to generate income.

Finally, credit unions will also be dealing with the effects of the introduction of FRS-102, which will unnecessarily burden credit unions with further operational pressures.

RE: Regulatory Impact Analysis

The RIA undertaken does not meet its objectives of helping "to identify possible side effects or hidden costs associated with regulation and to quantify the likely cost of compliance on the individual citizens or the business". The RIA does not provide adequate information on potential side effects, costs and the actual impact of the proposed new regulations.

Financial regulators in other jurisdictions carry out comprehensive regulatory impact assessments in advance of imposing any sort of regulatory change on financial institutions. This helps the institutions subject to the regulations to better understand the underlying rationale for such proposals, but also assists the institutions in putting in place the necessary change management structures to ensure a smooth transition to the new regulatory framework. Regretfully we believe that the draft regulations as currently constituted leave credit unions in the dark as to the Central Bank's thinking on a wide range of issues, a situation which could not reasonably form the foundations for a constructive relationship going forward.

Yours faithfully,

John Daly,
Chairman.