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Central Bank of Ireland

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**Report of the Resolution Division to the Governor of the  
Central Bank of Ireland in relation to the Proposed Resolution  
of Charleville Credit Union Limited**

*11 October 2017*

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Resolution Report on the rationale for liquidation and other matters relevant to a petition under the Central Bank and Credit Institutions (Resolution) Act 2011 (the “2011 Act”) for the winding up of Charleville Credit Union Limited (“Charleville” or “the Credit Union”) under the Companies Act 2014 (the “2014 Act”).

To: The Governor

From: The Resolution Division (“RES”) of the Central Bank of Ireland (the “Central Bank”)

Date: 11 October 2017

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## 1. INTRODUCTION

- 1.1 This report (the “Report”) has been prepared in order to assist you in the performance of your functions under the 2011 Act in respect of the matters discussed herein. To the extent that this Report outlines a policy position or suggests a course of action, this is done for consideration and discussion purposes only and does not purport to represent an official policy view or decision of the Central Bank, whether for the purposes of the 2011 Act or any other purpose, and whether with respect to institutions named in this Report or generally.
- 1.2 This Report includes information made available to RES by the Registry of Credit Unions (“RCU”). RCU is the division of the Central Bank that is responsible for the registration, regulation and supervision of credit unions. Credit unions are mutual not-for-profit organisations whose principal activities are the acceptance of shares and deposits from, and the making of loans to, members. Credit unions are regulated in accordance with the Credit Union Act, 1997 (as amended) (the “CUA”).
- 1.3 The purpose of this Report is to outline the facts that may assist you to determine: (a) whether it is appropriate for the Central Bank to present a petition to the High Court for the winding-up of Charleville; and (b) whether the Central Bank has sufficient grounds upon which to present such a petition. In addition, the Report sets out the reasons for RES’s recommendation that, if the Central Bank decides to present a petition to the High Court for the winding-up of Charleville, the Central Bank should immediately thereafter also make an application to the High Court for the appointment of a liquidator to Charleville on a provisional basis pending the hearing of the petition.
- 1.4 Throughout this Report, RES refers to various documents and correspondence concerning Charleville that it has reviewed and considered during the course of its examination of the matters referred to herein. Regulatory directions issued to Charleville pursuant to section 87 of the CUA, and the responses or submissions received from Charleville in connection with those directions, along with all documents that RES considers material to the issues considered in this Report are available for your review at your request.
- 1.5 In this Report, RES has set out, for your consideration:
- (a) in Section 2, a summary of key considerations;
  - (b) in Section 3, an overview of RCU’s engagement with Charleville during the period between 2007 to date, along with RES’s views with respect to, *inter*

*alia*, certain issues that have been raised by Charleville during the course of that engagement;

- (c) in Section 4, RES's assessment of the reasons for Charleville's failure;
- (d) in Section 5, RES's assessment as to why it is appropriate that the Central Bank exercises its power under the 2011 Act to present a petition to the High Court for the winding-up of Charleville;
- (e) in Section 6, the grounds upon which the Central Bank may, pursuant to the 2011 Act, present such a petition, together with an analysis as to why, in RES's view, those grounds have been satisfied in this case;
- (f) in Section 7, RES's analysis as to why it is appropriate for the Central Bank to make an application for the appointment of a liquidator to Charleville on a provisional basis pending the hearing of any petition; and
- (g) in Section 8, RES's recommendation on how to proceed given the information set out in the preceding sections, together with a summary of the next steps to be taken, should you decide, having considered this Report, that the Central Bank should present a petition to the High Court for the winding-up of Charleville and for the appointment of a provisional liquidator.

## 2. **KEY CONSIDERATIONS**

- 2.1 Charleville is a credit union based in Charleville in County Cork, founded in 1963 with a common bond encompassing the parishes of Charleville, Ballyhea, Newtownshandrum, Ballyagran and Effin. Charleville is an affiliate credit union of the Irish League of Credit Unions ("ILCU").
- 2.2 Charleville has been the subject of intensive regulatory and supervisory engagement for a period of more than ten years. The extensive interaction between RCU and Charleville during this period is summarised in Part 1 of Section 3 of this Report, which also contains, at paragraph 3.6, a table setting out a chronology of the key events over the same period. Part 2 of Section 3 contains an assessment of the reasons for the lengthy period of regulatory action and why RES believes that action is now required. Finally, Part 2 of Section 3 also contains RES's review and consideration of certain assertions and criticisms raised by Charleville in its recent correspondence with the Central Bank.
- 2.3 Charleville is in a distressed financial position. As at 30 June 2017, Charleville reported a reserve position ("**reserves**") of 3.5% of total assets in its Prudential Return ("**PR**"). In RES's opinion, Charleville has, since 2009, been unable to raise and maintain its reserves to the regulatory reserve requirement of at least 10.0% of total assets of the credit union (the "**reserve requirement**") as is demonstrated by Table 1 below:

**Table 1 - Summary of Charleville's financial position (from 30 September 2009 to June 2017)**

€'000s Period end					Original draft accounts				Prudential Return Jun 2017
	Final Accounts	Final Accounts	Final Accounts	Draft Accounts	Draft Accounts	Draft Accounts	Draft Accounts	Draft Accounts	
	Sept 2009	Sept 2010	Sept 2011	Sept 2012	Sept 2013	Sept 2014	Sept 2015	Sept 2016	
Total assets	62,653	47,564	41,724	44,624	44,008	44,096	42,453	42,649	41,882
Fixed assets	2,222	2,133	2,032	1,928	1,868	1,780	709	668	347
Gross loans	42,726	37,508	28,559	16,457	14,379	13,726	12,392	11,536	10,755
Bad debt provisions	(9,229)	(14,695)	(13,244)	(5,174)	(4,851)	(4,520)	(5,724)	(5,601)	(4,744)
Total reserves (excl. unrealised)	263	(4,443)	(3,618)	3,564	4,135	4,700	1,939	1,657	1,455
<b>Reserve Position</b>	<b>0.4%</b>	<b>(9.3%)</b>	<b>(8.7%)</b>	<b>8.0%</b>	<b>9.4%</b>	<b>10.7%</b>	<b>4.6%</b>	<b>3.9%</b>	<b>3.5%</b>
€'000s Period end					Revised draft accounts				Prudential Return Jun 2017
	Final Accounts	Final Accounts	Final Accounts	Draft Accounts	Draft Accounts	Draft Accounts	Draft Accounts	Draft Accounts	
	Sept 2009	Sept 2010	Sept 2011	Sept 2012	Sept 2013	Sept 2014	Sept 2015	Sept 2016	
Total assets	62,653	47,564	41,724	44,624	41,219	40,836	42,230	42,415	41,882
Fixed assets	2,222	2,133	2,032	1,928	515	477	439	391	347
Gross loans	42,726	37,508	28,559	16,457	14,379	13,726	12,392	11,536	10,755
Bad debt provisions	(9,229)	(14,695)	(13,244)	(5,174)	(6,287)	(6,476)	(5,676)	(5,546)	(4,744)
Total reserves (excl. unrealised)	263	(4,443)	(3,618)	3,564	1,345	1,440	1,717	1,421	1,455
<b>Reserve Position</b>	<b>0.4%</b>	<b>(9.3%)</b>	<b>(8.7%)</b>	<b>8.0%</b>	<b>3.3%</b>	<b>3.5%</b>	<b>4.1%</b>	<b>3.3%</b>	<b>3.5%</b>

Source: Charleville's annual final accounts; Charleville's original financial statements as submitted by Charleville to RCU for relevant years; Charleville's revised financial statements submitted by Charleville to RCU in April 2017 following the adoption of FRS102; and prudential return submitted by Charleville to RCU for period ended 30 June 2017.

- 2.4 On 4 May 2017, the Registrar of Credit Unions (the "Registrar") issued a Regulatory Direction to Charleville, pursuant to section 87 of the CUA (the "May 2017 Direction"), which required Charleville to: (a) raise its reserves to 10.0% of total assets (c. [REDACTED] as at 31 March 2017) by no later than 18 May 2017; and (b) in order to mitigate against certain operational risks that have been identified with respect to Charleville, raise and maintain an additional reserve of 3.0% (c. [REDACTED] as at 31 March 2017). Charleville failed to comply with the May 2017 Direction by 18 May 2017, and it remains in breach of its obligations thereunder. Charleville also failed to comply and remains in breach of an earlier regulatory direction issued by the Registrar on 14 June 2016 ("the June 2016 Direction") requiring it to comply with the reserve requirement of 10.0% of total assets.
- 2.5 All credit unions in Ireland are currently required to maintain reserves of 10.0% of total assets. This requirement is a key component of the prudential framework for credit unions and is designed to ensure: (a) the stability of individual credit unions and the sector overall; and (b) to protect members' savings and continuity of access to those savings. The reserves of a credit union support a credit union's operations, provide a base for future growth and protect against the risk of unforeseen losses. Indeed, credit unions are expected for that purpose to operate with a level of reserves above the 10.0% requirement. The level of such operational risk reserve and/or any additional reserves are decided upon by the directors of each credit union having taken prudent account of the nature, scale and complexity of the credit union's business, its risk profile and prevailing market conditions.
- 2.6 Compliance with the reserve requirement enables a credit union to deal with future uncertainties and to act flexibly in light of a changing economic landscape. The failure on the part of a credit union to comply with the reserve requirement represents a significant threat to the orderly and prudent regulation of that credit union. This threat is exacerbated

where, as has been the case with respect to Charleville, there is a failure to comply with the reserve requirement over an extended period.

2.7 As is evident from Table 1 above, and discussed in more detail below, based on the revised financial statements submitted by Charleville to RCU in April 2017 it is now clear that since September 2009 Charleville has not complied with the reserve requirement of 10.0% of total assets. Earlier draft financial statements had stated the reserves as higher than in fact they were. It is now undisputed that based on the revised financial statements which the Credit Union, Charleville has been in breach of the 10% reserve requirement since 2009:

- (a) 30 September 2009 Charleville reported reserves of 0.4%;
- (b) 30 September 2010 Charleville reported reserves of -9.3%;
- (c) 30 September 2011 Charleville reported reserves of -8.7%;
- (d) 30 September 2012 Charleville reported reserves of 8%;
- (e) 30 September 2013 Charleville reported reserves of 3.3%;
- (f) 30 September 2014 Charleville reported reserves of 3.5%;
- (g) 30 September 2015 Charleville reported reserves of 4.1%; and
- (h) 30 September 2016 Charleville reported reserves of 3.3%.

2.8 As discussed further below, the directors of Charleville, in correspondence with the Central Bank, have complained that its inability to improve its financial position and meet the reserve requirement is due in part to lending restrictions, which were imposed on it by the Central Bank by way of regulatory directions limiting, *inter alia*, individual and monthly lending. However, the Central Bank introduced these restrictions following careful consideration and on foot of a decision, that it was necessary to do so in order to protect depositors. These directions were not the subject of a legal challenge by Charleville. The Central Bank reviewed the restrictions on lending at various points in time. However, having regard to the Central Bank's ongoing concerns in relation to the financial position of Charleville, and in particular its failure to meet the reserve requirements, the Central Bank decided it was not appropriate to lift the restrictions.

2.9 As noted above, Charleville's financial position between 2009 and 2017 has, for the reasons explained in more detail in Section 4 of this Report, deteriorated due to:

- (a) poor lending and inadequate credit controls during the period prior to June 2010;
- (b) in particular the origination by Charleville during and prior to 2009 of a large number of commercial and property loans to members, a number of which were only repayable by the borrower from the sale or refinancing of property assets, known as "bridging loans", and which resulted in the application of a significant level of write-offs and impairments to the carrying value of those loans;
- (c) impairments to the carrying value of Charleville's office premises located at Main Street, Charleville, County Cork (the "Premises"); and

- (d) the ongoing maintenance of a high fixed operating cost base (having regard to the reducing level of revenue generated from Charleville’s loan book and investment portfolio), resulting in a negative impact on Charleville’s profitability, and which, in the view of the Central Bank and a number of independent experts that have conducted reviews of Charleville’s business, gives rise to material concerns with regard to Charleville’s future viability.

2.10 The key views expressed in this Report are that, in the opinion of RES:

- (a) Charleville has failed to comply with, and remains in breach of:
  - (i) the June 2016 Direction; and
  - (ii) the May 2017 Direction;
- (b) although Charleville is not currently insolvent from a balance sheet or cash-flow perspective, Charleville is in a financially distressed position due to:
  - (i) its inability to raise and maintain the level of regulatory and operational risk reserves required by law; and
  - (ii) its high fixed operating cost base relative to reducing recurring income levels in recent years,

calling into question its viability on a standalone basis, a view shared by independent experts which have conducted recent reviews of Charleville’s business, and raising the risk of future insolvency;

- (c) Charleville’s financial distress has been materially exacerbated by the failure on the part of its board of directors (the “**Board**”) to acknowledge the extent of the required impairment of its balance sheet until after it had already twice sought and obtained significant financial support from ILCU in the form of Saving Protection Scheme (“**SPS**”) funding<sup>1</sup> (amounting in aggregate to c. ██████ received in the period between 2010 and 2014), thereby resulting in such funding being insufficient to raise and maintain Charleville’s reserves to the level required by law;
- (d) Charleville has now exhausted all feasible options available to it to raise and maintain its reserves at the required levels in order to protect members’ savings and it can no longer survive as a standalone entity. This situation has been acknowledged by Charleville’s Board, which since early 2016, to address Charleville’s financial distress, has actively sought to identify and complete a voluntary transfer of engagements (“**ToE**”) with another ILCU-affiliated credit union;
- (e) ILCU has made SPS funding available to Charleville on condition that it completes a ToE between Charleville and another suitable ILCU-affiliated credit union (██████ in 2016 following the issue of the June 2016 Direction and a further ██████ in June 2017). The purpose of the additional deposit of ██████ was to raise Charleville’s reserves to 10.0% of total assets and to raise an additional reserve of 3.0% of total assets to address key risk areas such

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<sup>1</sup> The ILCU-administered SPS fund provides support to ILCU-affiliated credit unions in financial difficulties.

as: (i) Charleville's reserves; (ii) credit risk; (iii) viability; and (iv) issues with [REDACTED], which were discovered during due diligence reviews. Notwithstanding this, Charleville has been unable to implement a ToE;

- (f) Charleville has, on three<sup>2</sup> separate occasions, sought to negotiate and implement a ToE with a third party credit union. However, in each instance those efforts were unsuccessful;
- (g) from March 2016, Charleville was granted an extended period of forbearance by RCU to facilitate the identification of a suitable and willing transferee, during which period Charleville has remained in breach of its obligation to maintain the reserves required by law. The Central Bank has now formed the view that Charleville does not have any reasonable prospect of: (i) raising the capital required to meet its reserve requirements; or (ii) implementing a ToE, having regard to the fact that it has now attempted on three occasions to do so;
- (h) as outlined in paragraphs 2.10(a) to (g) above, it is not appropriate for the Central Bank to forbear any further with respect to Charleville's continuing breach of its legal and regulatory obligations. Accordingly, the Central Bank should exercise its powers under the 2011 Act to present a petition to the High Court for the winding up of Charleville;
- (i) the Central Bank has adequate grounds under the 2011 Act to present a petition for the winding up of Charleville, and is duty bound do so as soon as possible; and
- (j) the Central Bank should, as soon as possible after the presentation of such a petition, make an application to the High Court for the appointment of a provisional liquidator to Charleville in order to, *inter alia*, preserve Charleville's assets, prepare the necessary Deposit Guarantee Scheme ("DGS") file and mitigate the risk of an unmanaged failure of Charleville's business pending the hearing of the petition, in the interests of its members, creditors and the public.

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<sup>2</sup> Sections 5 and 6 of this Report refers to a potential ToE with a fourth credit union. However, as the Central Bank was never provided with the required documentation necessary to initiate a ToE process, and as such, the Central Bank considers that there were only three attempted ToEs between Charleville and other credit unions.

### 3. **REGULATORY BACKGROUND**

- 3.1 For the purpose of this Report, RES has conducted a detailed review of RCU's extensive regulatory and supervisory file with respect to Charleville.
- 3.2 This Section of the Report consists of two parts, the first part comprising:
- (a) a table setting out the key events that occurred during the course of RCU's interactions with Charleville during the period between 2007 and the date of this Report;
  - (b) a summary of the key supervisory interactions between RCU and Charleville over that period, broken down according to the year in which each of those interactions occurred; and
  - (c) a detailed account of the most recent correspondence between RCU and Charleville since April 2017, when RCU issued Charleville with a letter indicating the Registrar's intention to issue the May 2017 Direction.
- 3.3 The second part of this Section of the Report sets out an assessment of:
- (a) the reasons why the regulatory interaction between RCU and Charleville continued for such an extensive period, and why action is now warranted; and
  - (b) the regulatory actions taken by RCU during the course of its interactions with Charleville, particularly in light of certain issues and assertions raised by Charleville in its most recent correspondence with RCU.

#### ***PART 1 – OVERVIEW OF THE REGULATORY ENGAGEMENT BETWEEN RCU AND CHARLEVILLE***

- 3.4 The intense regulatory engagement between RCU and Charleville occurred over the course of a ten-year period from early 2007 to date. During that period, at RCU's request, Charleville undertook a number of external expert reviews and inspections.
- 3.5 Those independent reviews, along with RCU's own inspections, highlighted the existence of very material and recurring issues in Charleville relating to: (a) its lending practices; (b) the manner in which it recorded bad debt provisions and the [REDACTED] reported in its financial statements; and (c) the future viability of Charleville's business.
- 3.6 Given the lengthy history of RCU's interaction with Charleville, for convenience, RES has prepared the following table that sets out the chronology of the key events from 2007 to present<sup>3</sup>.

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<sup>3</sup> Capitalised terms that are used, but not defined, in the following table have the meanings given to them elsewhere in this Report.



Date	Key Event
March 2007	RCU inspection identifies a significant number of large property and commercial loans granted to a small concentration of borrowers.
December 2009 and January 2010	RCU imposes lending restrictions on Charleville, limiting individual and monthly lending.
February 2010	Burke & Associates issues a report identifying loan impairment issues and recommends an increase in bad debt provisions from €2.8m to €9.9m.
13 May 2010	ILCU and Charleville enter into the 2010 ILCU Guarantee providing Charleville with a maximum of ██████ of SPS support.
27 October 2011	RCU imposes a regulatory direction on Charleville limiting individual and monthly lending and imposing other business restrictions.
25 November 2011	EY issues a report highlighting concerns with respect to the adequacy of Charleville's bad debt provisioning, as well as its solvency and viability.
7 March 2012	GVM Auctioneers issue a report valuing Charleville's Premises at ██████ compared with net book value of ██████ as reported in Charleville's audited financial statements.
5 April 2012	RCU imposes a regulatory direction on Charleville requiring it to raise and maintain its reserves of 10.0% of total assets.
25 April 2012	ILCU and Charleville enter into the 2012 ILCU Guarantee (replacing the 2010 ILCU Guarantee) providing Charleville with a maximum of ██████ of SPS support.
22 August 2012	AGMs are held for financial years ended 30 September 2010 and 2011, at which Charleville reported reserves of -9.3% and -8.7%, respectively.
April 2014	The 2012 ILCU Guarantee expires. Charleville has by this time drawn-down c ██████ of SPS support under both the 2010 and 2012 ILCU Guarantees.
7 October 2014	Charleville submits draft financial statements to RCU for the year ended 30 September 2014 reporting that it has met the 10.0% reserve requirement.
1 July 2015	EisnerAmper issues a report identifying material issues regarding Charleville's viability, financial projections and impairments to the Premises.
30 October 2015	DHKN issues a report identifying issues with respect to Charleville's viability and the carrying value of the Premises.
29 January 2016	MSN issues a report that identifies issues with respect to Charleville's viability.
24 March 2016	Charleville informs RCU that its directors have decided to pursue a ToE rather than continue to operate on a standalone basis.
19 April 2016	Charleville informs RCU that it has held initial ToE discussions with ██████ Credit Union.
14 June 2016	RCU issues the June 2016 Direction requiring Charleville to raise and maintain its reserves to 10.0% of total assets.
20 August 2016	ToE negotiations with ██████ Credit Union are terminated.
September 2016	Charleville enters into ToE discussions with Clonmel Credit Union.
22 March 2017	ToE negotiations with Clonmel Credit Union fail.
5 April 2017	Charleville submits restated financial statements for the financial years ended 2014, 2015 and 2016 showing that Charleville has not complied with reserve requirements for those financial years.
4 May 2017	RCU issues the May 2017 Direction requiring Charleville to raise its reserves to 10.0% and to also raise and maintain additional reserves of 3.0% of total assets.
23 May 2017	RCU requires Charleville to submit a plan to comply with the May 2017 Direction by 16 June 2017.
23 June 2017	RCU grants Charleville an additional period to 6 July 2017 to propose a viable ToE (subsequently extended to 1pm on 7 July 2017).

Date	Key Event
29 June 2017	RCU imposes a regulatory direction on Charleville limiting individual and monthly lending and imposing other business restrictions.
17 July 2017	Charleville enters into informal ToE discussions with ██████████ Credit Union.
17 August 2017	Charleville commences formal ToE discussions with ██████████ Credit Union.
1 September 2017	██████████ withdraws from ToE discussions with Charleville.
20 September 2017	RCU met with Charleville to discuss the withdrawal of ██████████ from ToE discussions, and the fact that Charleville remains in breach of the May 2017 Direction. Charleville advised that there are two further unnamed credit unions considering a ToE with Charleville.
22 September 2017	RCU writes to Charleville requiring it to make any further written submissions regarding its position and the outcome of discussions with the two unnamed credit unions regarding a potential ToE, by 5pm on 29 September 2017.
29 September 2017	Charleville informs RCU that ██████████ Credit Union Limited ("██████████") are considering entering into ToE discussions and a meeting with ██████████ would take place on 4 October 2017 with a view to entering into a ToE.
3 October 2017	RCU write to Charleville advising them of the immediate requirement to provide them with an update of the ██████████ discussions.
10 October 2017	Following receipt of a letter from ██████████, which failed to confirm the commencement of formal ToE negotiations, RCU write to Charleville providing a further day to make final submissions.
11 October 2017	Charleville write to RCU stating that it is not possible for Charleville and ██████████ to comply with the Central Bank's requirements in respect of a ToE between the credit unions, within the timeframe provided. Charleville requests that the Central Bank not take any action which might be detrimental to the members of Charleville.

- 3.7 A detailed chronological summary of the key supervisory interactions between RCU and Charleville from 2007 to date, broken down into three time periods, is set out below.

### ***Overview of Regulatory Engagement – 2007 to 2010***

#### ***2007***

- 3.8 From 20 to 23 March 2007, RCU carried out an inspection of Charleville. This inspection identified significant concerns in relation to the loan book, namely that Charleville had a significant number of large loans – the top 100 loans in the credit union accounted for 42.0% of the total borrowings as at 21 March 2007.
- 3.9 On 11 April 2007, RCU issued a letter to Charleville, setting out the areas of concern identified during the RCU inspection. The areas of concern included: (a) Charleville's loan provisioning policies; (b) lump sum repayments; (c) loan rescheduling; (d) evidence of borrower ability to repay; and (e) bank reconciliations. This letter requested that an independent review of Charleville's loan book is carried out. Charleville subsequently appointed Susan Morrissey & Co. Chartered Accountants & Registered Auditors to undertake this review. In the report completed by Susan Morrissey (the "**June 2007 Susan Morrissey & Co. Report**"), additional provisions of €1.0m against specific loans were recommended, which would have increased Charleville's total bad debt provisions, following the review, to €3.0m.

- 3.10 The June 2007 Susan Morrissey & Co. Report contained a list of large business / property-related loans to 10 members (amounting to €4.1m or 9.7% of the total loan book of €42.1m as at 18 June 2007). The report set out that most of these large business / property loans were not meeting their scheduled loan repayments as per the underlying credit agreement. No additional bad debt provisions were recommended based on the security attached to these loans (the “**Appendix 2 Loans**”). In relation to the Appendix 2 Loans, the June 2007 Susan Morrissey & Co. Report stated, “*as the building boom and housing market seems to be slowing down, it would be advisable to closely monitor the following loans and to keep up to date valuations on properties held as security*”.
- 3.11 In a letter dated 24 July 2007, RCU requested confirmation that Charleville would immediately increase the bad debt provision as recommended in the June 2007 Susan Morrissey & Co. Report in respect of the loans set out in appendix 1 to that report. RCU required Charleville to submit quarterly updates on the Appendix 2 Loans. RCU also required Charleville to cease granting additional loans to members to service existing loans or to make interest repayments on lump sum repayment loans and amend the credit policy to reflect same, noting this practice “*is not considered prudent*”.
- 3.12 At the end of 2007, Charleville had updated its bad debt provisions to the level required by the June 2007 Susan Morrissey & Co. Report and convened its Annual General Meeting (“**AGM**”) for the financial year ended 30 September 2007.

## **2008**

- 3.13 On 21 January 2008, Charleville submitted the first quarterly review of the Appendix 2 Loans. The review highlighted that a number of loans, which had fallen due, had not yet been repaid and that full repayment was not expected for a number of months, depending on individual circumstances. It was also unclear from this review whether Charleville had allocated any bad debt provisions in respect of the Appendix 2 loans.
- 3.14 On 25 July 2008, Charleville submitted a further quarterly review of the Appendix 2 Loans, which indicated that there were issues in relation to the recoverability of a number of the loans and the adequacy of the bad debt provisions. Arising from this review, RCU requested that Charleville engage its auditor, PriceWaterhouseCoopers (“**PWC**”), to complete an assessment of Charleville’s provisioning requirements on specific loans as listed in a letter dated 31 July 2008. The PWC report dated 15 September 2008 identified additional bad debt provisions of €0.2m.
- 3.15 In a letter to Charleville dated 2 October 2008, RCU noted the high level of loan arrears reported in Charleville’s PR for the period ended 30 June 2008. Charleville was requested to provide a written response setting out the reasons for the high level of arrears and its proposals regarding bad debt provisions and loan write-offs to be included in the audited financial statements for year ended 30 September 2008.
- 3.16 RCU received Charleville’s 2008 AGM booklet dated 10 December 2008, which included the audited financial statements for the year ended 30 September 2008 (the “**2008 Accounts**”). The 2008 Accounts reported a surplus for the year of €1.7m and total bad debt provisions of €2.8m. Charleville’s Board proposed a dividend of 2.0%. The total reserves amounted to €7.2m or 10.1% of total assets.

## 2009

- 3.17 Following an analysis of the quarterly updates on the performance of Charleville's loan book, and the six monthly security reviews of Charleville's top 100 loans, RCU continued to express concerns regarding the level of bad debt provisions, the recoverability of loans, the strength of underlying loan security, and whether repayments were being made on the Appendix 2 Loans. RCU required Charleville to engage PWC to carry out a further assessment in respect of all loans where the amount outstanding was greater than €0.1m. RCU required the review to focus on property/business loans and to review all of the top 100 loans to assess the adequacy of provisions. The review was also required to take into account the valuation of security and the repayment history.
- 3.18 On 8 October 2009, PWC provided a report on Charleville's top 100 loans as at 30 June 2009. The report failed to give an opinion on the adequacy of the bad debt provisions despite an earlier undertaking to do so. Subsequently, Charleville engaged Burke & Associates Public and Forensic Accountants ("**B&A**") to review the top 100 loans (the "**B&A Top 100 Loan Review**"). In December 2009, the draft B&A Top 100 Loan Review identified additional bad debt provisions of €4.4m on the top 100 loans, resulting in total provisions on the top 100 loans increasing to €6.6m as at 30 September 2009 (15.3% of total gross loans in that regard).
- 3.19 At a meeting on 16 December 2009, RCU requested that Charleville engage B&A to carry out a full loan book review (the "**B&A Loan Book Review**") to determine the required provision for bad and doubtful debts in the audited financial statements for the year ended 30 September 2009 (the "**2009 Accounts**"). On 17 December 2009, RCU advised Charleville, in writing, to commence discussions with ILCU regarding SPS support for the credit union.
- 3.20 On 23 December 2009, Charleville advised RCU that it had been in contact with ILCU regarding SPS support.

## 2010

- 3.21 On 15 January 2010, in light of the issues identified in the draft B&A Top 100 Loan Review, RCU wrote to Charleville imposing a maximum loan limit of €20k to an individual and a total monthly lending limit of either 75% of cash receipts from borrowers adjusted for savings, or €0.4m, to protect liquidity and to meet any contingencies that may arise.
- 3.22 On 4 February 2010, RCU received the final B&A Loan Book Review dated 2 February 2010. The B&A Loan Book Review identified additional provisions of €7.1m which it considered "*should be recognised in the financial statements at 30<sup>th</sup> September 2009*". The impact of the additional provisions identified in the final B&A Top 100 Loan Review reduced Charleville's reserves from 10.1% to 0.4% per the financial statements for the year ended 30 September 2009.
- 3.23 On 13 May 2010, Charleville entered into an agreement with ILCU (the "**2010 ILCU Guarantee**") which made up to ██████ of SPS funds available to Charleville to offset losses incurred on non-performing loans, subject to the satisfaction of certain conditions.
- 3.24 In a letter to Charleville dated 23 July 2010, RCU stated that following a "*review of the state of affairs of the Credit Union, and concerns held by this office as to the management and functioning of the Credit Union*", further business restrictions were appropriate to protect members' savings. Restrictions were imposed on the following terms:

- (a) lending was to be limited to €0.02m plus shares for individual members, subject to an overall lending limit per member of €0.04m;
  - (b) Charleville was prohibited from making investments other than investments in short-term (maximum 90 day) deposit accounts in credit institutions where the amount deposited was statutorily guaranteed; and
  - (c) a maximum savings limit of €0.05m per member was imposed, with an instruction not to accept additional savings or deposits from members with this amount in their account.
- 3.25 On 28 July 2010, Charleville held its AGM for the year ended 30 September 2009. The 2009 Accounts, published in the 2010 and 2011 AGM booklets, reported a loss of €5.6m (excluding the 2010 ILCU Guarantee) and total bad debt provisions of €9.2m. The 2009 Accounts included the 2010 ILCU Guarantee as a post-balance sheet event and included a note in the financial statements that stated: *"This guarantee will advance funds to the Credit Union in the event that certain loans are not recovered within a two-year period"*.
- 3.26 On 24 September 2010, RCU held a meeting with B&A to discuss progress on the loan book review for the year ended 30 September 2010 during which RCU again expressed concerns regarding the level of bad debt provisions in the audited financial statements for the year ended 30 September 2010 (the **"2010 Accounts"**).

#### **Summary 2007-2010**

- 3.27 Following RCU's inspection in 2007, concerns were raised in relation to Charleville's loan book and its lending, including commercial or property-type loans with one-off lump sum repayments from the sale or realisation of assets, known as bridging loans. The June 2007 Susan Morrissey & Co. Report indicated a requirement to increase Charleville's bad debt provisions in the financial statements for the year ended 30 September 2007 to €3.0m. As at 30 September 2007, Charleville had total assets of €73.4m and reserves of 9.3%. RCU continued to express concerns during 2008 regarding the management of Charleville's loan book and the type of lending it was undertaking. Notwithstanding these concerns, Charleville only increased its bad debt provisions by c.€0.2m to €2.8m in the 2008 Accounts. Charleville reported total assets of €71.5m and reserves of 10.1% in the 2008 Accounts.
- 3.28 In 2009, RCU continued to engage with Charleville with respect to the bad debt provisions, the recoverability of loans, [REDACTED], and whether or not repayments had been made. Arising from the reviews completed, Charleville's bad debt provisions increased from €2.8m in the 2008 Accounts to €9.2m in the 2009 Accounts. The 2009 Accounts reported total assets of €62.7m and reserves of 0.4% (the 30 September 2009 reserve requirement was at least 7.5%). RCU advised Charleville to seek financial support to raise and maintain its reserves to the minimum 7.5% required. RCU imposed lending and business restrictions on Charleville in light of RCU's concerns in relation to the financial position of the Credit Union and the management of its loan book.
- 3.29 During 2010, Charleville's financial position continued to deteriorate. As a result, RCU issued further restrictions on Charleville's business, citing concerns held regarding the management and functioning of the credit union. In April 2010, ILCU and Charleville entered into the 2010 ILCU Guarantee. Charleville's actual reserve position of -9.3% for the year ended 30 September 2010 was only established in mid-2012, following significant

interaction between RCU and Charleville in relation to its loan book during 2011 and 2012. Further details regarding the establishment of Charleville's true financial position are set out in the section on Overview of Regulatory Engagement - 2011 to 2014 below.

### **Overview of Regulatory Engagement – 2011 to 2014**

#### **2011**

- 3.30 In March 2011, Charleville submitted a set of draft 2010 Accounts that reported a deficit of €3.3m, total bad debt provisions of €9.5m and reserves of 1.6%. RCU again raised concerns regarding the level of provisions contained in the draft 2010 Accounts.
- 3.31 On 10 June 2011, RCU held a meeting with Charleville and its auditor to discuss the draft 2010 Accounts. RCU outlined its concerns regarding the adequacy of Charleville's bad debt provisioning. In particular, RCU highlighted concerns regarding Charleville's failure to appropriately provide for certain property-related loans. Charleville asserted that adequate provisions had been applied to those loans on the basis that they were secured. RCU required an independent expert to undertake a review of the property-related loans.
- 3.32 In June 2011, Charleville engaged Moore Stephens Nathans Chartered Accountants and Registered Auditors ("**MSN**") to carry out a review of the property-related loans. In July 2011, MSN submitted its report (the "**2011 MSN Report**") which recommended additional bad debt provisions of €2.2m in respect of the property-related loans (in addition to the total bad debt provisions of €9.5m reported in the draft 2010 Accounts at that time).
- 3.33 On 22 September 2011, RCU held a meeting with ILCU who confirmed that it had conducted a review of Charleville's loan book from 8 to 18 August 2011 (the "**2011 ILCU Review**"). The 2011 ILCU Review identified additional bad debt provisions of c.€3.4m (in addition to the total bad debt provisions of €9.4m reported in the management accounts submitted for July 2011). The 2011 ILCU Review also listed a number of issues relating to loan write-offs, the adequacy of Charleville's credit control policy, the requirement to review security held on loans, and the frequency of Charleville's assessment of its bad debt provisions.
- 3.34 At the meeting on 22 September 2011, ILCU advised that it was arranging for Ernst & Young ("**EY**") to carry out a viability review of Charleville. In an email to Charleville dated 23 September 2011, RCU stated that the additional bad debt provisions arising from the 2011 MSN Report would render Charleville insolvent on a stand-alone basis when reflected in the draft 2010 Accounts and that this raised the issue of additional SPS funding being required.
- 3.35 On 27 October 2011, the Registrar issued a regulatory direction to Charleville (the "**October 2011 Direction**") restricting its business activities on the following terms:
- (a) a maximum savings limit of €0.05m per member was imposed, with an instruction not to accept additional deposits from members with this amount in their account;
  - (b) lending was to be limited to €0.01m plus shares for an individual member;
  - (c) lending was to be limited to €0.2m in a calendar month;
  - (d) expenditure on fixed assets was limited to €0.024m in any one financial year;

- (e) Charleville was prohibited from making investments other than investments in short-term (maximum 90 day) deposit accounts in credit institutions where the amount deposited was statutorily guaranteed; and
  - (f) Charleville was required to maintain at all times a liquidity requirement of 35.0%.
- 3.36 On 25 November 2011, ILCU provided the draft EY viability review dated 4 November 2011 (the “**EY Viability Review**”) to RCU, which raised material concerns with respect to the adequacy of Charleville’s bad debt provisioning, solvency and viability.
- 3.37 In a letter to Charleville dated 8 December 2011, RCU stated that it was not in a position to revisit the current lending restrictions given Charleville’s reserves of -5.1%, as reported in its September 2011 PR. The letter also referred to the draft EY Viability Review, which identified additional bad debt provisions of €2.0m.
- 3.38 In a letter to RCU dated 21 December 2011, Charleville submitted the draft financial statements for the year ended 30 September 2011 (the “**2011 Accounts**”). The draft 2011 Accounts reported:
  - (a) a deficit of €4.2m;
  - (b) total bad debt provisions of €13.2m (46.4% of gross loans);
  - (c) reserves of -7.7% (excluding unrealised reserves); and
  - (d) Charleville was balance sheet insolvent, reporting a net liability position of -€3.2m.

The letter contained an explanation and reconciliation regarding the movement in the total bad debt provisions from €10.0m originally reported in the September 2011 management accounts, to €13.2m as reported in the draft 2011 Accounts. In respect of Charleville’s negative reserves, Charleville noted that in order to comply with its reserve requirements it would require additional capital of €7.0m.

## **2012**

- 3.39 On 27 January 2012, RCU in a letter to ILCU noted Charleville required c.€9.0m as per the draft 2011 Accounts to meet the reserve requirement of 10.0%. RCU also requested that ILCU confirm whether it would provide the necessary financial support to restore Charleville’s reserves.
- 3.40 On 3 February 2012, RCU met with Charleville’s representatives and gave them a regulatory direction (the “**February 2012 Direction**”) limiting its business activities. In the February 2012 Direction, the Registrar considered it appropriate to impose regulatory directions on the following terms:
  - (a) a maximum savings limit of €0.05m per member was imposed, with an instruction not to accept additional deposits from members with this amount in their account;
  - (b) lending was to be limited to €0.005m plus shares for an individual member;
  - (c) lending was to be limited to €0.1m in a calendar month;

- (d) expenditure on fixed assets was prohibited;
  - (e) Charleville was prohibited from making investments other than investments in short-term (maximum 90 day) deposit accounts in credit institutions where the amount deposited was statutorily guaranteed; and
  - (f) Charleville was required to maintain at all times a liquidity requirement of 35.0%.
- 3.41 At this meeting, RCU requested that Charleville seek, in writing, the additional financial support necessary to restore its reserves to 10.0% of total assets. In addition, RCU requested that Charleville confirm, in writing, by no later than 15 February 2012, whether it had received the necessary financial support required to meet the 10.0% reserve requirement.
- 3.42 On 6 February 2012, ILCU provided RCU with the final EY Viability Review. The findings set out in the final EY Viability Review did not differ materially from those in the draft received on 25 November 2011, in particular questioning bad debt recognition, solvency and viability.
- 3.43 In a letter to RCU dated 13 February 2012, ILCU confirmed that, in principle, it would provide Charleville with additional financial support to restore the Credit Union's reserves to 9.0% of total assets based on figures reported in the draft 2011 Accounts. ILCU stated that this was subject to the following conditions:
- (a) Charleville to be given permission to hold AGMs in respect of the years ended 30 September 2010 and 2011;
  - (b) lending restrictions imposed on Charleville be eased to the limits stipulated in the EY Viability Review; and
  - (c) urgent agreement being reached with respect to a plan concerning Charleville's *"viability (to include any governance changes the Central Bank may deem appropriate) into the future"*.
- 3.44 On 7 March 2012, in an email to RCU, Charleville submitted a valuation carried out by GVM Auctioneers dated 20 December 2011, valuing the Premises at €0.65m. The carrying value of the Premises recorded in Charleville's draft 2011 Accounts was €1.9m.
- 3.45 In an email to Charleville dated 7 March 2012, RCU requested an explanation for the significant increase in the level of loan arrears greater than nine weeks as reported in the 31 December 2011 PR. On 9 March 2012, in an email to RCU, Charleville indicated that the increase in the level of loan arrears, from 38.8% in the September 2011 PR to 50.1%, in the December 2011 PR was due to the: *"large amount of bridging loans that became due around that time and subsequently fell into 9 weeks plus in arrears, total amount €2,908,648. Loan provisions on these accounts are €2,027,108. The difference is the discounted value of security we hold."*
- 3.46 On 29 March 2012, Charleville in a letter to RCU, requested that the restrictions contained in the February 2012 Direction be lifted, stating that the restrictions were forcing Charleville to *"refuse loan applications from members in good standing"*. On 30 March 2012, Charleville, in an email to RCU, commented that the lending restrictions caused the following: (a) Charleville to have to refuse loans to members with a *"premium track*



*record*"; (b) savings were being withdrawn at a *"faster rate [that] they did heretofore"*; and (c) rumours amongst its membership suggesting that *"the Credit Union is in serious difficulty"*. RCU continued to have significant concerns in relation to Charleville's financial position and level of arrears and, as a consequence, did not consider it appropriate to lift the February 2012 Direction.

3.47 On 5 April 2012, the Registrar issued a regulatory direction (the **"April 2012 Direction"**) requiring Charleville to raise and maintain its reserves to 10.0% of total assets by not later than 4pm on 27 April 2012. On the same date, the Registrar also notified ILCU of the April 2012 Direction, noting that Charleville required █████ of solvency support to restore its reserves to 10.0% of total assets and that the deadline to address this was 27 April 2012. In the same letter, RCU also addressed, as follows, the three conditions that ILCU, in its letter of 13 February 2012, indicated would need to be satisfied before further SPS support would be made available to Charleville:

- (a) RCU confirmed that it would review the position with respect to the AGMs for the financial years ended 30 September 2010 and 2011 once Charleville complied with the April 2012 Direction;
- (b) RCU confirmed that the lending restrictions were put in place to protect the savings of Charleville's members and to *"ensure that the Credit Union focuses on such risks when making lending decisions"* and that the restrictions would be reviewed once the April 2012 Direction had been complied with; and
- (c) RCU urged ILCU to address any concerns regarding Charleville's viability directly with the Credit Union, and noted that the *"requirement on the Credit Union to restore its RRR to 10% cannot await such correspondence"*.

3.48 On 25 April 2012, Charleville entered into an agreement with ILCU (the **"2012 ILCU Guarantee"**) which made up to █████ of SPS funds available to Charleville to offset losses incurred on non-performing loans, subject to the satisfaction of certain conditions.

3.49 RCU met with Charleville on 27 June 2012 to discuss the status of the proposed SPS support, the AGM process, the requirement for a rotation of board members over a number of AGMs, and lending restrictions. Charleville requested a relaxation of the lending restrictions, which it said, was preventing Charleville from advancing further credit to members of strong credit standing. RCU agreed to review the lending restrictions in the run up to the forthcoming AGM, and in particular to consider the idea of a specific pool of funds to allow borrowings by members in excess of €0.01m. Having carefully considered the lending restrictions RCU decided it was not appropriate to lift them due to Charleville's financial position and in particular its reported reserve position.

3.50 On 4 July 2012, RCU in a letter to Charleville concerning its Board rotation plan stated: *"At the meeting 27 June 2012, it was outlined to the board of directors that it would be in order and consistent with good governance and practices for those directors in position pre the 2008 annual general meeting to resign from their positions. This change in governance should be exercised over time, but at a minimum, by resignations taking place over the 2011, 2012 and 2013 annual general meetings. In addition, the board is required to engage an independent consultant to carry out a full review of the assets of Charleville Credit Union Limited."* In response, Charleville, by letter of 11 July 2012, accepted RCU's request regarding the proposed board rotation and detailed the timing for the resignations of the

- directors concerned. Charleville also noted RCU's request for a full review of Charleville's assets and requested a terms of reference for same.
- 3.51 On 30 July 2012, following engagement with Charleville concerning its draft accounts for the years ended 30 September 2010 and 2011, RCU advised Charleville that it could proceed with the finalisation of details for the AGMs for the years ended 30 September 2010 and 2011. On 2 August 2012, Charleville confirmed the date for the upcoming AGMs as 22 August 2012.
- 3.52 On 3 August 2012, further to a review by RCU of Charleville's PR as at 30 June 2012, which reported, *inter alia*, that: (i) gross loans greater than 9 weeks in arrears represented 57.1% of the total loan book; (ii) 9.2% of the loan book had been written-off; and (iii) a further 1.3% had been rescheduled, RCU issued a letter (the "**August 2012 Letter**") to Charleville, which relaxed the February 2012 Direction as follows:
- (a) restricting the maximum size of loans to members to an amount not exceeding €0.015m (net exposure);
  - (b) prohibiting Charleville from making advances of loans to members in any calendar month where the total loans in that calendar month would exceed €0.25m;
  - (c) prohibiting Charleville from accepting deposits from new or existing members through the issue of shares, where the amount of shares held by any individual member of Charleville together with the amount of deposit held by that member with Charleville would exceed €0.1m; and
  - (d) imposing restrictions regarding investments and expenditure on fixed assets and a requirement to maintain liquidity above 40.0%.
- 3.53 On 14 December 2012, Charleville informed RCU by email that there would be a slight delay in the finalisation of the draft financial statements for the year ended 30 September 2012 (the "**2012 Accounts**") as Charleville's Board had decided to increase the previous SPS claim from ██████ to approximately ██████.

## **2013**

- 3.54 In the period January to March 2013, RCU and Charleville exchanged regular correspondence regarding Charleville's draft 2012 Accounts and the ILCU SPS claim. In an email dated 8 April 2013, Charleville notified RCU that ILCU had requested more information on a substantial number of loan accounts relating to Charleville's claim under the 2012 ILCU Guarantee.
- 3.55 On 22 May 2013, RCU received an email from Charleville setting out that in the 4 months from October 2012 to January 2013, Charleville had not reached the maximum monthly lending limit as set out in the August 2012 Letter. Charleville advised that "*we wish to allocate the above unused lending limit to satisfy current demand this month.*" On 24 May 2013, RCU wrote to Charleville permitting an additional €0.1m to supplement increased lending demand for May 2013. RCU also reminded Charleville that the restrictions of the August 2012 Letter remained in place.
- 3.56 On 25 May 2013, RCU received an email from Charleville, which indicated that ILCU had issued a letter, dated 22 May 2013, confirming that it had engaged MSN to review all of

Charleville's SPS guaranteed loans and the remainder of its loan book. ILCU's letter also requested that Charleville update its strategic plan and financial projections to incorporate the proposed SPS funding and submit these to ILCU.

- 3.57 On 17 July 2013, Charleville indicated that MSN had issued a draft report on 15 July 2013 (the "2013 MSN Report"). Charleville provided RCU with the correspondence it had issued to MSN outlining its concerns and disputing certain findings contained within the 2013 MSN Report.
- 3.58 On 1 August 2013, RCU received an email from Charleville advising that it had breached the monthly lending restriction of €0.25m set out in the August 2012 Letter by approximately €0.0042m. On 1 August 2013, RCU reminded Charleville of the monthly lending limit, and requested that it put in place internal controls to prevent further breaches from occurring.
- 3.59 On 2 September 2013, RCU received an email from Charleville in which it stated that: "*I confirm that a sum of [REDACTED] was received from the ILCU on Tuesday the 27th of August, 2013[sic].*"
- 3.60 On 29 October 2013, in an email to RCU, Charleville advised that its reserves were 9.2% as per the draft management accounts as at 30 September 2013.
- 3.61 In an emailed dated 26 November 2013, RCU advised Charleville of its concern that the Credit Union would fail to meet its reserve requirement for the years ended 30 September 2012 and 30 September 2013, unless it drew down the remainder of the 2012 ILCU Guarantee before the guarantee expired in April 2014.
- 3.62 On 29 November 2013 RCU requested, and was furnished with, a copy of the final 2013 MSN Report. MSN stated that: "*on a strict application of the credit control policy as it is currently stated, we find it difficult to understand how 108 non-guarantee loans have not been written off as they are either over 52 weeks or have made no principal payments in the past 12 months (€4,083,518 are both over 52 weeks and have made no principal payment). These loans have a total loan value of €7,249,642 and therefore are material*".
- 3.63 On 12 December 2013, RCU received an email from Charleville regarding bridging loans. Charleville stated in the email that: "*In relation to your comment on the possibility of converting some of the bridging loans to a term loan, perhaps you might note the following:*
- [REDACTED]
- (b) *To convert one of these to a term loan would require us to reschedule it. We may then run into difficulties with the section 35 guidelines. We would have a concern that it would be just masking the situation on accounts with obvious performance issues.*
- (c) *Prudently we would have to carry [REDACTED] provision on all these accounts. This cost is too onerous on the Credit Union which is the basis for requesting funds under the SPS in the first place.*"
- 3.64 On 13 December 2013, in an email to Charleville, RCU noted: "*that excluding the remaining guarantee (which is deemed as non-claimable at present) the credit union would fail to meet its reserve requirement as at 30 September 2013.*" RCU also commented that: "*this*

*office retains significant concerns in relation to the reliance placed on SPS guarantee to support the reserve position of the credit union."*

## **2014**

- 3.65 On 21 March 2014, RCU received a letter from Charleville setting out that: *"approval of this further payment under the SPS Guarantee brings the Credit Unions reserves to 9.83% at the end of February 2014 and 9.52% as at the 30th of September 2013."* Charleville requested: *"in view of the greatly improved reserve position of the Credit Union, and in view of the ongoing security provided by the SPS Guarantee, that the Central Bank now authorise this Credit Union to proceed with our 2012 and 2013 AGMs"*.
- 3.66 On 26 March 2014, RCU received a further update from Charleville outlining that: *"ILCU are still processing the remaining [REDACTED]"* of its outstanding claim on the 2012 ILCU Guarantee. Charleville reiterated the request that it be permitted to convene AGMs in respect of the financial years ended 30 September 2012 and 30 September 2013, respectively.
- 3.67 On 25 June 2014, RCU received an email from Charleville, which included the GVM Auctioneers valuation of the Premises indicating a value of €0.65m as at 23 June 2014. The email also contained responses to queries raised by RCU on Charleville's financial projections and value in use ("ViU") calculation on the Premises.
- 3.68 On 30 June 2014, prior to it receiving any response from RCU to its last email, Charleville provided further financial projections and ViU<sup>4</sup> calculations to RCU. In the same email, Charleville requested that the monthly credit lending limits: *"should be re-visited in light of the strong and consistent positive performance of our lending portfolio since 2010"*. This email was followed up with a further email from Charleville to RCU dated 8 July 2014, which attached two reports in support of the earlier request to ease lending restrictions and which purported to demonstrate the change in Charleville's lending practices since the lending restrictions were initially imposed on it in December 2009.
- 3.69 Following further correspondence concerning Charleville's ViU calculations, on 9 July 2014, RCU emailed Charleville stating that it would: *"review the existing lending restrictions in due course, following completion of the work on ViU"*.
- 3.70 On 25 July 2014, RCU met Charleville. The primary issues discussed at that meeting included: (a) Charleville's financial position; (b) the drawdown of outstanding SPS claims; (c) the ViU calculation submitted to RCU with respect to the Premises; and (d) the outstanding AGMs for the financial years ended 30 September 2012 and 30 September 2013. RCU outlined to Charleville that the ViU calculation, which it was completing would need to be finalised and agreed by all parties, in advance of a review of the lending restriction and the outstanding AGMs being held.
- 3.71 On 7 October 2014, RCU received a letter from Charleville enclosing the August 2014 management accounts and the management accounts for the year ended 30 September 2014. In this letter, Charleville stated: *"we have attained the required 10% Regulatory Reserve Ratio as previously indicated."* Charleville also requested that the lending restrictions be lifted, or at least reduced, and that it hoped to hold the 2012 and 2013 AGMs in December 2014. While Charleville stated in this letter that it had met the reserve

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<sup>4</sup> ViU is the present value of the future cash flows expected to be derived from an asset, in the case of Charleville, the Premises.

requirement, the revised financial statements which it submitted in April 2017 reported that the reserve ratio was in fact 3.5% as at 30 September 2014.

- 3.72 On 22 October 2014, RCU requested a meeting with Charleville to discuss RCU's concerns over the ViU calculations submitted to RCU and the valuation of the Premises as per the most recent draft financial statements. In its response dated 23 October 2014, Charleville set out that it would not meet with RCU until such time as it had received, in writing, RCU's concerns with respect to its financial position.
- 3.73 On 11 December 2014, RCU wrote to Charleville outlining its concerns regarding Charleville's assumptions in the financial projections in its ViU calculation, advising that these projections did not appear to be realistic and achievable. RCU again requested a meeting with Charleville to discuss all outstanding matters in relation to same.

#### **Summary 2011 - 2014**

- 3.74 RCU retained concerns in respect of Charleville's financial position for the year ended 30 September 2010. In this regard, a number of reviews were carried out by external consultants and by ILCU. The EY Viability Review raised significant concerns regarding the adequacy of Charleville's bad debt provisioning, its solvency and viability. The effect of the independent reviews resulted in Charleville increasing the level of bad debt provisions in the 2010 Accounts and the 2011 Accounts. The Registrar, noting Charleville required [REDACTED] of solvency support, issued the April 2012 Direction, directing the Credit Union to raise and maintain its reserves to 10.0% of total assets by no later than 27 April 2012.
- 3.75 In 2011, Charleville received, in cash, [REDACTED] of the total [REDACTED] of SPS Support under the 2010 ILCU Guarantee. On 25 April 2012, ILCU provided a second SPS guarantee the 2012 ILCU Guarantee to Charleville (replacing the 2010 ILCU Guarantee) of up to [REDACTED]. On 22 August 2012, Charleville held the AGMs for the financial years ended 30 September 2010 and 2011. In the AGM notice for the financial years ended 2010 and 2011, the following financial position for each year was set out:
- (a) for the year ended the 30 September 2010, Charleville reported a balance sheet of €47.6m, total bad debt provisions of €14.7m, and reserves of -9.3% (the 30 September 2010 reserve requirement was at least 8.0%); and
  - (b) for the year ended the 30 September 2011, Charleville reported a balance sheet of €41.7m, total bad debt provisions of €13.2m, and reserves of -8.7% (the 30 September 2011 reserve requirement was at least 8.5%).
- 3.76 The reduction in bad debt provisions in the year ended 30 September 2011 was largely due to loan write-offs of €2.8m and the subsequent release of bad debt provisions of €1.5m. RCU continued to consider the appropriateness of the business restrictions. In light of the significant issues identified in respect of Charleville's financial position and viability, lending restrictions were issued to Charleville in order to limit the potential loss of members' funds.
- 3.77 In the period 2012-2014, Charleville drew down [REDACTED] in cash under the 2012 ILCU Guarantee.
- 3.78 In respect of the financial years ended 30 September 2013 and 30 September 2014, while Charleville received SPS support, RCU still had significant concerns in relation to the level of bad debt provisions and the carrying value of the Premises. RCU required Charleville to

carry out further work in relation to these matters. As noted above, the revised financial statements submitted in April 2017 for this period show that the reserve ratio was in fact 3.3% in the year ended 30 September 2013 and 3.5% in the year ended 30 September 2014.

### **Overview of Regulatory Engagement – 2015 to 2017**

#### **2015**

- 3.79 On 30 January 2015, RCU notified Charleville that MKO Partners (now known, and hereinafter referred to, as “EisnerAmper”) was appointed to undertake an asset review of Charleville pursuant to section 90 and 91 of the CUA.
- 3.80 In a letter dated 27 April 2015, Charleville advised RCU that it: *“has inadvertently breached the requirements of Section 35 as it related to the rescheduling of loans.”*
- 3.81 On 1 July 2015, RCU issued the draft report arising from the asset review undertaken by EisnerAmper to Charleville (the **“Draft 2015 EisnerAmper Asset Review Report”**). Charleville was invited to make any submissions it deemed relevant by 15 July 2015. The Draft 2015 EisnerAmper Asset Review Report identified issues with respect to Charleville, specifically: (a) the viability of its business; (b) its inability to maintain the reserve requirement; (c) the carrying value of the Premises; (d) the reliability of its financial projections and ViU calculation; (e) inadequate bad debt provisions; (f) the methodology and application of its loan provisioning policy; (g) the impact of the business restrictions imposed by the Registrar on the credit union by regulatory direction; (h) its lending practices; (i) its credit control practices; and, finally; (j) [REDACTED]
- 3.82 On 14 August 2015, Charleville made its submissions on the Draft 2015 EisnerAmper Asset Review Report, stating that it had: *“carefully studied and considered the EisnerAmper report, and fundamentally disagrees with, and has serious concerns about, large aspects of the report.... Projections provided to the Central Bank by this Credit Union previously are still valid and show that the Credit Union can operate a viable business model. Notwithstanding this the Credit Union has engaged the ILCU to provide support”*. In addition, Charleville requested an immediate review and lifting of the lending and investment restrictions.
- 3.83 On 30 October 2015, Charleville submitted a report prepared by DHKN to RCU (the **“2015 DKHN Report”**), which identified that an impairment to the value of the Premises was necessary to bring it to market value, as per the GVM Auctioneers valuation dated April 2015. In addition, the 2015 DHKN Report raised concerns in relation to Charleville’s financial position noting the following as *“key challenges”* facing the credit union:
- (a) continued decline in Charleville’s loan book and associated loan interest income;
  - (b) decreasing investment income due to falling rates of return;
  - (c) increased regulatory and compliance costs;
  - (d) investment in IT infrastructure;
  - (e) member expectations of dividend and increased service offerings; and
  - (f) competition from other financial institutions, including other credit unions.

- 3.84 Furthermore, the 2015 DHKN Report stated that: *“due to the level of uncertainty with respect to loan growth, declining investment returns and increasing costs, it is our opinion that the future viability of CCU, operating with no restrictions, will remain challenging and uncertain”*.
- 3.85 RCU met with Charleville on 12 November 2015 to discuss the findings of the Draft 2015 EisnerAmper Asset Review Report and the 2015 DHKN Report regarding the carrying value of the Premises and the [REDACTED]. RCU also highlighted the potential negative impact of these impairments on Charleville’s financial position.
- 3.86 On 18 November 2015, Charleville submitted additional information regarding the status of the *“32 secured loans”* as reported in the 2015 DHKN Report. Charleville noted that *“this figure has reduced to 23 Active loans, with 7 resolved since the DHKN review of April, 2014, and a further 2 resolved since the DHKN review of October, 2015. Regarding the further three performing secured loans we discussed previously, please note that the Credit Union takes your comments fully on board. I wish to confirm that in the event any of these performing loans falls into arrears, Charleville Credit Union Limited will disregard the value of security attaching to the loan, and will fully apply the appropriate Resolution 49 provision, without discount.”*
- 3.87 In an email dated 20 November 2015, RCU acknowledged the additional information provided by Charleville, noted the matters discussed at the meeting on the 12 November 2015, and advised Charleville that it was *“prudent that Charleville Credit Union reflect full provisions for the remaining 23 Active Loans”*.
- 3.88 In an email exchange between Charleville and RCU on 24 November 2015, RCU clarified the need for Charleville to recognise on a prudent basis the bad debt provision requirement on a specific portfolio of non-performing loans and a fixed asset impairment as identified in the Draft 2015 EisnerAmper Asset Review Report and the 2015 DHKN Report.
- 3.89 In an email dated 27 November 2015, Charleville advised, *“the Board of Directors agreed at their meeting last night to resubmit the Prudential Return for September as per your request”*.
- 3.90 On 30 November 2015, Charleville submitted a revised PR for the financial period ended 30 September 2015 (the **“Revised September 2015 PR”**). Bad debt provisions increased to €5.6m and an impairment to the carrying value of the Premises of €0.98m was included. Based on the Revised September 2015 PR, Charleville reported reserves of 4.6% of total assets.
- 3.91 In a letter dated 1 December 2015, Charleville outlined to RCU the updates contained in the Revised September 2015 PR. Charleville advised it was reducing the carrying value of the Premises to market value in line with the 2015 DHKN Report, and stated that its Board had decided to *“[REDACTED]”* thereby ensuring that loans greater than 52 weeks in arrears were fully provided for.
- 3.92 On 21 December 2015, RCU requested Charleville to engage a firm of consultants to complete an updated assessment of Charleville’s viability.
- 3.93 On 22 December 2015, based on Charleville’s reserve position of 4.6%, as reported in the Revised September 2015 PR, the Registrar issued a letter to Charleville confirming that she

was “minded to” issue a regulatory direction in respect of Charleville’s capital and business activities. RCU requested that Charleville revert with any submissions deemed relevant by 14 January 2016.

## 2016

- 3.94 On 29 January 2016, Charleville provided RCU with a report prepared by MSN (the “**2016 MSN Report**”) relating to a review of specified viability matters. On 22 February 2016, Charleville provided additional information on foot of a request from RCU, which included an internal audit report dated January 2016 (the “**2016 Internal Audit Report**”). The 2016 Internal Audit Report focused on the risk management and compliance processes within Charleville.
- 3.95 On 9 March 2016, RCU met with representatives of Charleville to discuss the findings of the 2016 MSN Report. During this meeting, RCU outlined its concerns regarding the risks to the future viability of Charleville, its ability to continue to operate on a standalone basis and grow the performing loan book to the minimum loan level (€13.5m) to be sustainable on a standalone basis within the required timeframe as outlined in the 2016 MSN Report. The 2016 MSN Report noted that the: “*loan to asset ratio is the single biggest threat to the future viability of CCU*” and highlighted the risks that: “*the credit union becomes undercapitalised during the period of growth, mindful that the regeneration of the loan book to €13.5m will take a number of years*”.
- 3.96 On 24 March 2016, Charleville advised RCU that its Board had: “*decided that a voluntary transfer of engagements would be in the best interest of the Credit Union*” and in doing so it effectively acknowledged that the Credit Union could not continue as a standalone entity. In addition, Charleville stated that: “*the Board is in discussion with the Irish League of Credit Unions to ensure that appropriate financial support will be made available by the League through its SPS Fund to facilitate an approved voluntary transfer*”. On 19 April 2016, Charleville advised RCU that it met with ██████ Credit Union Limited (“█████”) to discuss a potential transfer of engagements (“**ToE**”).
- 3.97 In the PR for the financial period ended 31 March 2016, Charleville reported reserves of 4.9% of total assets. On this basis, RCU issued the June 2016 Direction directing Charleville to raise and maintain its reserves to 10.0% of total assets and limiting Charleville’s business activities.
- 3.98 In an email dated 21 April 2016, RCU stated it did not have a: “*fundamental objection to ██████ Credit Union as a potential transferee*”. However, RCU also set out its concerns in relation to the potential ToE, in particular in respect of the potential post-transfer issues arising from the recent conclusion of a number of other ToEs by ██████ as noted by: “*as per our discussion there are existing transfer of engagements underway which may increase the overall risk of a proposed transfer of engagement of Charleville Credit Union to ██████ Credit Union. It is imperative that the Board considers all options available to ensure that any transfer of engagements creates a stable entity for the benefits of the combined membership*”.
- 3.99 On 22 June 2016 Charleville emailed RCU advising that: “*as of 1 January, 2016, the Credit Union held 5 accounts with balances in excess of €100k*”. Charleville noted that one member’s savings account remained above €0.1m stating that it was “*proving difficult to resolve*”. This matter gravely concerned RCU as it breached the Credit Union Act 1997 (Regulatory Requirements) Regulations 2016 (the “**2016 Regulations**”). Charleville had



previously advised RCU, on a number of occasions, that none of its members' savings exceeded the €0.1m limit imposed on Charleville.

- 3.100 By way of email dated 5 July 2016, Charleville confirmed that: *“Charleville Credit Union has fully complied with the Regulatory Direction dated 14 June, 2016 to raise ██████ in solvency support by 4pm on 5 July 2016, to restore regulatory reserves to the required 10%. Written confirmation will follow when it is received from the ILCU”*. In respect of Charleville maintaining reserves of at least 10.0% of total assets, Charleville stated that it is: *“at an advance stage of negotiations with MCU regarding a transfer of engagement”*. It is important to note that ILCU's funding was conditional on the proposed ToE process completing. In addition, ILCU was the only party mandated to access the funds (which were held in an account in the National Treasury Management Agency (“NTMA”), in the name of Charleville) and as such, Charleville was unable to draw down these funds.
- 3.101 The SPS fund administered by ILCU provides support to ILCU-affiliated credit unions in financial difficulties, and is provided at ILCU's discretion. Prior to 2014, SPS support was generally provided in the form of a “loan guarantee”, which is more accurately described as a binding agreement to acquire a credit union's non-performing loans for a certain value, subject to the credit union satisfying certain specified conditions, including that the relevant loans covered by the “guarantee” are written-off or impaired within two years. Under these arrangements, once the conditions with respect to the loans covered by the guarantee were satisfied, the credit union applies to drawdown funds from SPS and ownership of the loans would pass to ILCU on behalf of SPS.
- 3.102 Previously, the Bank accepted that the SPS support provided in the manner described above could be taken into account by the relevant credit union when calculating its reserves even in circumstances where the SPS guarantee had not been drawn down. However, with effect from 1 January 2016 as per the requirement set out in 2016 Regulations, the Central Bank requires any financial support received by credit unions in financial difficulties, would not satisfy the reserve requirement unless such support is provided in cash, which is unrestricted, fully realised and non-distributable and is fully loss-absorbing capital, to ensure greater certainty in respect of a credit union's reserves. This aspect of the 2016 Regulations emerged following a public consultation undertaken by the Central Bank on regulations for credit unions in respect of the commencement of the remaining sections of the Credit Union and Co-operation with Overseas Regulators Act 2012 (the “**2012 Act**”) in November 2014. A feedback statement along with final regulations was published in July 2015. Furthermore, a notification regarding the commencement of these regulations was sent to all credit unions on 22 December 2015 ahead of commencement of the regulations on 1 January 2016. The June 2016 Direction issued to Charleville on 14 June 2016 set out, *“Credit Union must raise and maintain its regulatory reserve requirement (as set out in the Regulations) to at least 10% of the assets as at 31 March 2016 and in order to do so must raise an amount of ██████ in solvency support. This solvency support must be in place no later than 4pm on 5 July 2016 and this support must be provided in cash form only and lodged to a bank account in the name of the Credit Union.”*
- 3.103 Having regard to the foregoing and requirements of the 2016 Regulations, it was incorrect for Charleville in its email of 5 July 2016 to assert that it had complied with the June 2016 Regulatory Direction due to the conditional offer of funds from ILCU.
- 3.104 By email dated 25 July 2016, Charleville noted: *“at this point in the month, we are in a position that, following our recent loan approvals, we will exceed the maximum of*

€250,000.00 loan sanctions for the month of July". Charleville stated that as: "we have advanced loans to less than the permitted €250,000.00 for the past two months, €68,900.00 below in May and €25,325.09 in June, we request that you give favourable consideration to permitting us advance loans to say, €350,000.00 for the month of July (a minimum of an additional €100,000 for this month)". In an email dated 25 July 2016, RCU stated that it had considered Charleville's request and noted that: "this office is not in a position to approve your request at this time and that the monthly loan issuance level as set out in the Regulatory Direction of 14 June 2016 remains in place".

- 3.105 On [REDACTED], RCU emailed Charleville advising that the proposed ToE to [REDACTED] should not proceed: "[REDACTED]". RCU had decided this as [REDACTED] - factoring in Charleville's issues – would not have been feasible. RCU advised Charleville that it remained: "fully committed to working with the credit union to help identify the most suitable transfer option to address the financial position of the credit union".
- 3.106 In a letter to RCU dated [REDACTED], Charleville stated: "in light of the Bank's view that [REDACTED], the Board of CCU have decided to terminate the transfer process with [REDACTED] and have advised [REDACTED] accordingly". Charleville advised that it had made: "informal contact with Clonmel" in relation to a proposed ToE.
- 3.107 On 22 September 2016, Charleville requested RCU to permit it to temporarily exceed the monthly lending limit as detailed in the June 2016 Direction, specifically that it be: "permitted to carry forward elements not drawn down from previous months". On 28 September 2016, RCU responded to Charleville setting out the rationale for issuing the June 2016 Direction: "the circumstances that required the issuance of a Regulatory Direction remain present and as such, the Credit Union is not currently in a position to demonstrate that it has adequate capital resources as required under Regulation 4 of the 2016 Regulations."
- 3.108 At a meeting on 17 October 2016, RCU met with representatives of Charleville, Clonmel Credit Union Limited ("Clonmel") and ILCU to discuss the proposed ToE. RCU outlined the steps involved in the ToE process and issued a timeline for the completion of the proposed ToE. RCU noted three key issues for consideration at this stage of the process: (a) Charleville's operating cost base; (b) the operating structure for the combined entity; and (c) the carrying value of the Premises. RCU outlined that operational risk would be reviewed as part of its assessment of the asset review and due diligence reports that were being prepared by Grant Thornton ("GT") on behalf of Clonmel as part of the ToE process.
- 3.109 In an email dated 4 November 2016, RCU noted that based on the PR for September 2016 there was a single member with savings in excess of €0.1m. RCU referred Charleville to Regulation 35 of the 2016 Regulations, regarding the savings limit of €0.1m. RCU formally reminded Charleville of the legislative requirement that no member is permitted to hold savings in excess of €0.1m and that Charleville was required to arrange and effect the repayment of the remaining savings over €0.1m. RCU requested that Charleville revert with details as to how the repayment was to be made.

- 3.110 On 8 November 2016, Charleville responded to RCU in relation to savings in excess of €0.1m and stated it had been: *“endeavouring to resolve this matter which is quite difficult given the personal circumstances of the parties involved”* and advised it would revert once the matter is finalised.
- 3.111 In an email dated 1 December 2016, Charleville confirmed that there were no member savings in excess of €0.1m, as the member who previously had savings in excess of €0.1m had been repaid.
- 3.112 On 6 December 2016, RCU issued a letter to Charleville indicating its intention to issue a regulatory direction restricting the business activities of Charleville. The proposed limits were the same as those set out in the June 2016 Direction. On 12 December 2016, Charleville responded to RCU’s letter in which it acknowledged: *“the view points of the Central Bank”* and had no objection to proposed regulatory direction number 3 regarding restrictions on investments. However, Charleville requested RCU to revisit the proposed limits in relation to lending.
- 3.113 On 19 December 2016, RCU issued a regulatory direction (the **“December 2016 Direction”**) on business activities to Charleville as the June 2016 Direction had expired<sup>5</sup>. In considering its submissions, RCU noted that Charleville was reporting reserves of 4.8% of total assets as at 30 September 2016 and as such, did not comply with the requirement to maintain reserves of at least 10.0% of total assets. In addition, RCU noted that Charleville had previously received SPS support in the form of the 2010 ILCU Guarantee and the 2012 ILCU Guarantee (together the **“ILCU Guarantees”**) to raise and maintain its reserve position to 10.0% of total assets. RCU acknowledged that Charleville was in a ToE process with Clonmel but noted that ILCU’s support of █████ was conditional on the proposed ToE completing.
- 3.114 In light of above, the December 2016 Direction also imposed regulatory lending restrictions on the following terms:
- (a) restricting the maximum size of loans to members to an amount not exceeding €0.015m (net exposure);
  - (b) prohibiting Charleville from making loans to members in any calendar month where the total loans in that calendar month would exceed €0.25m; and
  - (c) refrain from making investments other than investments in deposit accounts of the kind set out in Regulation 25(1)(b) of the 2016 Regulations.

### **2017 – January to March**

- 3.115 On 4 January 2017, RCU received Charleville’s asset review conducted by GT (the **“GT Asset Review”**). On 7 February 2017, as part of the ToE process, RCU was provided with an updated market valuation by D.J. Hayes & Co. Ltd Certified Auctioneers and Valuers, dated 2 February 2017, valuing the Premises at €0.38m. On 14 February 2017, Charleville submitted GT’s due diligence report on Charleville, (the **“GT Due Diligence Report”**) which identified material risks with regard to its business including, *inter alia*: (a) capital risk; (b) governance risk; (c) operational risk; and (d) strategic risk.

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<sup>5</sup> Regulatory directions relating to certain business activities are valid for a period of six months (section 87(3)(a) CUA).

- 3.116 On 15 February 2017, RCU raised queries with Charleville regarding the Premises, savings stamps and ILCU pension scheme in the context of the ToE. RCU noted that a number of adjustments were identified in the GT Asset Review and GT Due Diligence Report including an impairment to the Premises and asked Charleville to confirm whether these adjustments had been subsequently reflected in the draft financial statements. On 20 February 2017, Charleville responded to RCU's queries and confirmed it would discuss the adjustments arising from the GT Due Diligence Report with its auditors and the revised market valuation of the Premises, in the sum of €0.38m, would be reflected in the final financial statements.
- 3.117 On 23 February 2017, RCU met with representatives from Clonmel, Charleville and ILCU to discuss the proposed ToE. RCU raised concerns in relation to: (a) the market valuation and [REDACTED]; and (b) the detailed business case and financial projections received in respect of the organisation structure of the proposed combined credit union, the lack of cost saving analysis and the absence of detailed assumptions.
- 3.118 On 27 February 2017, Charleville emailed RCU advising there was a delay in receiving the 2016 draft financial statements from its auditor as: *"they speak about including the impairment of the building for all the years as far back as 2012, the situation is similar with [REDACTED]"*.
- 3.119 On 2 March 2017, Clonmel emailed RCU a copy of the signed petition from its members to hold a Special General Meeting ("**SGM**") to discuss the proposed ToE following the public meeting held on 28 February 2017. In an e-mail, dated 2 March 2017, Clonmel confirmed that the 75 signatories on the petition were from a qualifying group as per the CUA. During a call with RCU on the same day, Clonmel stated that it was committed to the ToE proceeding. However, Clonmel noted that there were obstacles in the process, which needed to be addressed. RCU noted the urgency of the situation advising that a timeline to address outstanding actions needed to be prepared. Clonmel requested a meeting with RCU on 9 March 2017.



- 3.121 On 8 March 2017, RCU met with representatives from both Clonmel and ILCU. Clonmel advised that its board of directors was committed to proceeding with the due diligence stage of the ToE. However, Clonmel expressed its concern regarding the recent media coverage and the possible reputational damage to Clonmel.
- 3.122 In an email to Clonmel dated 15 March 2017, RCU requested that before Clonmel undertook any further actions in respect of the ToE or proposed SGM, that Clonmel would meet with RCU to discuss outstanding matters and issues in respect of the ToE.
- 3.123 At a meeting dated 22 March 2017 with representatives from RCU, Clonmel, Charleville and ILCU, Clonmel advised all parties that it had decided not to proceed with the ToE referring to the number of risks it presented as outlined in previous correspondence. Clonmel advised that [REDACTED] was a major factor in Clonmel's board of directors' decision not to proceed with the ToE.

- 3.124 In an email to RCU dated 23 March 2017, Charleville stated that it had: *“resolved to source another suitable Credit Union with which to complete a merger”*.

#### **Summary – 2014 to March 2017**

- 3.125 Notwithstanding Charleville’s reported reserves of 10.7% as at 30 September 2014, RCU continued to have concerns regarding the level of bad debt provisioning and Charleville’s viability due to the assumptions used in the financial projections in its ViU calculation. In fact, as is clear from the revised financial statements submitted in April 2017 for the year ending 30 December 2014 the actual reserves were 3.5%.
- 3.126 Charleville requested that RCU review its lending restrictions. However, following the completion of the reviews undertaken by EisnerAmper and DHKN in 2015, which identified viability, Premises impairment and loan portfolio impairment issues, RCU did not consider it appropriate at that time to review the restrictions.
- 3.127 The Draft 2015 EisnerAmper Asset Review Report and the 2015 DHKN Report identified requirements for additional bad debt provision and impairments to the Premises. When these adjustments were taken into account by Charleville, its financial position deteriorated further. Charleville submitted its Revised September 2015 PR, in which it increased its bad debt provision to €5.6m and reflected an impairment to the Premises of €0.98m. As such, Charleville reported total assets of €42.5m and reserves of 4.6% of total assets.
- 3.128 Following the 2016 MSN Report, Charleville advised RCU that a ToE was in the best interests of its members. Two proposals with respect to two credit unions followed. The first proposal was initiated in early 2016. However, this process ultimately failed to complete in August 2016. The second proposal was initiated in September 2016. However, in March 2017, this process failed. A further updated market valuation (which was required as part of the ToE process) dated 2 February 2017 valued the Premises at €0.38m. When Charleville reflected this further impairment in its March 2017 PR it reported reserves of 3.3% of total assets.
- 3.129 Given the on-going uncertainty with respect to Charleville’s financial position, RCU did not consider it appropriate, at that point in time, to relax the lending restrictions, as a fundamental priority of RCU is the protection of members’ savings. RCU was particularly mindful of the financial projections Charleville submitted, which indicated it would have to re-enter the lending market and potentially lend at levels similar to prior years (2007-2009), which would have increased the possibility of further losses and, therefore, the ability of Charleville to maintain reserves at the appropriate levels in the interests of protecting members’ funds.

#### **Detailed account of regulatory engagement with Charleville from April 2017 to date**

- 3.130 On 5 April 2017, Charleville submitted revised draft financial statements for the financial years ended 30 September 2014 - 2016. The figures reported in these revised accounts in respect of bad debt provisions and fixed assets materially differed from the original financial statements submitted by Charleville in the respective years. The information at Section 4 below provides a summary of these revised financial statements and the impact thereof on Charleville’s financial position compared with the position originally reported to RCU. It is now evident from the revised financial statements that, since the introduction of the reserve requirement at 30 September 2009, Charleville has failed to consistently maintain its reserves at the required level.

- 3.131 In a letter dated 7 April 2017, the Registrar notified Charleville that, in light of its failure to comply with its obligation to continually maintain reserves of at least 10.0% of total assets, she was minded to issue a regulatory direction to Charleville requiring it to: (a) raise its reserves to at least 10.0%; and (b) raise and maintain an additional reserve of 3.5% in the form of €1.5m in solvency support and to demonstrate a capacity to maintain the additional reserve at that level. In that letter, the Registrar invited Charleville to make any submissions regarding the proposed regulatory direction in writing to RCU by not later than 21 April 2017. The Registrar also confirmed that if the regulatory direction was issued, Charleville would be expected to comply within a two-week timeframe from the date of issue.
- 3.132 Charleville provided submissions on 12 April 2017 to RCU in response to the Registrar's letter of 7 April 2017. The key comments made by Charleville in those submissions may be summarised as follows:
- (a) Charleville commented that the: *"ongoing existence of draconian lending and investment restrictions over such a duration has had the inevitable consequence of limiting the Credit Union's ability to grow and develop its business base, rectify legacy loan book issues, and the sustainment of adequate reserves"*, and that: *"these are the reasons for the Credit Union's inability to generate the required levels of operational income"*;
  - (b) Charleville asserted that it: *"had obtained a Regulatory Reserve position of 10.3%, as @ 31 December, 2014"* and had *"been given to understand by your office, that when the Regulatory Reserve had attained the required 10%, that you would be favourably disposed to reviewing the lending restrictions in place in the Credit Union"*;
  - (c) Charleville further asserted that it had: *"worked very hard to achieve the required Regulatory Reserve, and it has been an ongoing cause of frustration and disappointment that the lending and investment restrictions continue to remain in place with no easing or reduction whatsoever"*;
  - (d) Charleville contended that: *"the key issue is the continued decline of the Credit Union loan book, and the associated loss of business to other financial institutions, as a direct result of the Credit Union's inability to trade normally due to the presence of lending restrictions"*;
  - (e) Charleville offered the view that the: *"Central Bank inaction regarding the easing of both lending and investment restrictions, because they have been in place for such a considerable period of time, did make the viability of the Credit Union challenging, but also, in our considered view, eminently achievable, because of our fiercely loyal membership, and our ongoing inability to consider applications from members because of the existence of the lending restrictions"*; and,
  - (f) Charleville commented that it had taken: *"actions regarding writing down the value of the premises, and disregarding security valuations on loans, in the belief that we would get fair play, and support from the Central Bank"*, that such actions: *"had a clear and obvious impact on the Regulatory Reserve, reducing it to a figure of 4.9%"* and it believed that having taken these measures: *"we would quickly see a review of the lending and investment restrictions, as outlined, as tangible evidence of your support for*

*the Credit Unions' addressing these legacy issues" but that: "sadly this has proven not to be the case".*

- 3.133 With respect to the June 2016 Direction, Charleville commented that given the continuation of the lending and investment restrictions: *"income generation was never going to be anywhere near the required level to achieve a Reserves figure of 10%", that the issuance of the June 2016 Direction "smacked of a "box-ticking" exercise - and was clearly never going to be achieved by the Credit Union, because the Central Bank, the very organisation insisting that the Reserves be restored, were at the same time preventing the Credit Union from being in a position to do so".*
- 3.134 In relation to the proposed ToE with [REDACTED] Charleville asserted that: *"unfortunately and inexplicably, the Credit Union did not receive the necessary support we believed was necessary from your office, to facilitate and reassure all stakeholders, that this merger was in the best interests of all parties".*

- [REDACTED]
- 3.136 Regarding the Registrar's concerns in relation to governance issues, Charleville commented that it: *"fundamentally disagrees" with RCU's assessment and that: "the challenges that Charleville Credit Union Limited has been working through, are not attributable to negative or lax Governance as implied, but because of the presence of restrictions limiting the ability of the Credit Union to trade normally".* Charleville also asserted that: *"the Directors, the membership and the public in Charleville deserve to be informed as to what the Central Bank considers to be the most appropriate plan for their Credit Union", and that: "clearly the Central Bank has a view as to what they perceive to be the best solution for the membership of Charleville Credit Union Limited, but have never disclosed this to the Credit Union".*
- 3.137 Finally, Charleville notified RCU that it had written to ILCU outlining the SPS funding required to comply with the proposed directions, that the deadline for submissions was *"very tight"* and therefore requested an extension: *"for a number of weeks, to permit us to make the necessary representations, and obtain the required support from the Irish League of Credit Unions, and raise the funding required".*
- 3.138 On 19 April 2017, RCU issued a letter to Charleville in which it confirmed that: (a) the Reilly Report had previously been provided to Charleville by email on 12 April 2017 (but provided another copy for convenience); and (b) the deadline for further submissions was extended to 28 April 2017. On 20 April 2017, Charleville submitted a PR to RCU for the period ended 31 March 2017 (the **"March 2017 PR"**), which reported that Charleville's reserves were 3.3% as at 31 March 2017.
- 3.139 In a further letter to RCU dated 28 April 2017, Charleville advised that it had formally applied to ILCU for further SPS support. This letter also enclosed a further letter from NLCC Solicitors dated 27 April 2017, which sought to address the concerns raised by RCU on foot

of the Reilly Report with respect to [REDACTED]. In their letter, NLCC Solicitors:

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

3.140 Having duly considered Charleville's submissions received on 12 April 2017 and 28 April 2017, and the continuing financial issues faced by Charleville, the Registrar issued the May 2017 Direction on 4 May 2017 requiring Charleville to:

- (a) raise its reserves to 10.0% as at 31 March 2017 and in order to do so, raise €3.14m in solvency support in cash to be lodged in an account in the name of Charleville; and
- (b) raise and maintain an additional reserve of 3.0% of its total assets and in order to do so, raise €1.27m in solvency support; and
- (c) comply with the above directions on or before 4pm on 18 May 2017.

3.141 In the May 2017 Direction, RCU noted the following with respect to the submissions received from Charleville:

- (a) with respect to Charleville's submissions concerning the ongoing lending and investment restrictions imposed by RCU on Charleville, RCU noted that: "*there has been an extensive regulatory engagement with the Credit Union over an extended period of time*" which has focused on the failure of the Credit Union to: "*adequately address the pervasive and reoccurring issues relating to loan impairments, bad debt provisioning and fixed asset impairments*";
- (b) RCU noted that in its letter dated 12 April 2017, Charleville asserted it: "*had obtained a Regulatory Reserve position of 10.3% as @ 31 December, 2014*". However, RCU pointed out that on 5 April 2017 Charleville had submitted revised draft financial statements to RCU in respect of the years ended 30 September 2014 - 2016, and that the revised financial statements for the year ended 30 September 2014 included additional bad debt provision of



€2.0m and an impairment in the carrying value of the Premises totalling €1.3m which reduced the previously reported reserves as at 30 September 2014: *“from 10.7% to 3.5%”*;

- (c) RCU asserted that it is clear that: *“the Credit Union is failing and has failed over a period of time to maintain the required minimum reserve of 10% of total assets”*; and on that basis: *“the Central Bank has not been, and is not in a position to consider removing the restrictions placed on the Credit Union’s business activities, in the interest of safeguarding member’s funds and the stability of the credit union sector”*; and
- (d) RCU noted that, notwithstanding the additional information contained within the letter received by Charleville from NLCC Solicitors [REDACTED]  
[REDACTED]  
[REDACTED]. However, having considered the advice received from NLCC Solicitors, RCU revised the additional reserve requirement proposed in its letter of 7 April 2017 from 3.5% to 3.0% of total assets, thereby decreasing the amount of the additional reserve from €1.5m to €1.27m as at 31 March 2017.

3.142 On 17 May 2017, RCU received a letter from Charleville in response to the May 2017 Direction on the following terms:

- (a) Charleville disputed that it had failed to address the fundamental issues affecting it, noting that it had been working with RCU over a prolonged period of time at huge operational cost. Charleville asserted that it: *“always fully adhere to your directives”* which it claimed had the effect of reducing the reserves to the present levels rather than any inaction on Charleville’s part;
- (b) Charleville noted that, whilst an additional operational risk reserve of 3.5% had been proposed by RCU in its letter of 7 April 2017, the May 2017 Direction provided for a reduced additional reserve of 3.0% in light of the advices provided to Charleville by its solicitors, NLCC Solicitors with respect to [REDACTED]  
[REDACTED]
- (c) Charleville stated that ILCU had confirmed to it in writing that if Charleville found a suitable transferee for a ToE that was acceptable to RCU, it would give *“serious consideration”* to providing SPS support for any such ToE; and
- (d) Charleville advised that it was continuing with its efforts to identify a suitable transferee and that it had had initial discussions with a potential transferee. However, Charleville asserted that it was *“completely pointless”* to continue with those efforts without the Central Bank’s support and requested that the Central Bank give detailed guidance and direction as to which credit union it deems most suited to a ToE with Charleville.

3.143 On 23 May 2017, RCU responded to Charleville’s letter of 17 May 2017 on the following terms:

- (a) RCU rejected Charleville's assertion that it had always fully adhered to regulatory directions issued by the Central Bank and noted that despite receiving c█████ in SPS support between 2010-2014, Charleville: (i) has been unable to raise and maintain its reserves to 10.0% since 2009; (ii) has been unable to convene an AGM since the year ended 30 September 2011; and (iii) is in breach of its obligations under both the June 2016 Direction and the May 2017 Direction;
- (b) RCU reiterated its view that Charleville has been unable to address its fundamental financial difficulties and in that context referred to: (i) the revised financial statements relating to each year since 2013 submitted by Charleville in April 2017 which made it clear that Charleville had previously materially understated bad debt provisioning requirements and fixed asset impairments, and had not met the reserve requirement of 10.0% during those periods and; (ii) the most recent PR submitted by Charleville which reported reserves of 3.3% as at 31 March 2017;
- (c) RCU reiterated that the Central Bank holds significant concerns regarding Charleville's future viability and its ability to remain as a standalone credit union, concerns which have been confirmed by a number of independent reviews conducted in respect of Charleville in recent years;
- (d) RCU noted that Charleville had unsuccessfully attempted on two previous occasions to implement a ToE and that accordingly, RCU had serious concerns with regard to Charleville's ability to complete a ToE even if another suitable transferee was identified;
- (e) RCU explained that it was not the role of the Central Bank to identify or propose potential transferees but rather to ensure that the ToE process complies with the requirements of the CUA and to consider whether the Central Bank should confirm the ToE, and that if Charleville had identified a suitable and willing transferee it should immediately notify the Central Bank; and
- (f) RCU advised of its view that it was not in the interests of the public, Charleville's members, or the credit union sector as a whole, for Charleville's current situation to continue indefinitely, and the Central Bank reserved the right to exercise its powers under the 2011 Act should Charleville be unable to submit a detailed proposal to RCU by 16 June 2017, detailing how it could immediately comply in full, and on a sustainable basis, with its obligations under the May 2017 Direction.

3.144 On 8 June 2017, RCU received a letter that was printed on the office paper of Charleville, but which was signed by a number of its employees in which they outlined concerns with regard to the future of Charleville.

3.145 On 13 June 2017 RCU received a further letter from Charleville confirming that: *"the Board of the Irish League of Credit Unions formally resolved on Saturday, 10<sup>th</sup> June, 2017, to lodge a further ██████ to the National Treasury Management Agency account in the name of Charleville Credit Union Limited"* and asserting that such lodgement would *"increase the total funds in this account to ██████, which will have the effect of both restoring the Regulatory Reserves position to the required levels, while also providing finance for the Additional Reserve of 3%"*.

3.146 On 15 June 2017 RCU received a detailed letter from Charleville in response to RCU's letter to Charleville of 23 May 2017. The principal issues raised in the letter are summarised below:

- (a) Charleville reiterated that it had *"at all times co-operated with the Central Bank"* and had *"undertaken all necessary actions within the power and scope of the Credit Union, to ensure compliance with all relevant legislative and regulatory directions"*.
- (b) Charleville asserted, with respect to the June 2016 Direction, that it had *"sourced funding support from the Irish League of Credit Unions to restore our Reserves, and such funds had been placed in a NTMA account in accordance with your instructions"* and that *"up until the time of your instruction of 24<sup>th</sup> November 2015, to disregard security valuations and readjust the premises valuation, the Credit Union had been in full and complete compliance with the 10% reserve requirement"*.
- (c) With regard to the May 2017 Direction, Charleville also asserted that it will be in a position to comply as a result of the decision of ILCU to *"provide SPS support to any TOE by the Credit Union which has Central Bank approval"*.
- (d) Charleville stated, with regard to the Central Bank's letter of 23 May 2017 and the fact that Charleville had failed to raise and maintain its reserves to the required level, that the letter created a *"false and potentially misleading impression"* that Charleville had *"permitted such a position regarding the Reserves to arise, and had chosen a course of inaction in response"* and the reason that its reserves are at their current levels below 10.0% *"was as a result of the Credit Union complying with your instructions to both disregard the [REDACTED] and apply an adjustment to the premises valuation"*.
- (e) Charleville acknowledged that it is *"important to point out"* that the additional lodgement of [REDACTED] into the NTMA account in the name of Charleville *"is not taken into account by the Central Bank for the purposes of calculating the present statutory reserve position of Charleville Credit Union Ltd"*.
- (f) Charleville referred to an email exchange between it and Mr Eamon Clarke of the Central Bank from 24 November 2015 which, Charleville asserts, constituted an instruction to amend its PR for 30 September 2015 to *"[REDACTED]"* and *"[REDACTED]"*. Further, Charleville asserts that the *"nett effect of the board's compliance with these instructions by the Central Bank was to reduce Charleville Credit Union Ltd reserve by a further 6%"* and that the email exchange with Mr Clarke demonstrated that *"this was the decision of the Central Bank and the Credit Union was required to comply with it"*.
- (g) Charleville stated that it had restated its financial statements for the financial years ended 30 September 2013 to 2016 because there had been a change in applicable financial reporting standards and asserted that Charleville *"did not materially understate the provisioning requirements and"*

*fixed asset impairments, but reported them in a factual manner in accordance with accepted accounting standard requirements”.*

- (h) In response to the Central Bank’s comment in its letter of 23 May 2017 with regard to Charleville’s high cost base, Charleville stated that over the previous five years it had *“almost halved its payroll cost and has reduced its staff compliment by 40%, together with absorbing significantly increasing regulatory and compliance expenditure in common with the Credit Union movement generally”.*
- (i) Charleville asserted that it was: *“unable to improve its trading position because of the ongoing draconian and punitive operational restrictions imposed by the Bank on lending and investments, both in place for a considerable period of time”,* which had as a consequence *“the gradual reduction of our ability to grow and develop our business - primarily through core lending income”.* Charleville further asserted that its inability to grow its business was the *“fundamental issue in Charleville Credit Union Ltd”* not *“solely the reserves position”* as suggested by the Central Bank in its letter of 23 May 2017.
- (j) With regard to Charleville’s efforts to implement a ToE with [REDACTED] Charleville claimed that the Central Bank, having initially indicated its support for the ToE *“had a change of mind to this joint approach at some point”* and complained that it was *“confusing in the extreme for Charleville Credit Union Ltd to be permitted by your office to proceed with a merger process with [REDACTED] Credit Union Ltd, [REDACTED]”.*
- (k) Charleville further claimed it had taken encouragement from an email from the Central Bank dated [REDACTED] which stated that it *“intended to engage in a more active way with the Credit Union”* after the proposed ToE with [REDACTED] did not proceed, but again complained that the Central Bank appeared to *“again have changed its mind on this approach at some point”* and referred to the statement in the Central Bank’s letter of 23 May 2017 wherein it reminded Charleville that it was *“not the role of the Central Bank to identify or propose potential ToEs between credit unions”.*
- (l) With regard to the proposed ToE with Clonmel, Charleville stated that the *“circumstances surrounding the termination of the ToE process by Clonmel Credit Union Ltd are unclear”* and *“came as a huge surprise and shock”* and claimed that *“on 15 March, 2017, the Central Bank directed Clonmel Credit Union Ltd to cease all ToE activities and requested a meeting between the Central Bank and Clonmel Credit Union Ltd, which we understand did not take place”.*
- (m) Charleville also asserted that *“the reasons the two proposed Transfers of Engagement did not proceed were because your office did not permit the first to proceed, having initially permitted it, and the second is less clear, because at an advanced stage of the transfer of engagement process, the Central Bank met with the Board of Clonmel Credit Union Ltd, and shortly thereafter, all activities were halted, and the transfer process terminated by Clonmel Credit Union Ltd”.*

- (n) Finally, with regard to its continuing efforts to identify a ToE, Charleville argued that it would *“not be unduly difficult to source a suitable partner Credit Union, with your support, assistance and encouragement”* for which the process would be *“greatly eased by the decision made in May 2017 by the Board of Directors of ILCU to provide SPS support to any ToE by the Credit Union which has Central Bank approval”*. However, Charleville also confirmed that it had not, at the date of its letter, *“obtained a formal expression of interest from a potential ToE partner”* but contended that *“without the constructive engagement of the Bank in that process, it is possible that we may not succeed”*.

3.147 On 23 June 2017 the Central Bank responded to Charleville’s letters of 13 June 2017 and 15 June 2017 on the following terms:

- (a) The Central Bank noted that while Charleville argued that the recent deposit of ██████ made by ILCU into an account with the NTMA, resulted in it having restored its reserves to the required levels, pursuant to Regulation 3 of the 2016 Regulations, in order for SPS support to be included within Charleville’s reserves it must constitute *“capital that is unrestricted, fully realised, non-distributable and therefore fully loss-absorbing”*. The Central Bank also explained that any deposit made by ILCU with the NTMA that is *“only available to the Credit Union in the event that a ToE is completed”* cannot be *“included within the calculation of the Credit Union’s regulatory reserve ratio”*. The Central Bank also noted that this position was acknowledged by Charleville in its letter of 15 June 2017 and also in its most recent PR which *“specified that the Credit Union had a regulatory reserve of 3.4% as at 31 March 2017”*.
- (b) The Central Bank refuted Charleville's assertion that it had agreed to accept the ILCU lodgement with the NTMA to secure Charleville’s reserves and commented that *“the Credit Union is aware that the Central Bank did not at any time agree that the restricted NTMA deposit could constitute regulatory reserves”* and that *“it would not be legally permissible for the Central Bank to do so”*. Further, the Central Bank pointed out that it was *“clear that the Credit Union remains in breach of its obligations”* under the May 2017 Direction and that the sums lodged by ILCU with the NTMA do not *“have any impact on the regulatory reserve position of the Credit Union”*.
- (c) Regarding Charleville’s claims that the Central Bank instructed it ██████, the Central Bank noted that Charleville had previously expressed concern to the Central Bank with regard to “████████████████████”, and referred to an email from Charleville on 12 December 2013 in which it stated, in respect of the relevant loans that “████████████████████” and that *“prudently we would have to carry ██████ provision on all of these accounts”*.
- (d) The Central Bank also disputed Charleville’s assertion that Charleville was *“instructed”*, (by virtue of Mr Eamon Clarke’s emails of 24 November 2015), to make changes to bad debt provisioning and fixed asset impairments on the basis that this assertion was *“misleading and inaccurate”* and that the emails *“appear to have been taken out of context for that purpose”*. The



was prepared to allow Charleville a final period of forbearance until close of business on 6 July 2017 by which time Charleville must: *“submit to the Central Bank (a) a letter of consent signed by the board of a proposed transferee in respect of their intentions to enter ToE negotiations with the Credit Union and (b) a High Level Business Case supporting the feasibility in respect of any such ToE proposal”*.

- 3.148 On 26 June 2017, RCU received an email from Charleville raising an issue with the fact that the Central Bank’s letter of 23 June 2017 was received at 23.07 that evening, and requesting that the deadline of close of business on 6 July 2017 specified in the Central Bank’s letter should be extended to close of business on 10 July 2017. The Central Bank responded later that day and extended the deadline to 1pm on Friday 7 July 2017 in recognition of the fact that Charleville did not receive its letter of 23 June 2017 until late in the evening.
- 3.149 On 29 June 2017, RCU issued a regulatory direction (the **“June 2017 Direction”**) on business activities to Charleville as the December 2016 Direction had expired. In this letter, RCU noted that Charleville was reporting reserves of 3.3% of total assets as at 31 March 2017 and as such, did not comply with the requirement set out in the May 2017 Direction to raise reserves of at least 10.0% of total assets and raise and maintain an additional operational risk reserve of 3% of total assets. The June 2017 Direction imposed regulatory lending restrictions on Charleville on the following terms:
- (a) restricting the maximum size of loans to members to an amount not exceeding €0.015m (net exposure);
  - (b) prohibiting Charleville from making advances of loans to members in any calendar month where the total loans in that calendar month would exceed €0.25m; and
  - (c) requiring Charleville to refrain from making investments other than investments in deposit accounts of the kind set out in Regulation 25(1)b of the 2016 Regulations.
- 3.150 The June 2017 Direction also reminded Charleville that the liquidity requirement set out in the Regulatory Direction letter dated 14 June 2016 would remain in place until such time as it is revoked by the Registrar of Credit Unions by notice in writing.
- 3.151 On 6 July 2017, RCU received a detailed letter from Charleville in response to RCU’s letter to Charleville dated 23 June 2017, which addressed the following issues:
- (a) Charleville expressed disappointment in RCU’s response letter dated 23 June 2017 stating that it did *“not acknowledge or address all of the relevant matters”* Charleville had set out therein.
  - (b) With respect to the additional funding of █████ deposited by ILCU into an NTMA account in the name of Charleville, and the Central Bank’s assertion that such funding was conditional and therefore could not be counted towards Charleville’s reserves, Charleville claimed that the Central Bank had previously accepted that a previous deposit secured from ILCU in July 2016 on similar conditions was *“a means for securing our reserve position at that time”*. Charleville also argued that this additional funding was *“ringfenced”*

and that it would continue in its *“endeavours to source a suitable merger partner”*.

- (c) Charleville further claimed that the Central Bank had taken a *“revised stance on the matter of the reserves and solvency support”* and in particular noted that it now required solvency support to be *“unrestricted, fully realised, non-distributable and therefore fully loss absorbing”*. Charleville advised of its *“formal request to the Board of Directors of the Irish League of Credit Unions for the appropriation of the entire of the [REDACTED] now standing to the credit of the National Treasury Management Agency account in the name of Charleville Credit Union Limited”*. Charleville stated that it would inform RCU of ILCU’s decision on its request, which was due for consideration at ILCU’s upcoming board meeting on the 15 July 2017. In light of this, Charleville requested further time to obtain the requested confirmation from ILCU *“so as to resolve your concerns in this regard once and for all”*.
- (d) Charleville advised it took issue with the *“pejorative language”* that it claims RCU used with regard to secured loans held at the credit union. Charleville asserted that it *“had secured its legal position on its property related loans”*.
- (e) Charleville asserted that the Central Bank had, in RCU’s letter dated 23 June 2017, quoted an email from Charleville to RCU on 12 December 2013 in a manner that was *“highly selective and had been taken out of context”*. Charleville requested that RCU *“issue a correcting addendum”* to its letter dated 23 June 2017, *“confirming that the passage quoted from our email of 12 December 2013 does not refer to the entire loan book, but to a portion of the loan book”*. Charleville further advised that loans referred to in the email *“were the subject of support from the Savings Protection Scheme claim, and were fully provided for, or written off as required”*.
- (f) Charleville disagreed with RCU’s comments in its letter dated 23 June 2017 in respect of emails exchanged between Charleville and RCU, which RCU stated had appeared *“to have been taken out of context”*. Charleville claimed *“the Credit Union was ‘instructed’”* by RCU to take *“the steps outlined”* in its email dated 24 November 2015 and that *“Mr. Clarke confirmed these instructions”*.
- (g) Charleville complained about certain statements in RCU’s letter of 23 June 2017, which it believed suggested that *“the Credit Union deliberately understated certain matters in draft financial statements for several years”*. In this regard, Charleville stated that the *“Board of Directors and staff wholly reject any suggestion of impropriety on their part”* and requested that the Central Bank *“provide an addendum to your letter dated 23<sup>rd</sup> June to correct the record immediately”*.
- (h) In response to RCU’s comments on the imposition of lending restrictions, Charleville contended that the restrictions have been in effect *“since the 17th December, 2009, not October, 2011”*. Charleville made further allegations in relation to the lending restrictions in place, stating, *“the Central Bank has created and maintained an environment of stagnant/regressive growth potential in Charleville Credit Union Ltd”*. Charleville reiterated that concerns raised by RCU in respect of Charleville’s financial



position, while continuing to impose the restrictions, were *“disingenuous, and at worst, a cause for concern at a short sighted perspective of aggressively and effectively “running down” the operational effectiveness of our community Credit Union”*.

- (i) Charleville disputed RCU’s comments around the two unsuccessful transfers, stating that RCU *“directed that no further progress be made on the [REDACTED] ToE”*. Charleville stated that RCU had denied any *“instruction”* given to Clonmel to cease all ToE activities.
- (j) Charleville outlined that it had *“entered into discussions/ negotiations with two Credit Unions”* and reiterated that it had secured SPS funding from ILCU.
- (k) In response to RCU’s comments around its role in the ToE process, Charleville asserted *“The Central Bank has a key role in that no ToE may proceed without the ultimate sanction of the Central Bank”*.



- (m) Charleville referred to the letter of consent requested by RCU, to be signed by the board of a proposed transferee Credit Union, and advised that it had *“been in contact with a suitable Credit Union who indicated that they are interested at exploring the prospect of entering a ToE with Charleville Credit Union Ltd.”* However, Charleville argued that the short timeframe imposed by RCU meant it had yet to obtain a letter of consent from the Credit Union.
- (n) Charleville suggested the use of an intermediary acceptable by both RCU and the Credit Union to assist in resolving the ongoing matters.

3.152 On 7 July 2017, RCU wrote to Charleville and advised that the Central Bank took issue with a number of points raised in its letter of 6 July 2017 and intended to respond in further detail thereto. In the meantime, it responded on the following points:

- (a) RCU noted that Charleville had requested that ILCU allow the Credit Union to have unrestricted access to the sum of [REDACTED], which ILCU would consider at its board meeting on 15 July 2017.
- (b) RCU agreed to allow Charleville additional time, until 5pm 17 July 2017, to revert with written confirmation from ILCU that the [REDACTED] held in the NTMA account in the name of Charleville, will be transferred into an account in the Charleville’s name, by not later than 1pm on Friday 21 July 2017; and that *“the NTMA funds are made available to the Credit Union in accordance with the requirements of Part 2 section 3(1) of the Credit Union Act 1997 (Regulatory Requirements) Regulations 2016”*.
- (c) RCU noted that Charleville had not submitted a letter from a proposed transferee credit union confirming its intentions to enter into ToE

negotiations, as required by RCU. RCU advised that if Charleville had identified a suitable transferee then this must be communicated to RCU immediately. In addition, RCU required that if the proposed transferee was unable, for unavoidable logistical reasons, to formally confirm a decision to commence ToE negotiations, then that party should instead confirm that it: (i) had entered into preliminary discussions with Charleville; (ii) is interested in exploring a potential ToE with Charleville; (iii) anticipates that its board of directors would meet within three weeks to approve the commencement of ToE negotiations; and (iv) if such approval is forthcoming it will confirm this to the Central Bank.

- (d) RCU noted Charleville's suggestion of appointing an intermediary between RCU and Charleville, advising Charleville of *"the statutory role of the Central Bank as regulator"*, and as such, disclosed it is *"not in a position to entertain any such proposal."*

3.153 Charleville, on the 17 July 2017 acknowledged RCU's letter dated 7 July 2017 and responded as follows:

- (a) Charleville asserted that it *"has at all times co-operated with the Central Bank, and has undertaken all necessary actions within the power and scope of the Credit Union, to ensure compliance with all relevant legislative and regulatory directions"*.
- (b) Charleville reported that it received an enclosed letter from ILCU, addressed to RCU in which ILCU confirmed that it would *"give serious consideration to providing SPS support for the transfer to take place"*. The letter from ILCU further provides that it *"would give serious consideration to providing SPS support to the Credit Union to raise its regulatory reserve requirement to a minimum of 10% of total assets as at 31 March 2017 (being [REDACTED]), if the Central Bank of Ireland lifts the lending and investment restrictions that are currently in place in the credit union."*
- (c) Charleville reported that it had informal discussions in relation to a potential ToE with [REDACTED] Credit Union ("*[REDACTED]*") and that RCU should expect correspondence shortly from [REDACTED] to confirm its interest. Charleville also stated that another credit union, that wished to remain unnamed, had expressed an interest in initiating ToE discussions. Charleville advised that this unnamed credit union was unable to formally hold a board meeting due to the unavailability of its directors over the summer period.
- (d) Charleville requested an extension of RCU's deadline of the 17 July 2017 (for the commencement of formal ToE discussions) to the 30 September 2017. Charleville outlined that it was committed to a ToE and confirmed that it had secured appropriate funding from ILCU. Charleville requested that RCU engage constructively with it and expressed disappointment at RCU's decision not to consider the proposal of appointing an intermediary to assist in resolving the ongoing matters.

3.154 On 20 July 2017, RCU referred to Charleville's letters of 7 July 2017 and 17 July 2017 and ILCU's letter of 18 July 2017, responding on the following terms:

- (a) RCU stated that the *“statement set forth in ILCU’s letter of 18 July 2017 does not constitute the confirmation sought in our letter of 7 July 2017”* noting that ILCU is only prepared to give *“serious consideration”* to making part of the NTMA Funds, i.e. [REDACTED], available provided that certain conditions are met.
- (b) RCU further added that *“even if ILCU were prepared to provide a binding commitment to make [REDACTED] available then such amount would be insufficient to enable the Credit Union to comply with its obligations under the May 2017 Direction.”*
- (c) RCU confirmed that the conditions specified by ILCU in its letter are not terms that RCU is in a position to agree to, most notably, the lifting of lending and investment restrictions. RCU concluded that Charleville is in breach of its obligation to raise and maintain its reserves to the level required by the May 2017 Direction on a standalone basis.
- (d) RCU acknowledged that to date, it had not received formal confirmation from [REDACTED] or any other credit union in relation to a potential ToE. RCU informed Charleville that it must provide confirmation from either [REDACTED] or the unnamed credit union to RCU by not later than 5pm Monday 31 July 2017. RCU requested that the relevant credit union confirm it is willing to proceed with ToE negotiations, in which case RCU will provide guidance on the timeline to be established, should ToE negotiations commence. RCU stated that the Central Bank is not prepared to allow the situation to continue indefinitely, in which Charleville is in clear breach of a regulatory direction.

3.155 On 20 July 2017, RCU issued a second letter to Charleville, by way of detailed response to Charleville’s letter dated 6 July 2017 and outlined the following:

- (a) RCU disputed Charleville’s assertion that RCU did not address all of the issues raised in previous correspondence noting that RCU carefully considered each letter and all material issues were adequately addressed. RCU also confirmed that it had endeavoured to address each of the notable points raised in Charleville’s letter of the 6 July 2017. However, RCU noted that any point raised by Charleville, not addressed by RCU, should not be construed as acceptance on the Central Bank’s behalf.
- (b) RCU rejected Charleville’s assertion that the sum of [REDACTED] (the **“Relevant Deposit”**) deposited by ILCU in the name of Charleville could be included in Charleville’s reserves. RCU referred to the letter dated 23 June 2017, in which RCU stated *“the Central Bank did not at any time agree with the Credit Union that the Relevant Deposit could be included within the Credit Union’s reserves”*. RCU reminded Charleville that in its letter dated 23 June 2017 it had explained to the Credit Union that the characteristics of a credit union’s regulatory reserves are set out in Regulation 3 of the 2016 Regulations. For ease of reference, RCU attached a copy of both the 2016 Regulations and guidance on same.
- (c) Following Charleville’s submission of the March 2017 PR, RCU noted that Charleville reported reserves of 3.3% as at 31 March 2017. RCU added that the directors did not include the Relevant Deposit within the regulatory

reserves reported in the March 2017 PR, nor was it included in the regulatory reserves in any PR submitted by Charleville, since the Relevant Deposit was made. Contrary to Charleville's position set out in its letters dated 13 June 2017, 15 June 2017, and 6 July 2017, RCU stated that Charleville and its directors understood at all times that the Relevant Deposit could not be included within its regulatory reserves due to the fact that the Relevant Deposit can only be used to support a voluntary ToE with another ILCU-affiliated credit union.

- (d) RCU repudiated Charleville's assertion set forth in its letter dated 15 June 2017 that RCU "instructed" it to make certain changes to its fixed assets impairment and bad debt provision, stating that Charleville has no basis for this assertion. For clarification, RCU highlighted that the relevant impairments were made following a decision by Charleville's Board and this was relayed to RCU in a letter dated 1 December 2015 the ("**December 2015 Letter**"). RCU further added that following this decision there was a meeting between Charleville and RCU on 12 November 2015 to discuss the findings of the Draft 2015 EisnerAmper Asset Review Report and the 2015 DHKN Report.
- (e) RCU rejected Charleville's assertion that it had misquoted an email from Charleville to RCU on 13 December 2013. RCU outlined its letter of 23 June 2017 accurately quoted the email in question. RCU advised that the email from Charleville confirmed that the directors of Charleville had concerns regarding the [REDACTED] as far back as December 2013.
- (f) RCU rejected Charleville's assertion that RCU had implied that Charleville's Board had deliberately misinformed or misled RCU when it submitted the draft financial statements, which were subsequently revised. RCU noted that the draft financial statements for the financial year ended 30 September 2014 were submitted by Charleville to RCU on 26 May 2015. RCU outlined that Charleville had reported reserves of 10.7% as at 30 September 2014 and further outlined that on 5 April 2017 Charleville had submitted revised draft financial statements for the financial year ended 30 September 2014 in which it reported regulatory reserves of 3.5% on that date. RCU stated that, contrary to previous assertions by Charleville, Charleville had not been able to satisfy the reserve requirement of 10% in any financial year since 2009.
- (g) RCU also disputed Charleville's assertion that the Central Bank had conducted itself in a manner that was: "*at best disingenuous, and at worst, a cause for concern at a short sighted perspective of aggressively and effectively running down the operational effectiveness of our community Credit Union*" in relation to the imposition of the lending restriction on Charleville. RCU explained that the Central Bank's policy is to impose lending restrictions on credit unions where it has concerns with regard to the financial position of that credit union, including where a credit union is unable to raise and maintain regulatory reserves at the required minimum. RCU outlined that Charleville has been unable to raise and maintain its reserves at the required 10.0% of total assets for a number of years and as

such, RCU could not consider a removal of the lending restrictions in those circumstances.

- (h) In response to Charleville's assertion that RCU sought to prevent the Credit Union from completing a ToE, RCU advised that these assertions had no basis in fact and rejected them in their entirety. RCU advised that the proposed ToE to ██████ had not proceeded on the basis that ██████ had recently completed a number of ToEs and that the supporting high-level business case for the ToE was inadequate, as previously outlined to the credit unions. RCU further noted that the proposed ToE with Clonmel did not proceed as Clonmel withdrew from negotiations after issues were identified during the due diligence review. RCU reiterated that it had not, at any stage, instructed Clonmel to withdraw from ToE discussions with Charleville.
- (i) RCU refuted suggestions that it had discouraged credit unions from engaging with Charleville in relation to a ToE and further added that at no stage did RCU seek to interfere with Charleville's efforts to identify a ToE partner.
- (j) RCU noted that Charleville had engaged in a third attempt to negotiate and complete a ToE with either ██████ or another unnamed credit union and in this regard, provided Charleville with a final deadline of 31 July 2017 to:
  - (i) obtain confirmation from ██████, or the unnamed credit union, that it was interested in commencing ToE negotiations; and
  - (ii) confirmation from Charleville to RCU that Charleville was willing to commence ToE negotiations with ██████ or the other unnamed credit union.

3.156 On 31 July 2017, RCU received a letter from Charleville in response to RCU's letters dated 20 July 2017. Charleville stated that ILCU's reservations as set out in ILCU's letter, dated 18 July 2017, related to the lending restrictions imposed on Charleville. Charleville expressed frustration at RCU's unwillingness to articulate any vision for the future of Charleville and reported that Charleville would be unable to grow its lending business resulting in the further depletion of the its reserves if the current lending restrictions remained in place. Charleville confirmed that the Credit Union had begun exploratory discussions with ██████.

3.157 RCU issued an email to Charleville on 31 July 2017 at 17:14pm, acknowledging receipt of the Credit Union's email of 31 July 2017. RCU outlined that the Central Bank had yet to receive confirmation from the proposed transferee that was sought in RCU's letter dated 7 July 2017.

3.158 On 4 August 2017, RCU responded to Charleville's letter dated 31 July 2017. RCU provided an extended deadline of 21 August 2017, for Charleville and ██████ to submit confirmation that the board of each credit union had resolved to proceed with a ToE and that there were no further unresolved issues or conditions, which would prevent both credit unions from proceeding with a ToE.

3.159 In a letter to RCU dated 18 August 2017, Charleville stated that its Board had resolved to proceed with the ToE with ██████. Charleville's letter enclosed a letter from ██████ dated 15 August 2017 (the "15 August 2017 Letter") advising that its board of directors had agreed to enter negotiations on a proposed ToE with Charleville. In the 15 August 2017 Letter, ██████ set out a number of terms and conditions in respect of the proposed ToE.

The primary terms and conditions included the imposition of a limit on individual savings balances held at Charleville, a "media blackout" relating to the ToE process and an agreement from Charleville that it would reimburse ██████ for any costs incurred, should the ToE fail where ██████ was not at fault.

- 3.160 On the 24 August 2017, RCU met with ██████ to discuss, and gain an understanding of the terms and conditions agreed by both credit unions. By email dated 25 August 2017, RCU advised both ██████ and Charleville of the previous evening's meeting and noted that RCU intended to schedule a meeting with all applicable parties over the following 10 days, to outline the ToE process and next steps.
- 3.161 On the 28 August 2017, RCU telephoned the CEO of ██████ (who was acting as project manager for the proposed ToE), in order to convene a round-table meeting between all parties involved in the proposed ToE. The CEO advised that he would contact all relevant parties that day to confirm availability for a suitable date and time for the meeting.
- 3.162 RCU received correspondence from ██████ and Charleville dated 1 September 2017, outlining that the boards of both credit unions had met the previous day, during which ██████ notified Charleville that it did not wish to proceed further with the ToE discussions. ██████ advised RCU that it had withdrawn from the ToE discussions on the basis that ██████ "...own asset size was not sufficiently large enough to enable them to proceed." ██████ further outlined that "having run and assessed high level financial projections for the combined businesses of ██████ and CCU, the Board of ██████ cannot support a business case that would see a TOE of CCU to ██████". RCU noted ██████ comments and requested additional detail on the high-level projections that had caused concern for the management and board of directors of ██████.
- 3.163 In respect to a request from RCU, ██████ provided its own high-level financial projections for the proposed ToE and a summary analysis regarding same. ██████ outlined the following concerns:
- (a) the projections outlined that Charleville would incur losses (excluding its level of debt recovery) and that ██████ was not strong enough to support and sustain the level of projected losses;
  - (b) Charleville's projected level of debt recovery was unsustainable and its professional and legal fees were high, and would likely continue in an effort to recover bad debts;
  - (c) while funding of ██████ from ILCU remained available to Charleville for a ToE with certain reasonable ToE related costs, ILCU confirmed to ██████ that it had not quantified what level of costs it considered to be reasonable;
  - (d) ██████ would require ILCU to agree to underwrite the P&L of the combined entity for a minimum of 4 years to allow the business to stabilise and grow. ██████ considered that ILCU were unlikely to do this and would seek to attach repayment of this support again to a portion of the loan book. ██████ highlighted that this could further impact on projected loan interest income;
  - (e) while ██████ recognised the potential loan growth and business, the loan interest income projected in the years 2018-2020 was insufficient; and,

- (f) there would be high fixed costs and high staff costs, in taking on Charleville's members' shares. Given Charleville's current financial position, the existing directors could not remain on the board of the proposed merged entity, and Charleville would be unlikely to accept this position.
- 3.164 On the 8 September 2017, RCU issued a letter to Charleville acknowledging the position in relation to recent ToE discussions with [REDACTED]. RCU reiterated that Charleville remained in breach of the May 2017 Regulatory Direction. In response to Charleville's request for a meeting, RCU advised that a meeting should be convened, subject to the availability of Charleville's representatives, as a matter of urgency.
- 3.165 On the 20 September 2017, RCU met with representatives from Charleville and ILCU, at which the following key points were discussed:
- (a) Charleville's chairman, Mr. Pat Savage, advised that Charleville had made contact with the chairpersons of two unnamed credit unions regarding a potential ToE. However, Mr. Savage could not provide formal details until the boards of directors of those credit unions had agreed formal expressions of interest. RCU requested that formal correspondence would be required from Charleville and the credit union interested in commencing a ToE by Friday, 29 September 2017.
  - (b) Mr. Savage noted that Charleville's reserve position and lending restrictions imposed by the Central Bank were contributing factors to the previous ToEs not progressing and he requested that those restrictions be eased on a phased basis. RCU reiterated that given Charleville's current financial position, the Central Bank were not in a position to ease the restrictions.
  - (c) RCU outlined that the Central Bank had identified serious issues with respect to Charleville's business, viability and financial position, which had been detailed in previous correspondence with Charleville. RCU noted that those concerns had been confirmed by the recent correspondence received from [REDACTED] detailing its reasons for withdrawing from the ToE process.
  - (d) Charleville questioned RCU as to whether the lifting or easing of restrictions would be considered if SPS funding was received to restore Charleville's reserves to 10% and the operational risk reserve of 3%. RCU advised that it would consider all of Charleville's submissions. However, RCU reiterated the Central Bank's concerns regarding the viability of Charleville on a standalone basis, the financial issues that remained and the level of funding that would be required in the future.
  - (e) Mr. Savage asked RCU to confirm the alternative actions that may occur if a ToE was unattainable, to which RCU stated that the Central Bank would need to consider exercising its powers under the 2011 Act. RCU noted the urgency of Charleville's situation, the lack of details that it could provide regarding the potential transferees and that the current situation could not continue for an indefinite period. RCU also highlighted its concerns that any other transferee in a ToE process may identify similar issues as those identified by [REDACTED].
  - (f) In conclusion, RCU advised that it would consider the matters discussed at the meeting and that formal correspondence would issue to the Credit

Union outlining the 29 September 2017 deadline, for any submissions to RCU.

3.166 RCU issued a letter to Charleville on the 22 September 2017, which can be summarised as follows:

- (a) RCU noted that since the June 2016 Direction, Charleville had been in continuous breach of the regulatory directions issued by the Central Bank to raise and maintain its regulatory reserves to the required minimum, and that some eighteen months previously, Charleville itself had acknowledged it was not viable as a standalone entity;
- (b) RCU also noted that Charleville remained in breach of its obligations under the May 2017 Direction and had been given additional time to enter into ToE discussions with [REDACTED];
- (c) RCU further noted that [REDACTED] had withdrawn from those discussions and had issued an email to RCU, which was enclosed in its letter to Charleville, setting out [REDACTED] reasons for withdrawing from the ToE process;
- (d) RCU highlighted that among the primary reasons for [REDACTED] decision to withdraw from ToE discussions with Charleville was the fact that Charleville was projected to make a loss in 2018, 2019 and 2020, and that in order to underwrite those losses, [REDACTED] would require additional financial support from ILCU on completion of the ToE, but was not confident that such support would be forthcoming;
- (e) RCU commented that over a period of eighteen months, Charleville had attempted and failed on three occasions to implement a ToE, and that issues identified by [REDACTED] are matters that any other credit union would also identify while considering a ToE with Charleville;
- (f) RCU acknowledged that at the meeting convened with the Charleville's Board, on 20 September 2017, the chairman of Charleville indicated that he had made initial contact with two unnamed credit unions to determine whether those parties were willing to engage in ToE discussions with Charleville and that he expected to hear back from those credit unions during the week commencing 25 September 2017; and
- (g) finally, RCU reminded Charleville that it was prepared to provide it with some additional time, until Friday 29 September 2017, to make any further submissions in relation to its current position, to include any response received or further engagement it had with the two unnamed credit unions. In this respect, RCU outlined in its letter that the Central Bank would require written confirmation from Charleville and any potential transferee that the boards of each credit union had resolved to commence ToE discussions. It was also requested from Charleville that if any expression of interest had been received from a credit union in relation to a ToE, that as part of its submissions, Charleville must explain why it believes it will be in a position to conclude a ToE with the relevant credit union, considering the issues identified by [REDACTED].



3.167 On 29 September 2017, Charleville wrote to RCU acknowledging the meeting with RCU on 20 September 2017, and RCU's letter of 22 September 2017. In its letter, Charleville responded to RCU's letter of 29 September 2017, as follows:

- (a) Charleville stated *"we must restate the fact that Charleville Credit Union Limited has at all times co-operated with the Central Bank, and has undertaken all possible actions within the power and scope of the Credit Union, to achieve compliance with all relevant legislative and regulatory directives"*.
- (b) Charleville acknowledged that *"Charleville Credit Union Limited has adhered to all regulatory directions by the Central Bank with the sole exception of the direction requiring a 10% reserve, and a 10% plus 3% operational reserve"*
- (c) In relation to RCU's assertion in its letter of 22 September 2017 that: *"... the board of directors of the Credit Union acknowledged some eighteen months ago that the Credit Union is not viable as a standalone entity"*, Charleville stated *"The directors took the decision in March 2016 to seek a merger partner as part of the strategic planning of the Credit Union on the recommendation of the Central Bank. The directors took this decision in view of the Central Bank imposed lending and investment restrictions over many years, which prevented the Credit Union from growing and developing"*.
- (d) Charleville advised that, *"sufficient SPS funding from ILCU SPS fund have been placed in a National Treasury Management Agency account in the name of Charleville Credit Union Limited to secure the Credit Union's 10% reserves"*.
- (e) Charleville objected to the reliance placed on the email from [REDACTED] (CEO of [REDACTED]) to RCU, 1 September 2017, and advised that *"We are in fundamental disagreement with many aspects of the email, and we take exception to your apparent acceptance of the summary conclusions made by [REDACTED] set out in this email"*. In its letter of 29 September 2016, Charleville identified the following issues with [REDACTED] projections: (a) inaccurate; (b) underestimated growth projections; (c) lending opportunities; (d) pessimistic loss projections; (e) payroll and other costs. Finally, Charleville noted [REDACTED] assertions that no current director of Charleville would have a place on the board of the merged entity and that the directors of Charleville may not be willing to proceed. Charleville advised this was not the position of its Board.
- (f) Charleville advised that it engaged with [REDACTED] Credit Union Limited ("*[REDACTED]*") to discuss a possible ToE. However, Charleville stated, *"We have been advised that [REDACTED] Credit Union Limited are not in a position to proceed further with merger discussions, at this time"*.
- (g) Charleville confirmed, *"we have been in contact with [REDACTED] Credit Union Limited, who wish to enter into discussions on ToE with CCU"*. Charleville attached a letter from [REDACTED], which stated, *"At a meeting of the Board of [REDACTED] Credit Union on 25<sup>th</sup> September 2017 and following a request from Charleville Credit Union, it was agreed to meet with their representatives on Wednesday, 4<sup>th</sup> October @ 8.00pm in our offices to discuss their current situation"*.

3.168 On 3 October 2017, RCU wrote to Charleville, in response to its letter of 29 September 2017, on the following terms:

- (a) RCU noted Charleville's acknowledgment that it had failed to meet both the June 2016 Direction and the May 2017 Direction. RCU advised that it was the Central Bank's belief that poor historic lending, inadequate credit controls, combined with a high fixed cost base, resulted in Charleville being non-viable as a standalone entity.
- (b) RCU reiterated why it is necessary for the Central Bank to impose lending restrictions and noted that even though Charleville has twice received SPS support it is still unable to raise and maintain its reserves at the required level. This resulted in Charleville deciding in March 2016 to seek to implement a ToE.
- (c) RCU again confirmed that the letter received from ILCU in respect of the SPS funding in a NTMA account in the name of Charleville, was insufficient to enable the Credit Union to comply with its obligations under the May 2017 Direction. RCU further stated "*The Central Bank remains of the view that the Credit Union does not have any reasonable prospect of obtaining funding from ILCU on terms that would enable it to comply with its obligations under the May 2017 Direction*" and that Charleville is unable to produce any evidence to the contrary.
- (d) RCU noted that Charleville does accept or agree with the conclusions and views of [REDACTED]. However, RCU pointed out that many of the issues identified by [REDACTED] arose in various expert reports carried out in respect of Charleville.
- (e) RCU note that [REDACTED] confirmed that it is not interested in entering into ToE discussions with Charleville.
- (f) RCU further noted that Charleville advised that [REDACTED] wishes to enter into ToE discussions with Charleville. However, the letter received from [REDACTED] did not refer to any such ToE discussions.
- (g) RCU reiterated that at the meeting on 20 September 2017 and in its letter of 22 September 2017, RCU clearly outlined the Central Bank's position and provided Charleville with an extended deadline of 5.00pm on Friday, 29 September 2017 to make any further submissions with regard to its position.
- (h) In RCU's view, Charleville has not satisfied any of the conditions set out in the letter of 22 September 2017, nor had Charleville's letter of 29 September 2017 provided RCU with any basis to believe there was any real possibility of a ToE with [REDACTED]. Noting the meeting between Charleville and [REDACTED] scheduled for 4 October 2017, RCU required Charleville to provide it with all documentation and materials which Charleville intended to provide to [REDACTED] at that meeting.
- (i) RCU reiterated that the Central Bank requires formal letters from [REDACTED] and Charleville confirming that the respective boards of directors have resolved to enter into ToE negotiations and a letter outlining why the parties

believe they can overcome the issues identified by [REDACTED] and successfully conclude a ToE.

- (j) RCU noted that based on recent submissions and subject to confirmations from [REDACTED], that the Central Bank has formed a view that: (a) it is very unlikely that a viable ToE could be implemented; (b) it is not in the interest of members for Charleville to be allowed source another potential ToE partner; and (c) it is not in the interest of members, nor the credit union sector as a whole for the Central Bank to exercise any further forbearance.
- (k) Finally, RCU stated that if Charleville *"...does not provide the Central Bank with the information required under paragraph 8, and in the form specified therein, within 7 days of the date of this letter, the Central Bank will proceed to exercise its powers under the Central Bank and Credit Institutions (Resolution) Act 2011. If there are any communications from [REDACTED] prior to this, the Central Bank requires to be informed immediately."*

3.169 On 9 October 2017, RCU received a letter from [REDACTED] addressed to the Central Bank, dated 5 October 2017, which stated that the *"Board of Directors of [REDACTED] Credit Union Limited and representatives of Charleville Credit Union Limited met last night"* and that following that meeting *"the Board of [REDACTED] agreed to continue informal discussions with Charleville in the short-term with a view to establishing whether there is a business case in support of pursuing a transfer of engagements of Charleville Credit Union into [REDACTED] Credit Union"*.

3.170 On 10 October 2017, RCU wrote to Charleville, informing it of the correspondence from [REDACTED], noting *"that the letter from [REDACTED] does not satisfy the requirements of the Central Bank as set out in the 3 October Letter insofar as the letter does not confirm that the board of directors of [REDACTED] have resolved to enter into ToE negotiations with the Credit Union, but rather that [REDACTED] has agreed to further "informal" discussions as to whether such ToE negotiations could be supported by a business case."* Furthermore, RCU notified Charleville that if it wished to make any final submissions to the Central Bank as to why it should not proceed to exercise its powers under the 2011 Act, then any such submissions should be made by 12pm, Wednesday 11 October 2017.

3.171 On 11 October 2017, RCU received a letter from Charleville which in summary provided the following response to RCU's letters of 3 October 2017 and 10 October 2017:

- (a) Charleville asserted that RCU's letter of 10 October 2017 made it *"clear that the Central Bank has not supported the possibility of a ToE by Charleville Credit Union Limited"* and commented that this is consistent with their experience *"over the past 18 months where one potential transferee after the other withdrew from negotiations with us, following contact between each transferee and the Central Bank"*.
- (b) Charleville also referred to the Central Bank's *"continuation of punitive lending and investments restrictions on Charleville Credit Union Limited over several years"* which *"maintained a vice like restraint on the Credit Union's endeavours to move forward"* and *"discouraged the ILCU from releasing the SPS funding committed by the ILCU to restore the Credit Union's 10% reserve"*.

- (c) Charleville notes that RCU's letters of 3 October 2017 and 10 October 2017 required ██████ to "commit to formal ToE negotiations immediately" and to "give chapter and verse on how ██████ and CCU propose to respond to concerns raised a third party Credit Union (SCU) in respect of an entirely different ToE proposal". Charleville then stated that "understandably, neither ██████ nor CCU are in a position to deal with these demands within the short timeframe set out in your letters".
- (d) In its letter Charleville stated that it is of the view that "the Credit Union's business would thrive in Charleville with the benefit of an appropriate ToE and the SPS support available from the ILCU" and that a "solution along these lines could have been funded entirely by the Credit Union sector without recourse to State funds".
- (e) Charleville notes that the Central Bank has not in its letters said "what form of "resolution" is contemplated by the Central Bank for Charleville Credit Union Ltd" and finally, that it was Charleville's "earnest hope that any action that the Central Bank might take will not be detrimental to the members of Charleville Credit Union".

3.172 Finally, on 11 October 2017 RCU responded to Charleville's letter of same date noting that Charleville has been unable to comply with the requirements set out in its letter of 10 October 2017 and that, having carefully considered the content of its letter, and that received previously from ██████, the Central Bank would now proceed to make a decision with respect to the exercise its powers under the 2011 Act. The Central Bank also requested a meeting with the board of directors of Charleville at their offices at 8pm on Thursday 12 October 2017 whereupon the Central Bank would inform Charleville of its decision and the next steps which it intended to take.

3.173 As at the date of this Report, Charleville has not been able to implement a ToE, nor is it engaged in any meaningful or formal discussions with any suitable or willing transferee. Furthermore, Charleville has not been able to provide RCU with any proposal as to how it intends to comply in full, and on a sustainable basis, with its obligations under the May 2017 Direction. Accordingly, both RES and RCU have formed the view that Charleville is in breach of its obligations under the May 2017 Direction and that it has exhausted all means available to it by which it can comply with those obligations.

## **PART 2 – RES'S ANALYSIS OF THE REGULATORY ENGAGEMENT BETWEEN RCU AND CHARLEVILLE**

### ***Reasons for the extensive period of regulatory engagement***

3.174 The summary provided in Part 1 of this Section highlights that RCU first became aware of Charleville's problems during the early part of 2007. Thereafter followed a ten-year period of intensive engagement between RCU and Charleville.

3.175 Despite Charleville's considerable efforts during this ten-year period, RCU was unable at any time to form the view that Charleville's financial difficulties had been resolved. This is reflected in the fact that, from December 2009 to date, RCU has considered it necessary to impose and maintain restrictions (initially non-legally binding restrictions, and from October 2011 by means of a binding regulatory direction) on the lending and business

activities of Charleville in order to protect members' savings.

- 3.176 It is important for the Central Bank to consider the reasons why: (a) the regulatory engagement between RCU and Charleville continued for such a lengthy period despite RCU having concerns with regard to Charleville's solvency and viability; (b) resolution action was not previously proposed to be taken with respect to Charleville; and (c) the Central Bank should now consider the exercise of its powers under the 2011 Act with respect to Charleville.
- 3.177 Having reviewed and considered, in detail, the regulatory and supervisory file in respect of Charleville it would not have been feasible for the Central Bank to seek to take action with respect to Charleville during the initial phase of interaction between RCU and Charleville in the period between 2007 and 2010 for the following reasons:
- (a) the full extent of Charleville's financial difficulties were still only being established in early 2010, at which point Charleville had engaged with ILCU, in order to obtain financial support;
  - (b) the resolution tools available to the Central Bank were relatively limited prior to the commencement of the 2011 Act in October 2011;
  - (c) the challenges faced by the credit union sector and the economy of the State as a whole during this period meant that there was a material risk of contagion across the credit union sector, as well as the wider banking market in the State, if the Central Bank had sought to liquidate Charleville; and
  - (d) Charleville received significant support from ILCU in the form of SPS funds during this period pursuant to the 2010 ILCU Guarantee and in those circumstances, it was reasonable for RCU to allow Charleville and ILCU time to try to deal with Charleville's capital deficiency under the terms of that support.
- 3.178 There were also considerations which influenced the Central Bank not to seek to take resolution action in respect of Charleville during the period from 2011 to 2015, which can be summarised as follows:
- (a) up to mid-2014, Charleville had the benefit of ILCU Guarantees. In total between the 2010 and 2014, Charleville received c. [REDACTED] of SPS funding, which indicated that Charleville continued to have the support of ILCU to address its financial issues;
  - (b) the process for the drawdown of SPS funds was a matter between Charleville and ILCU. RCU had no option but to monitor the position with respect to SPS funding and seek regular updates;
  - (c) in the period between early 2014 and late 2015 a difference had emerged between Charleville and RCU concerning the issue of whether or not Charleville had raised its reserves to the required level. RCU formed the view that an independent review was required to establish the position and on that basis it was appropriate for the Central Bank to allow those reviews to be conducted rather than at that time seek to implement one or more resolution tools with respect to Charleville;

- (d) the various independent reports prepared in respect of Charleville during the period between January 2015 and March 2016, for the purposes of establishing Charleville's true financial position, involved a comprehensive review of Charleville and therefore took a considerable amount of time to complete; and
- (e) it was appropriate to allow Charleville time to make submissions in respect of the findings of the Draft 2015 EisnerAmper Asset Review Report, and to properly consider the findings of the 2015 DHKN Report, along with the 2016 MSN Report (completed in January 2016). In such circumstances, it would have been inappropriate for the Central Bank to seek to take action with respect to Charleville, whilst such reports were still being considered by all parties.

3.179 On 24 March 2016, Charleville's Board wrote to RCU to advise that it had decided to seek to complete a ToE, effectively acknowledging that Charleville was unable to continue as a standalone entity. In this respect:

- (a) given that Charleville had expressed a desire to implement a ToE and had received a commitment of (although not direct access to) SPS funding from ILCU to facilitate such a transfer, it was reasonable for RCU to conclude that: (i) it was appropriate to allow Charleville time to try to identify a suitable transferee and explore the possibility of a ToE; and (ii) whilst such efforts were ongoing the Central Bank ought not to seek to implement a resolution solution with respect to Charleville;
- (b) RCU could have decided, once the [REDACTED] discussions had concluded, to consider its options with respect to Charleville. However, it was reasonable for RCU to decide to allow discussions with Clonmel to proceed, particularly given that Clonmel appeared to be a suitable transferee; and
- (c) it would have been very difficult for RCU to foresee that the proposed ToE with Clonmel would attract the level of controversy amongst the members of Clonmel that occurred, or to predict that further issues would emerge during the due diligence process concerning the nature and extent of Charleville's title to the Premises, which would result in the withdrawal of Clonmel from the proposed ToE.

3.180 On 17 July 2017, Charleville advised RCU that it had informal discussions with [REDACTED] in relation to a proposed ToE. Despite the fact that Charleville had not complied with the May 2017 Direction, RCU afforded Charleville an opportunity to progress discussions with [REDACTED] with a view to a ToE completing between the parties. Notwithstanding the fact that such ToE discussions had begun between the parties, [REDACTED] subsequently decided to withdraw from this process on 1 September 2017 stating: "*having run and assessed high level financial projections for the combined business of [REDACTED] and CCU, the Board of [REDACTED] cannot support a business case that would see a TOE of CCU to [REDACTED]*".

3.181 At a meeting with RCU, on 20 September 2017, Mr. Pat Savage, advised RCU that he had contacted the chairpersons of two other credit unions, to establish whether those credit unions were interested in engaging in a ToE with Charleville.

3.182 On 29 September 2017, Mr. Savage wrote to RCU to advising it that [REDACTED] was not in a position to engage with Charleville in respect of a potential ToE. However, Mr. Savage

advised that Charleville's Board had arranged to meet with the board of [REDACTED] at 8.00pm on 4 October 2017.

- 3.183 On 3 October 2017, RCU responded to Charleville's letter of the 29 September 2017 detailing the confirmations the Central Bank required in respect of any potential ToE between [REDACTED] and Charleville. RCU stated that if Charleville does not provide the requested confirmations, in the required form, within 7 days of the date of that letter (10 October 2017), the Central Bank would proceed to exercise its powers under the 2011 Act. RCU also stated that if there are any communications from [REDACTED] prior to 10 October 2017, the Central Bank was to be immediately informed of same.
- 3.184 On the 9 October 2017, the Central Bank received a letter dated 5 October 2017 from [REDACTED], in which it stated that the *"Board of Directors of [REDACTED] Credit Union Limited and representatives of Charleville Credit Union Limited met last night"* and that following that meeting *"the Board of [REDACTED] agreed to continue informal discussions with Charleville in the short-term with a view to establishing whether there is a business case in support of pursuing a transfer of engagements of Charleville Credit Union into [REDACTED] Credit Union"*.
- 3.185 By way of letter dated 10 October 2017, RCU wrote to Charleville informing it of the letter from [REDACTED]. In its letter, RCU noted *"that the letter from [REDACTED] does not satisfy the requirements of the Central Bank as set out in the 3 October Letter insofar as the letter does not confirm that the board of directors of [REDACTED] have resolved to enter into ToE negotiations with the Credit Union, but rather that [REDACTED] has agreed to further "informal" discussions as to whether such ToE negotiations could be supported by a business case."* Furthermore, RCU outlined that if Charleville wished to make any final submissions to the Central Bank as to why it should not proceed to exercise its powers under the 2011 Act, then any such submissions were to be made by 12pm, Wednesday 11 October 2017.
- 3.186 On 11 October 2017, RCU received a letter from Charleville which in summary provided the following response to RCU's letters of 3 October 2017 and 10 October 2017:
- (a) Charleville asserted that RCU's letter of 10 October 2017 made it *"clear that the Central Bank has not supported the possibility of a ToE by Charleville Credit Union Limited"* and commented that this is consistent with their experience *"over the past 18 months where one potential transferee after the other withdrew from negotiations with us, following contact between each transferee and the Central Bank"*.
  - (b) Charleville also referred to the Central Bank's *"continuation of punitive lending and investments restrictions on Charleville Credit Union Limited over several years"* which *"maintained a vice like restraint on the Credit Union's endeavours to move forward"* and *"discouraged the ILCU from releasing the SPS funding committed by the ILCU to restore the Credit Union's 10% reserve"*.
  - (c) Charleville notes that RCU's letters of 3 October 2017 and 10 October 2017 required [REDACTED] to *"commit to formal ToE negotiations immediately"* and to *"give chapter and verse on how [REDACTED] and CCU propose to respond to concerns raised a third party Credit Union ([REDACTED]) in respect of an entirely different ToE proposal"*. Charleville then stated that *"understandably, neither [REDACTED] nor CCU are in a position to deal with these demands within the short timeframe set out in your letters"*.

- (d) In its letter Charleville stated that it is of the view that *"the Credit Union's business would thrive in Charleville with the benefit of an appropriate ToE and the SPS support available from the ILCU"* and that a *"solution along these lines could have been funded entirely by the Credit Union sector without recourse to State funds"*.
- (e) Charleville notes that the Central Bank has not in its letters said *"what form of "resolution" is contemplated by the Central Bank for Charleville Credit Union Ltd"* and finally, that it was Charleville's *"earnest hope that any action that the Central Bank might take will not be detrimental to the members of Charleville Credit Union"*.

3.187 Finally, on 11 October 2017 RCU responded to Charleville's letter of same date noting that Charleville has been unable to comply with the requirements set out in its letter of 10 October 2017 and that, having carefully considered the content of its letter, and that received previously from [REDACTED], the Central Bank would now proceed to make a decision with respect to the exercise its powers under the 2011 Act. The Central Bank also requested a meeting with the board of directors of Charleville at their offices at 8pm on Thursday 12 October 2017 whereupon the Central Bank would inform Charleville of its decision and the next steps which it intended to take.

3.188 Having regard to the considerable period of forbearance exercised to date by the Central Bank, and Charleville's continued failure to address its difficulties, it is now appropriate for the Central Bank to refrain from offering any further forbearance, and to take action without delay, with respect to Charleville for the following reasons:

- (a) Charleville is in breach of both the June 2016 Direction and the May 2017 Direction and has been unable to raise and maintain its reserves at the required level since, at the latest, 2009;
- (b) although Charleville has indicated to RCU that further SPS funding from ILCU in the amount of [REDACTED] has been lodged into the NTMA account in the name of Charleville to meet its obligations under the May 2017 Direction, it would seem, given the conditions attached to the previous lodgement by ILCU of [REDACTED] in July 2016 into the NTMA account in the name of Charleville, that this further funding is conditional and therefore, for the reasons already explained above, does not meet the criteria for inclusion in Charleville's reserves;
- (c) given that Charleville has tried, and failed, on three occasions to complete a ToE, and RCU has no expectation that Charleville will be able to successfully identify a suitable transferee and/or implement a voluntary transfer, RCU has no reason to believe that Charleville has any reasonable prospect of being in a position to resolve its financial position via a ToE;
- (d) Charleville has not provided the Central Bank with any proposal as to how it could immediately, and on a sustained basis, raise and maintain its reserves to the level required by the May 2017 Direction and has exhausted all remaining avenues by which it can resolve its financial difficulties and comply with the reserve requirements imposed by the May 2017 Direction;
- (e) the findings of the reports of three separate firms, namely the Draft 2015 EisnerAmper Asset Review Report, the 2015 DHKN Report and the 2016



MSN Report, highlight significant concerns with regard to the viability of Charleville's business;

- (f) [REDACTED], in its reasons for withdrawing from the ToE process, called into question Charleville's viability in the absence of further support over and above the amount required in the May 2017 Direction, stating that "given the level of projected losses in the Merged Entity [REDACTED] would require ILCU to underwrite the P&L of the combined entity for a minimum of 4 years to allow the business to stabilise and grow"; and
- (g) Charleville has been unable to convene AGMs since 2012, in respect of the year ended 2011, which means there is a material risk that members may become concerned as to Charleville's solvency and/or viability, which could in turn lead to a run on members' savings/deposits and a disorderly cessation of Charleville's operations.

#### ***Review of RCU's regulatory response to Charleville's financial difficulties***

3.189 On 7 April 2017 the Registrar issued a letter to Charleville confirming that she intended to impose further regulatory directions on Charleville broadly on the terms that were ultimately contained in the May 2017 Direction. Charleville was invited to make submissions to RCU with respect to the proposed directions, to which it responded by way of letter dated 12 April 2017. In that letter, Charleville made a number of assertions and criticisms regarding RCU's conduct, and the adequacy of its regulatory response, during the course of its interactions with the Credit Union. On 17 May 2017, and again on 15 June 2017, Charleville made further assertions and criticisms with respect to RCU in its response to the May 2017 Direction and RCU's subsequent letter of 23 May 2017. A detailed summary of the key issues raised in all of this correspondence is summarised in Part 1 of this Section of the Report.

3.190 The assertions and criticisms made by Charleville in recent correspondence with RCU merit careful consideration in the context of any decision with regard to whether or not to liquidate Charleville. The key issues raised by Charleville in that correspondence can be summarised as follows:

- (a) Charleville has asserted that RCU had failed to provide the necessary support to Charleville with respect to its unsuccessful attempt at a ToE with [REDACTED] the implication being that if such support had been given Charleville may have been able to complete the ToE and avoid its current predicament;
- (b) Charleville has alleged RCU formed a view concerning the extent of any impairment required to the value of [REDACTED] based on the content of the Reilly Report without giving Charleville an opportunity to respond to the issues raised therein;
- (c) Charleville has asserted that the regulatory directions imposed by RCU, restricting Charleville's lending and business activities, impeded its ability to comply with the June 2016 Direction, and that RCU in not relaxing or lifting those restrictions, had prevented Charleville from being in a position to raise and maintain its reserves to the level required by the June 2016 Direction; and,

- (d) Charleville has also asserted that its reserves at its current level of 3.5% of total assets is due to the fact that it had been directed by RCU [REDACTED]

3.191 Each of these issues has been carefully considered with reference to the regulatory and supervisory file of Charleville.

***Charleville's criticisms concerning RCU's role in the failed ToE with [REDACTED]***

3.192 The interactions between RCU and Charleville with regard to the proposed ToE with [REDACTED] can be summarised as follows:

- (a) On 19 April 2016, Charleville advised RCU that a meeting was held with [REDACTED] to discuss a potential ToE.
- (b) On 21 April 2016, Charleville requested that RCU clarify any concerns that it may have regarding the proposed ToE to [REDACTED] and on the same day, RCU responded to say that: *"the Central Bank does not have a fundamental objection to [REDACTED] Credit Union as a potential transferee. As per our discussions, [REDACTED] Credit Union. It is imperative that the board considers all options available to ensure that any transfer of engagements creates a stable entity for the benefits of the combined membership"*.
- (c) An initial exploratory meeting was subsequently convened between [REDACTED] and Charleville on or around 23 May 2016, negotiations duly progressed and 17 June 2016 was fixed as the deadline for the delivery by both credit unions to RCU of the High Level Business Case (the "HLBC") for the proposed ToE. Following a delay in the preparation of the HLBC, this deadline was extended to 6 July 2016, and the HLBC was ultimately submitted to RCU on 11 July 2016.
- (d) On 18 July 2016, RCU expressed a number of concerns and queries to Charleville and [REDACTED] regarding the adequacy of the HLBC, including that it did not appear to: *"reflect the additional considerations for a transfer involving the difficulties currently experienced in [Charleville]"*. As an example, RCU noted there was no reference in the HLBC to the two key issues affecting Charleville, specifically: (a) the level of staff, and potential overstaffing, as Charleville effectively becomes a branch of [REDACTED]; and (b) the issues with respect to the value of the Premises.
- (e) RCU invited responses from Charleville and [REDACTED] with respect to its comments on the HLBC by 22 July 2016. Charleville responded to say that it *"was highly unlikely"* to be able to respond within that timeframe.
- (f) RCU did not receive any submissions or response from Charleville or [REDACTED] with respect to the concerns it expressed concerning the HLBC. Subsequently in an email to Charleville dated [REDACTED], RCU advised Charleville that the proposed ToE to [REDACTED] should not proceed: "[REDACTED]"

[REDACTED]". RCU noted that it also held concerns in relation to the information submitted by both credit unions regarding the proposed ToE. RCU stated that it remained: *"fully committed to working with the Credit Union to help identify the most suitable transfer option to address the financial position of the Credit Union"*.

3.193 In a letter dated [REDACTED], Charleville advised that: "[REDACTED]

[REDACTED]". Charleville advised that it had made *"informal contact with Clonmel"* in relation to a proposed ToE. In addition, Charleville stated that it was: *"glad to see from your emails of 20 August 2016 and 14 September 2016 that the Bank remains fully committed to working with our Credit Union to help identify the most suitable transfer option to address the financial position of the Credit Union."*

3.194 In order to assess whether or not there is any basis to Charleville's allegation with respect to RCU's conduct concerning the proposed ToE to [REDACTED] it is first necessary to consider the nature of RCU's role with regard to ToEs.

3.195 Sections 129 to 132 of the CUA sets out the legislative requirements and steps necessary for a voluntary ToE between two credit unions. In the first instance it should be noted that:

- (a) a ToE can only be instigated by two credit unions that resolve by a special resolution of their respective members to approve the voluntary ToE of one credit union to another (unless RCU consents to such transfer being approved instead by resolutions of their respective boards of directors);
- (b) although RCU will from time to time seek to facilitate discussions between credit unions with respect to potential ToEs, RCU's primary role, as a prudential regulator to the sector, in the ToE process is to confirm, or not confirm (as the case may be), any ToEs that are proposed to be undertaken by credit unions in accordance with section 131 of the CUA; and
- (c) it is not the role of RCU to propose or instigate potential ToEs, but rather to ensure that any applications that it receives with respect to proposed ToEs, comply with the requirements of the CUA, and in particular, are not contrary to the public interest or RCU's statutory functions with respect to the regulation and supervision of credit unions. It would be inconsistent with its role as regulator of credit unions, for RCU to propose potential ToEs to itself for confirmation.

3.196 Charleville's criticism of RCU with respect to the proposed ToE with [REDACTED] appears to be twofold: first, that RCU failed to provide the necessary support to the ToE; and second, that RCU's failure to provide such support was *"inexplicable"* (as stated in Charleville's letter to RCU dated 12 April 2017).

3.197 RCU is not required to support any given ToE that is proposed by a credit union. Rather, RCU's role as regulator is to analyse the issues that may be faced by any ToE, ensure that the credit unions concerned have identified any such issues prior to the ToE proceeding and have put in place appropriate arrangements to mitigate any risks that may threaten the stability and viability of the combined entity post-ToE, and finally, to decide whether

or not to confirm any ToE that is formally approved by both credit unions, having regard to the interests of all key stakeholders in both entities, and the sector as a whole.

3.198 It is clear from the correspondence that:

- (a) RCU explicitly conveyed to Charleville, prior to the commencement of its negotiations with [REDACTED];
- (b) RCU raised material concerns with respect to certain deficiencies with the HLBC, which were conveyed to both Charleville and [REDACTED] and that those issues and concerns were not adequately addressed or indeed responded to by either credit union; and
- (c) it was appropriate for RCU to provide notice to both credit unions that, in light of its concerns, it would be unable to confirm the proposed ToE.

***Charleville's criticisms regarding the value of [REDACTED]***

3.199 In its letter dated 12 April 2017, Charleville asserted that RCU, in its letter of 7 April 2017, had come to certain conclusions concerning [REDACTED] based on the conclusions of the Reilly Report, but without providing a copy thereof to Charleville, or allowing it an opportunity to respond to the issues raised therein.

3.200 Having reviewed all of the relevant correspondence and meeting notes relating to this issue it is clear that:

- (a) the Reilly Report was prepared by the solicitors for Clonmel as part of its due diligence exercise concerning the business and assets of Charleville, including [REDACTED];
- (b) whilst the file does not confirm that the Reilly Report was provided by Clonmel to Charleville prior to the date of RCU's letter of 7 April 2017, in an email dated 14 March 2017, Clonmel stated that a discussion was held with Charleville regarding, *inter alia*, matters concerning [REDACTED], and that accordingly, if Charleville did not have a copy of the Reilly Report by the time it received RCU's letter of 7 April 2017, it was nonetheless familiar with the issues raised by the Reilly Report with regard to [REDACTED];
- (c) a copy of the Reilly Report was forwarded by RCU to Charleville on 12 April 2017 and again on 19 April 2017;
- (d) in a letter to Charleville dated 19 April 2017, RCU agreed to extend the period within which Charleville could make submissions to the Registrar, in part to allow Charleville time to respond to the issues raised with respect to [REDACTED] in the Reilly Report;
- (e) Charleville did in fact make further submissions to RCU on 28 April 2017 with respect to [REDACTED] and the conclusions of the Reilly Report and submitted a written opinion from its solicitors seeking to address those conclusions; and
- (f) in light of the difference of views expressed in the Reilly Report, on the one hand, and the submissions of Charleville and its solicitors on the other hand,

RCU altered its position with respect to the additional operational risk reserve imposed on Charleville by the May 2017 Direction, and reduced the level of the additional operational risk reserve from 3.5% to 3.0% of total assets (a reduction from €1.5m to €1.27m as at 31 March 2017).

- 3.201 On the basis of the above, it is clear that Charleville was provided with adequate opportunity to consider and respond to the issues raised in the Reilly Report as reflected in its further submissions to RCU and that RCU duly considered those submissions and, as a direct result thereof, reduced the level of additional operational risk reserve imposed in the May 2017 Direction from 3.5% to 3.0% of total assets.

***Charleville’s criticisms with regard to the imposition of regulatory directions by RCU***

- 3.202 The regulatory directions imposed by RCU on Charleville form a central aspect of the regulatory and supervisory history of Charleville. Those regulatory directions included:
- (a) the requirement to raise and maintain Charleville’s reserves to a certain specified level, which directions are for ease of reference hereinafter referred to as “**Reserve Directions**”<sup>6</sup>; and
  - (b) restrictions on the lending and business activities of Charleville, with respect to: (i) limitations on lending to any individual member where the net exposure to that member would exceed a specified amount; (ii) limitations on the total amount of lending to members in any calendar month; (iii) prohibitions on Charleville accepting deposits from new or existing members which exceeded a specified limit; (iv) prohibitions on Charleville making certain investments and expenditure on fixed assets; and (v) the maintenance of liquidity above a specified level, which directions are for ease of reference hereinafter referred to as “**Conduct of Business Directions**”<sup>7</sup>.

***Rationale for imposition of the Reserve Directions***

- 3.203 All credit unions in Ireland are currently required to maintain reserves of 10.0% of total assets. This requirement is a key component of the prudential framework for credit unions and is designed to ensure: (a) the stability of individual credit unions and the sector overall; and (b) to protect members’ savings and continuity of access to those savings. The reserves of a credit union support a credit union’s operations, provide a base for future growth, and protect against the risk of unforeseen losses. Credit unions are required for that purpose to operate with a level of reserves above the 10.0% requirement. The level of such additional reserves is decided upon by the directors of each credit union having taken prudent account of the nature, scale and complexity of the credit union’s business, its risk profile, and prevailing market conditions.
- 3.204 Compliance with the reserve requirement enables a credit union to deal with future uncertainties and to act flexibly in light of a changing economic landscape. The failure on the part of a credit union to comply with the reserve requirement represents a significant

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<sup>6</sup> The first Reserve Direction was imposed on Charleville in April 2012, and further Reserve Directions were more recently imposed in June 2016 and May 2017.

<sup>7</sup> The first Conduct of Business Direction was imposed in October 2011, and further Conduct of Business Directions were more recently imposed in December 2016 and June 2017.

threat to the orderly and prudent regulation of that credit union. This threat is exacerbated where, as has been the case with respect to Charleville, there is a failure to comply with the reserve requirement over an extended period.

- 3.205 With effect from 30 September 2009, all credit unions are required to maintain reserves of not less than 10.0% of total assets on an ongoing basis, which is defined as: *“the amount held in the Total Regulatory Reserve of a credit union expressed as a percentage of Total Assets of a credit union”*. Reserves available to a credit union for the purpose of the “Regulatory Reserve Requirements” must be realised, unrestricted and non-distributable. Credit unions were required to remain in compliance with the reserve requirement on an ongoing basis.
- 3.206 Where a credit union’s reserves were less than 10.0%, the credit union was required to transfer other realised reserves to the total reserve requirement, in order to bring the reserves up to the required level. Where a credit union did not have adequate reserves to meet the reserve requirement by 30 September 2009, the board of directors of the credit union was required to provide the Registrar with a plan for achieving compliance within the shortest timeframe possible, but not later than the timeframes and percentages set out below:
- (a) 30 September 2009 – reserves of at least 7.5%;
  - (b) 30 September 2010 – reserves of at least 8.0%;
  - (c) 30 September 2011 – reserves of at least 8.5%;
  - (d) 30 September 2012 – reserves of at least 9.0%; and
  - (e) 30 September 2013 – reserves of at least 10.0%.
- 3.207 Credit unions that do not comply with the reserve requirement are issued with a regulatory direction pursuant to section 87 of the CUA, directing that the credit union raise and maintain its reserves to the required level.
- 3.208 The ILCU-administered SPS fund provides support to ILCU-affiliated credit unions in financial difficulties, which is granted at ILCU’s discretion. Prior to 2014, SPS support was generally provided in the form of a “loan guarantee”, which is more accurately described as a binding agreement to acquire a credit union’s non-performing loans for a certain value, subject to certain specified conditions being satisfied by that credit union, including that the relevant loans covered by the “guarantee” are written-off or impaired within two years. Under these arrangements, once the conditions with respect to the loans covered by the guarantee were satisfied, the credit union applies to drawdown funds from SPS and ownership of the loans would pass to ILCU on behalf of SPS.
- 3.209 Previously, the Bank accepted that the SPS support provided in the manner described above could be taken into account by the relevant credit union when calculating its reserves, even in circumstances where the SPS guarantee had not been drawn down. However, with effect from 1 January 2016 as per the requirement set out in the 2016 Regulations, the Central Bank requires any financial support received by credit unions in financial difficulties, would not satisfy the reserve requirement, unless such support is provided in cash, which is unrestricted, fully realised and non-distributable and is fully loss-absorbing capital, to ensure greater certainty in respect of a credit union’s reserves. This aspect of the 2016 Regulations emerged following a public consultation undertaken by the

Central Bank on regulations for credit unions, in respect of the commencement of the remaining sections of the 2012 Act in November 2014. A feedback statement along with final regulations was published in July 2015. Furthermore, a notification regarding the commencement of these regulations was sent to all credit unions on 22 December 2015 ahead of commencement of the regulations on 1 January 2016.

- 3.210 Following extensive discussions with ILCU, a standard capital contribution agreement (“CCA”) to be entered into between ILCU and credit unions availing of SPS support was approved in January 2015. Separately, a transfer of rights agreement (“TRA”) was devised which would be put in place between ILCU and any credit union availing of SPS support that would allow ILCU any future recovery values of a limited number of fully provided assets. The TRA provides for the assignment of rights of recovery typically with respect to written-off loans, written-off investments and any upside on the existing market value of premises in the event that the credit union decides to dispose of the premises. It is separate from, and does not impinge on, the capital contribution, which remains unrestricted, realised and non-distributable.
- 3.211 Charleville, like every other credit union in the State, currently has a statutory obligation to maintain reserves of 10.0% of total assets. This position would have been the case whether or not the Registrar had issued the various Reserve Directions imposed on Charleville since 2012. The most recent PR submitted by Charleville reported reserves of 3.5% as at 30 June 2017 (the “June 2017 PR”).
- 3.212 The rationale, purpose and effect of the Reserve Directions imposed on Charleville was to:
- (a) impose a specific legal duty on Charleville to take such measures as are necessary to raise and maintain its reserves at 10.0% (or in the case of the May 2017 Direction, raise and maintain its reserves to 10.0% and an additional operational risk reserve of 3.0% of total assets) by a date specified in the relevant Reserve Direction, for example by seeking support from external sources such as SPS;
  - (b) make certain legal remedies available to the Central Bank in the event that Charleville failed to comply with the Reserve Directions, including the power to seek a Court order requiring compliance and/or the power to petition for the winding up of Charleville; and
  - (c) highlight the seriousness of the financial situation faced by Charleville with a view to focussing the attention of its directors on the causes of Charleville’s financial distress.
- 3.213 Having regard to the above, RCU imposed the Reserve Directions on Charleville having considered: (a) the acute financial distress of Charleville; and (b) the regulatory policies and practices operated by RCU in respect of the entire credit union sector at the time concerned.

#### ***Rationale for imposition of Conduct of Business Directions***

- 3.214 RCU first imposed a formal Conduct of Business Direction on Charleville in October 2011, in response to a significant deterioration in Charleville’s reported financial position in the period since late 2009. Prior to the issue of the first Conduct of Business Direction, RCU’s practice was to issue written instructions to Charleville imposing similar restrictions, but

unlike formal regulatory directions, these instructions were not legally binding on the Credit Union.

- 3.215 As can be seen from the account of the regulatory interaction between RCU and Charleville as summarised earlier in this Section, Charleville has regularly requested that RCU ease or lift the restrictions imposed by the various Conduct of Business Directions. Apart from one occasion in May 2013, where RCU agreed on a one-off basis to increase Charleville's monthly lending limit by €0.1m, from €0.25m to €0.35m, RCU has been unable to ease or lift the restrictions imposed on Charleville by these Conduct of Business Directions. RCU has consistently explained to Charleville that it was not in a position to lift or ease the Conduct of Business Directions until it was satisfied that Charleville's financial difficulties had been fully addressed.
- 3.216 The statutory basis for the issue of regulatory directions by the Registrar arises under section 87 of the CUA, which confers the Registrar with the authority to issue conduct of business directions on credit unions where it deems it appropriate to do so. In general, the primary rationale and purpose of imposing conduct of business directions is the protection of members' savings.
- 3.217 Members' funds generally constitute a key, if not the primary, source of funding for new lending by credit unions. Therefore, where a credit union is experiencing financial difficulties, is unable to maintain reserves of 10.0%, has a history of engaging in lending activity involving high levels of risk of delinquency, or has failed to adopt appropriate credit risk policies, the Registrar will consider imposing one or more conduct of business directions in order to mitigate the risk to members' funds of that credit union. Although RCU generally regards a lending restriction as a short-term measure, it will usually not ease or lift any such lending restrictions unless, and until, it is satisfied that the credit union has fully addressed each of the issues identified by RCU that necessitated the imposition of the Conduct of Business Directions in the first place.
- 3.218 Clearly, the imposition of lending restrictions will have a negative impact on the ability of a credit union to grow its loan book. In fact, that is the purpose of those restrictions, which are designed to limit lending in order to allow the Credit Union an opportunity to ameliorate its financial position without incurring further risk with respect to members' savings. It is also clear that the restriction of a credit union's ability to grow its loan book and to offer credit to members can have negative consequences for that credit union's reputation and profitability. However, RCU has a duty to balance the potential negative consequences of imposing lending restrictions against: (a) the risk to members if the credit union is permitted to lend freely in circumstances where it is demonstrably financially distressed or has inadequate credit and risk policies in place, or is in fact already non-viable; and (b) the risk for the wider sector if a credit union were to suffer an unmanaged failure due to continuing uncontrolled lending at a time when it is already financially distressed.
- 3.219 Although each case is necessarily assessed on its merits, the Registrar will generally impose a conduct of business direction on any credit union that is unable to maintain the reserve requirement of 10.0% over a material period of time. This is because the inability to maintain reserves of 10.0% over a sustained period is a key indicator that a credit union is seriously financially distressed and is at material risk of failure. Generally speaking, RCU will not ease or lift lending restrictions, until it is satisfied that the credit union has raised its reserves to the required level, has demonstrated it can maintain its reserves at that level, and has further demonstrated that it has adequately addressed the issues that caused the credit union to have reserves of less than 10.0%.



3.220 Having carefully considered the regulatory, supervisory and financial history of Charleville, the issuing and maintaining of the Conduct of Business Directions imposed on Charleville was necessary and appropriate, in particular when considered by reference to:

- (a) the fact that various reviews conducted by independent experts in respect of Charleville (the findings of which are summarised earlier in this Section) highlighted the existence of poor lending policies and inadequate credit controls in respect of Charleville, during the period prior to June 2010;
- (b) the acute financial distress caused to Charleville as a result of poor lending practices, which resulted in the impairment of a substantial part of Charleville's loan book;
- (c) the fact that Charleville has not been able to raise and maintain the reserve requirement of 10.0% at any time since 2009 notwithstanding substantial SPS cash support received by Charleville from ILCU; and,
- (d) the fact that the Draft 2015 EisnerAmper Asset Review Report and the 2015 DHKN Report raised serious doubts as to the viability of Charleville's business, even if it managed to temporarily raise and maintain its reserves to 10.0% and the Conduct of Business Directions were lifted.

***Charleville's assertion with regard to provisions against property-related loans***

3.221 As is demonstrated from the summary of the regulatory interactions between RCU and Charleville set out above in the Report, the adequacy of Charleville's bad debt provisioning has been a central issue of concern to RCU throughout the entire period of its engagement with Charleville.

3.222 In particular, RCU held concerns regarding the [REDACTED]. Until late 2015, Charleville maintained the position that, although these loans were non-performing, it was entitled to reduce the bad debt provision required to be applied against [REDACTED]. However, RCU consistently raised concerns with Charleville with regard to the [REDACTED] and whether the extent of the reduction in provisioning was justified. The position was confirmed by Charleville in an email addressed to RCU dated 12 December 2013, wherein Charleville stated that in relation to the security for these property-related loans that: "[REDACTED]".

3.223 RCU's concerns with regard to the [REDACTED] also arose from the findings of a number of reviews undertaken in respect of Charleville's loan book, including the Draft 2015 EisnerAmper Asset Review Report and the 2015 DHKN Report, with regard to the [REDACTED]. RCU met with Charleville's Board on 12 November 2015 to discuss the findings of the Draft 2015 EisnerAmper Asset Review Report and the 2015 DHKN Report, wherein RCU outlined its concerns regarding these matters. Finally, in a letter dated 1 December 2015, Charleville informed RCU that its Board had decided to "[REDACTED]" thereby ensuring that loans that were in arrears for a period of more than fifty two weeks would be fully provided for. Charleville also submitted the Revised September 2015 PR, including the adjustment in its bad debt

provisioning levels, thus reporting reserves of 4.6% of total assets, as opposed to reserves of 10.3%, as reported in the PR for the period ended 30 June 2015.

3.224 Having considered all of the relevant correspondence and other materials relating to this issue, it is not evident that RCU "directed" or "instructed" Charleville to provide fully for its non-performing property-related loans, or to [REDACTED]. Furthermore:

- (a) Charleville did not provide RCU with justifications for its under-provisioning against these loans nor has it provided any substantive evidence that any of [REDACTED]; and,
- (b) in an email to RCU dated 12 December 2013 Charleville stated, in relation to the relevant impaired loans, that: "*prudently we would have to carry [REDACTED] provision on all these accounts*" and that: "*this cost is too onerous on the Credit Union which is the basis for requesting funds under the SPS in the first place*".

3.225 In conclusion:

- (a) the imposition of the Conduct of Business Directions and the Reserve Directions was an appropriate and necessary regulatory response by RCU to Charleville's financial distress;
- (b) RCU appropriately refused Charleville's request for the Conduct of Business Directions to be eased or lifted in circumstances where Charleville was not in a position to satisfy RCU that it had raised, or was in a position to maintain, its reserve requirement in accordance with the Reserve Directions and where RCU had material concerns regarding the viability of Charleville's business;
- (c) RCU was entitled to form the view, having regard to the overriding interest in protecting members' savings and the stability of the credit union sector as a whole, that: (i) it was not appropriate to ease or lift the Conduct of Business Directions imposed on Charleville because to do so could expose members' savings to further risk; and (ii) the restoration of Charleville's reserves must be achieved through the contribution to its reserves of additional permanent loss-absorbing capital in cash using a source such as SPS funding prior to any lifting or relaxation of the Conduct of Business Directions;
- (d) it is not correct, as asserted by Charleville, that Charleville's failure to raise and maintain its reserves to the required level was caused by the imposition and maintenance of the Conduct of Business Directions by RCU or that, by imposing the Conduct of Business Directions, RCU was preventing Charleville from complying with its obligation to raise and maintain its reserves to the required level;
- (e) Charleville was not "instructed" by RCU to provide fully for its impaired property-related loans or to [REDACTED] in support of those loans. However, the decision by Charleville's Board [REDACTED] significantly impacted on Charleville's reserves; and

- (f) Charleville's inability to raise and maintain the 10.0% reserve requirement had as its root cause poor lending practices prior to 2010, and the financial distress that resulted therefrom, as is more particularly described in the following Section 4.

#### 4. RES'S ASSESSMENT OF THE REASONS FOR CHARLEVILLE'S FAILURE

4.1 This Section of the Report sets out RES's assessment of the reasons for Charleville's failure, having regard to:

- (a) its recent financial performance, which raises concerns regarding future viability;
- (b) the evolution of Charleville's recent financial position;
- (c) the nature of its lending practices;
- (d) the approach to and recognition of bad debt provisioning and associated losses;
- (e) fixed asset impairments;
- (f) the impact of financial impairments on its reserves;
- (g) the recent revision of its historical financial statements; and
- (h) the conclusions of various expert reviews conducted in respect of Charleville.

4.2 Charleville's core underlying business, as with all credit unions, is the intermediation of members' savings by granting loans to other members, with surplus resources invested. The income earned from such activities should cover operating costs, the payment of a dividend to members (dividends in credit unions being the equivalent to deposit interest in banks), if possible, and ensure the credit union maintains adequate reserves to comply with the reserve requirements.

4.3 RES is of the view that Charleville's failure has resulted primarily from poor lending practices during the period prior to 2009. As a direct consequence of those practices, Charleville has, over time, needed to recognise a significant level of bad debt provisions and related loan write-offs. In addition, Charleville has had to recognise a sizeable impairment to the carrying value of the Premises. The combined impact of those factors has had a negative effect on Charleville's reserves, which according to the June 2017 PR were 3.5%, and consequently, it is not in compliance with the 10.0% reserve requirement.

##### ***Income and Expenditure Account***

4.4 Table 2 below sets out Charleville's income and expenditure from the year ended 30 September 2009 to 30 June 2017.

**Table 2: Charleville's income and expenditure 2009 - 2017**

€'000s Period end	Final	Final	Final	Draft	Original Financial Statements				Prudential Return Jun 2017
	Accounts Sept 2009	Accounts Sept 2010	Accounts Sept 2011	Accounts Sept 2012	Draft Sept 2013	Draft Sept 2014	Draft Sept 2015	Draft Sept 2016	
<b>Income</b>									
Loan interest	2,592	2,189	1,874	1,521	1,119	869	781	851	579
Other interest income	589	887	387	770	576	415	229	126	47
Other income	44	27	13	21	19	24	26	19	22
<b>Total Income</b>	<b>3,225</b>	<b>3,103</b>	<b>2,274</b>	<b>2,312</b>	<b>1,714</b>	<b>1,308</b>	<b>1,036</b>	<b>996</b>	<b>648</b>
<b>Ordinary operating expenses</b>									
Salaries and wages	1,173	1,047	1,184	588	590	590	530	496	380
Management expenses	973	983	902	840	712	565	595	615	568
Depreciation	115	105	112	105	105	100	89	41	0
<b>Total ordinary operating expenses</b>	<b>2,261</b>	<b>2,135</b>	<b>2,198</b>	<b>1,533</b>	<b>1,407</b>	<b>1,255</b>	<b>1,214</b>	<b>1,152</b>	<b>948</b>
<b>Ordinary operating (Loss) / Profit</b>	<b>964</b>	<b>968</b>	<b>76</b>	<b>778</b>	<b>307</b>	<b>53</b>	<b>(178)</b>	<b>(156)</b>	<b>(300)</b>
<b>Exceptional items</b>									
ILCU funding	0	0	(2,155)	(5,895)	0	0	0	0	0
Impairments	0	0	0	0	0	0	984	0	0
Bad debt provisions	6,461	5,259	(1,451)	(164)	305	(100)	2,030	(653)	(802)
Write offs	201	368	2,812	0	0	0	0	529	802
Recoveries	(66)	(52)	(61)	(139)	(569)	(412)	(431)	(317)	(334)
<b>Total non recurring items</b>	<b>6,596</b>	<b>5,574</b>	<b>(854)</b>	<b>(6,198)</b>	<b>(264)</b>	<b>(512)</b>	<b>2,583</b>	<b>(441)</b>	<b>(334)</b>
<b>Total Expenses</b>	<b>8,857</b>	<b>7,709</b>	<b>1,344</b>	<b>(4,664)</b>	<b>1,143</b>	<b>743</b>	<b>3,797</b>	<b>711</b>	<b>614</b>
<b>Net (Loss) / Profit</b>	<b>(5,632)</b>	<b>(4,606)</b>	<b>930</b>	<b>6,976</b>	<b>571</b>	<b>565</b>	<b>(2,761)</b>	<b>285</b>	<b>34</b>
Dividend	(1,298)	0	0	0	0	0	0	0	0
<b>Key ratios</b>									
Loan Interest/Total income %	80%	71%	82%	66%	65%	66%	75%	85%	89%
Cost Income ratio <sup>(1)</sup>	275%	248%	59%	(202%)	67%	57%	367%	71%	95%
Cost Income ratio <sup>(2)</sup>	70%	69%	97%	66%	82%	96%	117%	116%	146%

Source: Charleville financial accounts and prudential return.

Notes: (1) Cost income ratio including exceptional items; and (2) cost income ratio excluding exceptional items.

- 4.5 As Table 2 illustrates, Charleville's total expenses exceeded its income in the years ended 30 September 2009, 30 September 2010 and 30 September 2015. In the years ended 30 September 2011 and 2012, Charleville reported an increased trading surplus following the recognition of funds from the drawdown of SPS Support from ILCU. In the financial year ended 30 September 2016, Charleville reported a trading surplus of €0.3m, following the benefit of exceptional items (which included recoveries of loans previously written-off and the reversal of bad debt provision). This trading surplus would be reversed to a trading loss of €0.16m, when these exceptional items are excluded. It is instructive to note that [REDACTED], following a review of the financial position of Charleville carried out in late August 2017 as part of the ToE process, highlighted the sustainability of relying on loan recoveries to mask operating losses as a key reason for its withdrawal from that process. In that context [REDACTED] stated that: "CCU P&L is currently supported by Debt Recovered and its difficult to assess how sustainable this is long term ... We have assumed that CCU is currently recovering "easy wins" in their bad loan book which is reflected in their current P&L but this level of recovery is unlikely to be sustainable".
- 4.6 Charleville's cost income ratio is an important barometer of its underlying viability, and, as the analysis in Table 2 shows Charleville's cost income ratio has been unsustainably high over an extended period. Charleville's management sought to address the level of ordinary operating expenses over the financial years ended 30 September 2012, 2013 and 2014. Table 2 details the year-on-year reduction in ordinary operating expenses in these years. This resulted in Charleville's cost income ratio (excluding exceptional items) reducing

below 100% in those years to more sustainable levels. However, notwithstanding the reduction in operating expenses, Charleville's cost income ratio (excluding exceptional items) has remained above 100% since 2015. For any business to sustain itself, such a high cost income performance would present a significant threat to its future sustainability and viability. Indeed, given the level of operating expenses and the fact that Charleville is loss making, when exceptional items are excluded, it is unlikely that there exists a business case for a ToE in the absence of external support that would in essence under-write operating expenses for an extended period post transfer. In that regard, it is noted that as part of its explanation for terminating ToE discussions with Charleville, ██████ stated that: *"given the level of projected losses in the Merged Entity ██████ would require ILCU to agree to underwrite the P&L of the combined entity for a minimum of 4 years to allow the business to stabilise and grow. Based on projected losses this could cost in the region of €1m plus"*.

- 4.7 Charleville's loan book, a credit union's primary income generator, has declined significantly since 2009 (as outlined in Table 3 below), and consequently Charleville experienced a significant decline in interest income on its loan book. Interest income declined from €2.6m in the year ended 30 September 2009 to €0.9m in the year ended 30 September 2016, a 65.4% reduction.
- 4.8 As outlined in Table 3 below, since 2011 Charleville's cash, bank and investments has increased steadily as its loan book reduced in size, rising from €26.7m at 30 September 2009 to €35.8m at 30 September 2016. Surplus resources were invested mainly in short-term investments, typically on deposit in credit institutions. In light of the prevailing low interest rate environment, the income Charleville has been able to generate on its investments has diminished. Other interest income (which includes return on investments) has declined from €0.9m in the year ended 30 September 2010 to €0.1m in the year ended 30 September 2016, representing a decline of €0.8m or 88.9%. While Charleville's surplus funds available for investment has increased significantly in the period under review, the actual return on surplus funds has significantly reduced.
- 4.9 As Table 2 above illustrates, Charleville's income and expenditure has been negatively impacted by bad debt provisions, loan write-offs and fixed asset impairments. Resulting losses were to some extent mitigated through the provision of SPS Support from ILCU (reported in the financial years ended 30 September 2011 and 30 September 2012). However, since 2013 (with the exception of 2015) these exceptional items have had a positive impact on Charleville's income and expenditure as loans previously written-off are recovered and to a lesser extent bad debt provision are reversed. However, such loan recoveries and write-backs whilst helping to shelter trading losses and improve Charleville's cost income metrics in recent periods, are not sufficiently sustainable, given their one-off nature, to reverse Charleville's weak underlying cost income performance (as shown above by a cost income ratio, excluding one-off non-recurring items, in excess of 100% for the financial years ended 30 September 2015 and 2016).
- 4.10 Notwithstanding Charleville's efforts to manage its operating cost base, as noted above, its income generating capacity has been constrained by: (i) diminished investment returns given the low interest rate environment; and (ii) the reduced scale of Charleville's loan book, its primary income-generating asset from which it should earn interest income and (iii) the lending restrictions imposed on Charleville by RCU which were necessary for the reasons explained previously. The sustained reduction in its income generating capacity limits Charleville's ability to cover its operating cost base on an ongoing basis, which calls into question its underlying viability.

### Evolution of Charleville's balance sheet 2009 – 2017

- 4.11 Table 3 below sets out the evolution of Charleville's financial position for the period 30 September 2009 to 30 June 2017. As is evident from Table 3, Charleville's balance sheet has contracted significantly over that period, with loan and fixed asset carrying values declining significantly on the asset side and members' savings decreasing significantly on the liability side. Table 3 also identifies the negative effect of loan and fixed asset impairments and write-offs on Charleville's reserves.

**Table 3: Evolution of Charleville's balance sheet from 30 September 2009 to 30 June 2017**

€'000s Period end					Original Financial Statements				Prudential Return Jun 2017
	Final	Final	Final	Draft	Draft	Draft	Draft		
	Accounts	Accounts	Accounts	Accounts	Accounts	Accounts	Accounts		
	Sept 2009	Sept 2010	Sept 2011	Sept 2012	Sept 2013	Sept 2014	Sept 2015	Sept 2016	
<b>Assets</b>									
Fixed assets	2,222	2,133	2,032	1,928	1,868	1,780	709	668	347
Cash, bank & investments	26,664	22,411	21,996	25,316	31,629	32,951	34,867	35,829	35,432
Gross loans	42,726	37,508	28,559	16,457	14,379	13,726	12,392	11,536	10,755
Bad debt provisions	(9,229)	(14,695)	(13,244)	(5,174)	(4,851)	(4,520)	(5,724)	(5,601)	(4,744)
Net loans	33,497	22,813	15,315	11,283	9,528	9,206	6,668	5,935	6,011
Other assets	269	207	2,381	6,097	983	159	208	217	92
<b>Total Assets</b>	<b>62,652</b>	<b>47,564</b>	<b>41,724</b>	<b>44,624</b>	<b>44,008</b>	<b>44,096</b>	<b>42,452</b>	<b>42,649</b>	<b>41,882</b>
<b>Liabilities</b>									
Members savings	61,934	51,443	44,891	40,907	39,617	39,090	39,651	40,672	40,218
Other creditors	455	463	245	153	256	306	862	320	209
<b>Total Liabilities</b>	<b>62,389</b>	<b>51,906</b>	<b>45,136</b>	<b>41,060</b>	<b>39,873</b>	<b>39,396</b>	<b>40,513</b>	<b>40,992</b>	<b>40,427</b>
<b>Total reserves (excl. unrealised)</b>	<b>263</b>	<b>(4,443)</b>	<b>(3,617)</b>	<b>3,564</b>	<b>4,135</b>	<b>4,700</b>	<b>1,939</b>	<b>1,657</b>	<b>1,455</b>
Loans to Assets Ratio	68%	79%	68%	37%	33%	31%	29%	27%	26%
Cash, bank & investments to Assets	43%	47%	53%	57%	72%	75%	82%	84%	85%
Provisions / gross loans %	22%	39%	46%	31%	34%	33%	46%	49%	44%
Reserve Position %	0.4%	(9.3%)	(8.7%)	8.0%	9.4%	10.7%	4.6%	3.9%	3.5%

Source: Charleville's annual final accounts; Charleville's original financial statements as submitted by Charleville to RCU for relevant years; and prudential return submitted by Charleville to RCU for period ended 30 June 2017.

- 4.12 Members' savings, which stood at €61.9m at 30 September 2009 declined significantly in the following years, reducing to €39.1m by 30 September 2014, representing a 36.8% decline over a five-year period. Members' savings began to increase again in recent years and according to the June 2017 PR, totalled €40.2m. This represents an overall reduction of 35.1% in the period from 30 September 2009 to 30 June 2017.
- 4.13 Charleville's total assets have also declined, decreasing from €62.7m at 30 September 2009 to €42.6m at 30 September 2016, a 32.1% reduction during the period. The main decline in assets was the reduction in Charleville's net loan book and the carrying value of the Premises, while cash, bank and investments increased.
- 4.14 Since 2009, loans have represented a declining proportion of Charleville's overall asset mix, reducing from a loan-to-asset ratio of 68.2% as at 30 September 2009 to 25.7% as at 30 June 2017. Cash, bank and investments increased from €26.7m at 30 September 2009 to €35.4m as at 30 June 2017, an increase of 32.6% over the period. Cash, bank and investments as a percentage of total assets increased from 42.6% at 30 September 2009 to 84.6% as at 30 June 2017.
- 4.15 The evolution of Charleville's asset mix and associated imbalance, moving from a higher proportion of loans (which are typically the primary income generating asset of a credit

union) to a higher proportion of investments (returns on which are diminished in the current low-yield environment) has constrained Charleville's income and raises issues regarding its future viability, a matter that will be dealt with below.

- 4.16 In the year ended 30 September 2009, the book value of fixed assets (being primarily the Premises and other fixtures and fittings) was €2.2m. The recognition of sizeable impairments has resulted in the carrying value of the Premises declining to €0.35m as at 30 June 2017.

#### ***Loan portfolio and bad debt provisions***

- 4.17 In the year ended 30 September 2009, Charleville's gross loans totalled €42.7m. Its gross loan book has declined steadily over the period and at 30 June 2017 amounted to €10.8m, which represents an overall reduction of 74.7% from 30 September 2009 to 30 June 2017.
- 4.18 Prior to 2009, Charleville granted a significant number of property-related loans to a limited number of borrowers. As outlined earlier in the Report, a number of those loans were bridging finance loans, which effectively means that the loans were structured on the basis that they would be repaid by the borrower from the sale or refinancing of the underlying properties held as security, rather than from other resources of the borrowers. It is important to note that in some cases borrowers may have had no alternative means to repay the loans. As a result, this type of lending tends to be riskier in nature from a credit risk perspective given the size of the loan and the nature of the repayment obligations. Such lending is not typical within the credit union sector, where loans are usually of an unsecured short-term nature. The credit risk associated with these bridging finance loans may have also increased further due to Charleville advancing top-up facilities in some instances to the borrowers, to meet interest repayments or extend the term of the loans. This resulted in the overall exposure to those borrowers increasing, while at the same time masking the underlying performance of the original loan as arrears in principal and interest payments may have been cleared when the new facilities were made available.
- 4.19 Section 3 above sets out the interaction between RCU and Charleville in relation to the recognition of bad debt provisions, including in relation to secured or bridging finance loans. In light of RCU's concerns regarding the performance of Charleville's loan book due to an increase in arrears and in light of the nature of the lending Charleville undertook prior to 2009, a number of reviews of Charleville's loan book were undertaken. The successive reviews by RCU and third parties resulted in increases in the level of bad debt provisions held against Charleville's loan book.
- 4.20 There were three significant increases in bad debt provisions between 2009 and 2015:
- (a) in 2009 Charleville increased its bad debt provisions by €6.5m following the B&A Loan Book Review, resulting in total bad debt provisions of €9.2m being reported in the financial statements for the year ended 30 September 2009;
  - (b) Charleville increased its bad debt provisions by a further c.€5.5m following the 2011 MSN Report, resulting in total bad debt provisions of €14.7m reported in the financial statements for the year ended 30 September 2010; and,
  - (c) Charleville increased its bad debt provisions by €2.0m in the 2015 financial statements following a decision by its Board to no longer reduce the total bad debt provisions required under the approach prescribed by ILCU's 2003



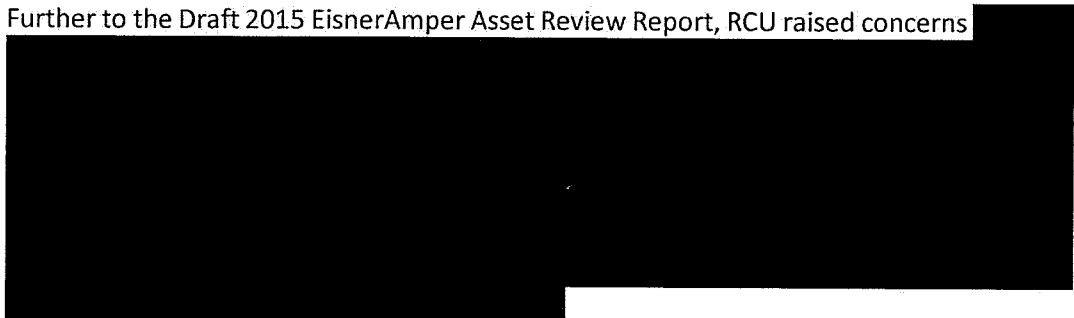
Resolution 49 methodology (“**Resolution 49**”), by the deemed value of property assets pledged as security against certain secured loans, resulting in total bad debt provisions of €5.7m as at 30 September 2015. The total bad debt provisions has declined marginally since then, amounting to €4.7m as at 30 June 2017, reflecting loans being written off and the consequent release of related bad debt of provisions.

4.21 While Charleville’s loan book has reduced in value, bad debt provisions as a percentage of the gross loans has increased principally due to the deterioration in the performance of the portfolio. In the year ended 30 September 2009, total bad debt provisions as a percentage of gross loans was 21.6%. This increased in the year ended 30 September 2011 to 46.4%, following impairments connected with the B&A Loan Book Review, 2011 MSN Report, the 2011 ILCU Review and the EY Viability Review.

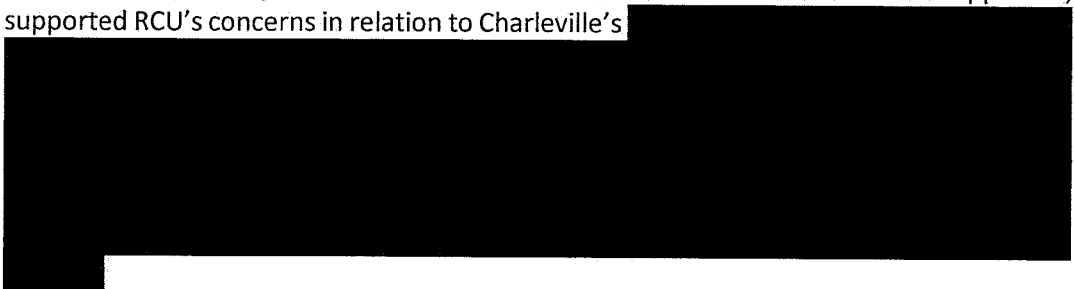
4.22 In the year ended 30 September 2012, total bad debt provisions as a percentage of gross loans reduced to 31.4%, reflecting loans being written-off and the consequent release of related provisions. In the year ended 30 September 2015, total bad debt provisions as a percentage of gross loans increased again to 46.2%. This followed the decision of Charleville’s Board to provide fully for a further €2.0m in bad debt provisions on certain loans with property pledged as security. As at 30 June 2017, the total bad debt provisions as a percentage of gross loans was 44.1%.

4.23 Charleville’s loan provisioning policy historically followed the Resolution 49 methodology. This methodology calculates the required provision on a non-performing loan based on: (a) the current loan balance in arrears; and (b) the number of weeks that the loan has been in arrears. However, Resolution 49 does not take into account the deemed value of property pledged as security against a loan, which as noted above Charleville held a large portfolio of secured loans. Until 2015, Charleville, in determining the level of bad debt provisions required for its secured loans, calculated the provisions using the methodology prescribed by Resolution 49 and, where Charleville deemed it appropriate, reduced the level of provisions based on the deemed value of the property security which was attached to the particular loans.

4.24 Further to the Draft 2015 EisnerAmper Asset Review Report, RCU raised concerns



4.25 Successive expert reports that identified risks associated with Charleville’s approach, supported RCU’s concerns in relation to Charleville’s



- 4.26 After detailed engagement with RCU on the findings in the Draft 2015 EisnerAmper Asset Review Report and other reports, Charleville eventually recognised an additional €2.0m of bad debt provisions in the financial statements for the year ended 30 September 2015, submitted to RCU in December 2015.
- 4.27 RES is of the view that if Charleville had more prudently [REDACTED] at an earlier stage, additional bad debt provisions may have been held at the point when Charleville sought SPS solvency support from ILCU in both 2010 and 2012. It is possible that such additional solvency support could have protected Charleville from the impact on its reserves of additional loan impairments that it incurred subsequently in 2015, which have materially contributed to Charleville's current minimum reserve shortfall.

#### ***Fixed Asset Impairment***

- 4.28 In accordance with Financial Reporting Standard 11 - *Impairment of Fixed Assets and Goodwill ("FRS 11")*, Charleville was required to carry out an impairment review of the Premises on an annual basis. FRS 11 requires Charleville to compare the carrying value of the Premises with the 'recoverable value', which in FRS 11 is defined to be the higher of the ViU or market value. As can be seen from Table 3 above, at 30 September 2009 Charleville's fixed assets had a carrying value of €2.2m, of which the Premises represented €1.9m, based on a valuation derived from the ViU calculation prepared by Charleville in the period.
- 4.29 RCU, in the context of annually reviewing a credit union's year-end draft financial statements, assesses the reasonableness of the assumptions used to derive the ViU calculation and the carrying value of the Premises arising therefrom. As outlined in Section 3 of this Report, RCU raised concerns over an extensive period in relation to the assumptions underpinning Charleville's ViU, questioning whether those assumptions were reasonable and supportable. The Draft 2015 EisnerAmper Asset Review Report and the 2015 DHKN Report supported the concerns raised by RCU in relation to the reasonableness of Charleville's assumptions and recommended that Charleville impair the value of the Premises in its balance sheet to market value. Charleville impaired the carrying value of its Premises to market value in the financial statements for the year ended 30 September 2015. Charleville's subsequent recognition of this impairment had the effect of reducing the carrying value of the Premises from €1.7m as at 30 September 2014 to €0.7m as at 30 September 2015. Charleville further impaired the carrying value of the Premises to c.€0.35m in the June 2017 PR.

#### ***Impact on Reserves***

- 4.30 Charleville's lending and provisioning practices have had a significant impact on its reserves in the period 30 September 2009 to 30 June 2017. Its reserves diminished further following the recognition of impairments to the carrying value of the Premises as noted above.
- 4.31 The summary of the evolution of Charleville's financial position in Table 3 above indicates that Charleville had reserves of 0.4% as at 30 September 2009 reflecting the recognition of €6.5m in additional bad debt provisions in that period. Notably, Charleville was balance sheet insolvent as at 30 September 2010 with reserves of -9.3% following the recognition of additional bad debt provisions of €5.5m in the year ended 30 September 2010. Charleville's financial position improved marginally in the financial year ended 30 September 2011, reporting reserves of -8.7%, which included the benefit of the drawdown of [REDACTED] in SPS support from ILCU.

- 4.32 Charleville received the benefit of the drawdown of further SPS support of [REDACTED] from ILCU in the year ended 30 September 2012, on foot of which it reported reserves of 8.0%. In its original submission of draft financial statements for the year ended 30 September 2014, Charleville reported reserves of 10.7%. This was the first time since 2009 that Charleville reported reserves in excess of the 10.0% reserve requirement. However, following Charleville's recognition of an additional €2.0m in bad debt provisions related to certain secured loans and further impairments of c.€1.0m to the carrying value of the Premises, its reserves reduced to 4.6% as at 30 September 2015. In the June 2017 PR, Charleville reported reserves of 3.5%, which is not in compliance with the 10.0% reserve requirement.

#### ***Revised Financial Statements***

- 4.33 On an annual basis, credit unions submit draft year-end financial statements to RCU in advance of convening an AGM. Charleville has not been in a position to convene an AGM since 2012 and consequently the AGMs for the financial years ended 30 September 2012 to 30 September 2016 have not taken place. The effect of this means that the financial statements remain in a draft form and are therefore not final accounts.
- 4.34 From the financial year ended 30 September 2016, credit unions have been required to prepare financial statements in accordance with Financial Reporting Standard 102 ("**FRS102**"). Consequently, Charleville revised its financial statements for the years ended 30 September 2014 to 30 September 2016 inclusive. On 5 April 2017, Charleville submitted revised draft financial statements to RCU for the years ended 30 September 2014, 2015 and 2016 (the "**Revised Financial Statements**") (and hereafter, the earlier submission of financial statements in draft form for the relevant years shall be referred to as the "**Original Financial Statements**"). The Revised Financial Statements for the financial year ended 2014 also contain for comparison purposes, the revised figures for the year ended 30 September 2013.
- 4.35 The Revised Financial Statements retrospectively restate Charleville's historic financial position, with material adjustments affecting total bad debt provisions and therefore the carrying value of loan assets. The relevant adjustments had the effect of revising the timing – to an earlier financial year-end - of the recognition of impairments to loan and fixed assets, thereby revising Charleville's historic year-end reserves.
- 4.36 Table 4 below sets out the principal movements in Charleville's balance sheet by comparing the Original Financial Statements to the Revised Financial Statements.

**Table 4: Summary comparison of Original Financial Statements to Revised Financial Statements**

€'000s					Original draft accounts				Prudential Return
	Final	Final	Final	Draft	Draft	Draft	Draft		
	Accounts	Accounts	Accounts	Accounts	Accounts	Accounts	Accounts	Accounts	
Period end:	Sept 2009	Sept 2010	Sept 2011	Sept 2012	Sept 2013	Sept 2014	Sept 2015	Sept 2016	Jun 2017
Total assets	62,653	47,564	41,724	44,624	44,008	44,096	42,453	42,649	41,882
Fixed assets	2,222	2,133	2,032	1,928	1,868	1,780	709	668	347
Gross loans	42,726	37,508	28,559	16,457	14,379	13,726	12,392	11,536	10,755
Bad debt provisions	(9,229)	(14,695)	(13,244)	(5,174)	(4,851)	(4,520)	(5,724)	(5,601)	(4,744)
Total reserves (excl. unrealised)	263	(4,443)	(3,618)	3,564	4,135	4,700	1,939	1,657	1,455
<b>Reserve Position</b>	<b>0.4%</b>	<b>(9.3%)</b>	<b>(8.7%)</b>	<b>8.0%</b>	<b>9.4%</b>	<b>10.7%</b>	<b>4.6%</b>	<b>3.9%</b>	<b>3.5%</b>
€'000s					Revised draft accounts				Prudential Return
	Final	Final	Final	Draft	Draft	Draft	Draft		
	Accounts	Accounts	Accounts	Accounts	Accounts	Accounts	Accounts	Accounts	
Period end:	Sept 2009	Sept 2010	Sept 2011	Sept 2012	Sept 2013	Sept 2014	Sept 2015	Sept 2016	Jun 2017
Total assets	62,653	47,564	41,724	44,624	41,219	40,836	42,230	42,415	41,882
Fixed assets	2,222	2,133	2,032	1,928	515	477	439	391	347
Gross loans	42,726	37,508	28,559	16,457	14,379	13,726	12,392	11,536	10,755
Bad debt provisions	(9,229)	(14,695)	(13,244)	(5,174)	(6,287)	(6,476)	(5,676)	(5,546)	(4,744)
Total reserves (excl. unrealised)	263	(4,443)	(3,618)	3,564	1,345	1,440	1,717	1,421	1,455
<b>Reserve Position</b>	<b>0.4%</b>	<b>(9.3%)</b>	<b>(8.7%)</b>	<b>8.0%</b>	<b>3.3%</b>	<b>3.5%</b>	<b>4.1%</b>	<b>3.3%</b>	<b>3.5%</b>

Source: Charleville's original financial accounts as submitted by Charleville to RCU for relevant years; Charleville's Revised Financial Statements as submitted by Charleville to RCU in April 2017 following the adoption of FRS102; and the prudential return submitted by Charleville to RCU for period ended 30 June 2017.

- 4.37 It is worth noting the impact of the Revised Financial Statements on Charleville's reported reserves:
- (a) in the Revised Financial Statements for the year ended 30 September 2013, Charleville's reserves are reported as 3.3% which is a more accurate reflection of its true financial position at that time, rather than reserves of 9.4% as reported by Charleville in the Original Financial Statements; and
  - (b) in the Revised Financial Statements for the year ended 30 September 2014, Charleville's reserves are reported as 3.5%, which is a more accurate reflection of its true financial position at that time, rather than reserves of 10.7% as reported by Charleville in the Original Financial Statements.
- 4.38 The Revised Financial Statements identify that Charleville's reserves have only exceeded 4.0% on one occasion since it reported the second drawdown of SPS support of [REDACTED] in the financial statements for the year ended 30 September 2012. Consequently, the Revised Financial Statements submitted by Charleville to RCU in April 2017, indicate that, since the introduction of the reserve requirement at 30 September 2009, Charleville has failed to raise and maintain its reserves at the required level.
- 4.39 As noted earlier in this Report, expert reviews have questioned Charleville's viability on a standalone basis. Further details on the views of third parties regarding Charleville's viability in this regard are set out in Section 5 of this Report.
- 4.40 In conclusion, RES has determined that Charleville's failure was primarily caused by:

- (a) poor lending practices during the period prior to 2009 which resulted in a significant level of property-related lending to a [REDACTED]
- (b) a significant number of those loans were not performing and top up loans were then provided which increased Charleville's overall exposure to the relevant borrowers, hereby masking the true underlying performance of the non-performing loans. When these loans subsequently defaulted, Charleville was required to recognise sizeable bad debt provisions or write-off the loans;
- (c) however, Charleville's Board failed to recognise at an early stage the full extent of required bad debt provisions by relying on [REDACTED], with the result that efforts to restore Charleville's reserves using SPS funding were inadequate and therefore ineffective;
- (d) by the time, in late 2015, that Charleville recognised the actual extent of bad debt provisioning that was required on its loan portfolio and the required impairment to the Premises, it had become clear that Charleville's financial position had deteriorated, reporting reserves of 5.0% at 31 December 2015, following which, in March 2016, Charleville's Board decided to pursue a ToE to address the credit union's financial difficulties (on the basis that Charleville could no longer operate on a standalone basis without third party support); and
- (e) finally, Charleville's inability to address the deterioration in its reserve position, which arose directly as a result of its failure to adequately provide for its non-performing loans and to impair the value of the Premises, has meant that RCU has been unable to lift or ease the Conduct of Business Directions which have been in place since October 2011. This has also contributed to the deterioration in the value of Charleville's loan book and, therefore, precluded its capacity to generate sufficient sustainable income on its assets (when factoring in diminished investment returns in the current low interest environment on its cash, bank and investments), to cover its recurring operating costs despite efforts to rationalise the same. With a cost income ratio (excluding the impact of one-off exceptional items), exceeding 100% in recent years, Charleville's sustainability and viability on a standalone basis is in question.

4.41 RES is of the view that Charleville is a failing institution. Charleville has breached its obligations under the June 2016 Direction and the May 2017 Direction, and has no reasonable prospect of complying with those obligations within a reasonable timeframe. RES believes that it is incumbent on the Central Bank in those circumstances to consider taking action exercising its powers under the 2011 Act with respect to Charleville.

5. **RES'S ASSESSMENT AS TO WHY LIQUIDATION IS THE APPROPRIATE APPROACH**

- 5.1 For the reasons outlined in Section 4 above, Charleville is financially distressed and there are concerns regarding its future viability.
- 5.2 In its June 2017 PR, Charleville reported reserves of 3.5%, which does not comply with the 10.0% reserve requirement applicable to all credit unions.
- 5.3 RES has also set out above in Section 4 an assessment of Charleville's deteriorating financial position, which can be summarised as follows:
- (a) Charleville's loan book has contracted significantly since 2010 arising from significant levels of loan impairments, write-offs and repayment of loans, which has negatively impacted Charleville's income generating capacity;
  - (b) a greater proportion of Charleville's surplus funds (derived from member savings) are invested in short-term investments (such as deposits in other credit institutions) rather than being extended as credit to members, and due to the current low interest rate environment with diminished investment returns available, has had the effect of lowering Charleville's investment income, which as a consequence is not compensating for its reduced capacity to generate interest income on its loan book in recent years;
  - (c) Charleville's overall income generating capacity has declined significantly and it has been loss making when exceptional items such as recoveries and write-backs are excluded; and
  - (d) notwithstanding that Charleville has implemented a number of cost saving initiatives in recent years, its operating costs remain high and they are not being covered by recurring income, with a cost income ratio – excluding the impact of one-off exceptional items – exceeding 100% in recent years.
- 5.4 The reduction in Charleville's ability to generate income, both sufficient to meet its day-to-day operating costs, as well as complying with the 10.0% reserve requirement, call into question the sustainability of Charleville's business and its ongoing viability. In reaching this conclusion, RES has taken into account, the restrictions imposed by RCU on the Credit Union's lending activities which impact the Credit Union's revenue generation. However, such restrictions were necessary for the reasons already explained, and would be likely to be a continuing feature having regard to Charleville's inability to meet its reserve requirement.
- 5.5 Charleville's loan book has contracted year-on-year since 2009 due to loan repayments, impairments and write-offs. At 30 June 2017, the value of Charleville's net loan book was c.€6.0m (gross loans minus bad debt provisions). A number of expert reviews examining, *inter alia*, Charleville's financial position and viability, identified that in order for Charleville to continue to operate on a standalone basis, a performing loan book of between €13.5m (the 2016 MSN Report) and €14.0m (the 2015 DHKN Report) would be required to generate a sufficient level of interest income for Charleville to cover its operating cost base and remain viable going forward.
- 5.6 In order to grow a performing loan book to between €13.5m to €14.0m, Charleville would be required to increase its loan book by c.130% in quantum terms. As set out in the 2015

DKHN Report, in order to achieve this, Charleville would need to lend €1.0m per calendar month. It is anticipated that it would take a significant period for Charleville to achieve this level of monthly lending. Charleville provided its financial projections to DHKN, which set out, on the basis that the RCU lending restrictions were removed, that this level of monthly lending would only be achieved by 2020. It is also worth noting that DHKN did not agree with Charleville's financial projections and viewed them as overly optimistic. The Draft 2015 DHKN Report identified that Charleville was not, on average, lending up to its monthly lending restriction level (of €0.25m per calendar month), and that its total annual lending levels, in fact, reduced from €2.7m (or on average €0.22m per calendar month) for the year ended 30 September 2014 to €2.5m (or €0.20m per calendar month on average) for the year ended 30 September 2015.

- 5.7 RES has set out its concerns regarding Charleville's viability on a standalone basis, concerns supported by the findings of a number of expert reviews. In that regard, ██████ raised similar concerns which caused them to withdraw from ToE discussions with Charleville, stating: "█████ did not believe that there was a business case to be made on which this TOE would be acceptable". The concerns raised by ██████, namely that Charleville is loss making, its high operating costs and the time it would take to regenerate the loan book while bearing the costs associated with the volume of member shares, is likely to render Charleville unattractive from a ToE perspective. These concerns are likely to arise irrespective of the size and relative strength of any alternative potential transferee credit union.
- 5.8 RES is also of the view that the Central Bank has provided Charleville with substantial time to rectify its reserves and to identify a suitable transferee credit union. Since the failure of negotiations with Clonmel in March 2017, the subsequent failure of negotiations with ██████ in September 2017 and the initial discussions with ██████, Charleville has failed to provide a basis upon which to suggest there is any realistic prospect of completing a ToE or meeting its reserve requirement. Charleville has failed to provide the Central Bank with any meaningful voluntary ToE proposal or any solution to address its difficulties. RES is of the view that Charleville has exhausted all voluntary avenues available to it to address its failure, as detailed in Section 4 and that, accordingly, it is now necessary for the Central Bank to intervene to resolve Charleville by means of the exercise of its powers under the 2011 Act.
- 5.9 In summary, RES, in forming the view that the Central Bank is required to intervene by means of the exercise of its powers under the 2011 Act, has considered the following:
- (a) despite receiving c ██████ in SPS support during the period between 2010 and 2014, Charleville has not had, or maintained, reserves of 10.0% since 2009 based on the most recent financial information provided by Charleville to RCU;
  - (b) Charleville's Board indicated in a letter to RCU dated 24 March 2016, that it had decided that a voluntary ToE was "*in the best interests of the Credit Union*", which suggests that Charleville's Board recognises that there was no reasonable prospect of Charleville continuing to operate on a standalone basis into the future;
  - (c) in a letter to RCU dated 13 June 2017, Charleville advised RCU that the ILCU had provided additional SPS support to the Credit Union conditional on a ToE process completing. However, ILCU has not indicated a willingness to

provide sufficient funding on an unconditional basis that would enable Charleville to satisfy its obligations under the May 2017 Direction;

- (d) Charleville has on three occasions sought to negotiate and implement a ToE process; with ██████ (in 2016), Clonmel (in 2017) and ██████ (in 2017) – none of these ToE processes were successful and in the case of Clonmel the failure to proceed was at least in part due to risks identified in the GT Due Diligence Report prepared in respect of Charleville, and concerns with regard to ██████, and consequently the appropriateness of the value ascribed to the Premises in Charleville’s financial statements;
- (e) in light of the fact that Charleville has tried but failed on three occasions to complete a ToE, RES is of the view that there is now no reasonable prospect of Charleville being able to successfully implement a voluntary transfer;
- (f) although Charleville is not currently insolvent (from a cash flow or balance sheet perspective) Charleville has been unable to convene AGMs since 2012 which, combined with the public speculation concerning its financial issues at the time of the failed Clonmel ToE, the risk that the collapse of the failed ToE with ██████ becomes public, and the lack of any remaining avenues to resolve Charleville’s financial issues, highlights for RES a material risk that members may become concerned as to Charleville’s solvency, which could lead to a run on members’ savings and a disorderly cessation of Charleville’s operations;
- (g) consequently, RES has formed the view that there is no reasonable prospect of Charleville being in a position to comply with the requirements imposed by the May 2017 Direction; and
- (h) RES retains significant concerns with regard to the viability of Charleville (a view shared by three separate parties that have carried out viability analyses on the credit union and cited by ██████ as a reason for deciding to withdraw from a ToE due to concerns regarding Charleville’s viability), and the risk of future insolvency.

5.10 The options available to the Central Bank under the 2011 Act are as follows:

- (a) under Part 4 of the 2011 Act, the Central Bank has the power to establish a bridge bank into which Charleville’s business, assets and liabilities could be transferred on a temporary basis with a view to a transfer to a third party transferee as soon as is practicable; or
- (b) under Part 5 of the 2011 Act, the Central Bank has the power to make a proposed transfer order and apply to the High Court for an order transferring all of the assets and liabilities of Charleville to a third party institution that is willing to accept such a transfer; or
- (c) under Part 6 of the 2011 Act, the Central Bank can seek to appoint a Special Manager to Charleville in order to take over the functions of its Board and the management of Charleville’s business; or



- (d) under Part 7 of the 2011 Act, the Central Bank can seek to present a petition for the winding-up of Charleville.

### **Bridge Bank**

- 5.11 A bridge bank allows for certain assets and liabilities of a failing, or failed entity, to be transferred into a new entity which will hold the assets and liabilities on a temporary basis, with a view to their transfer to another person as soon as practicable. In the case of Charleville, there is no requirement for any of the assets or liabilities of Charleville to be transferred to a separate entity prior to seeking an onward sale. RES also believes that the creation of a bridge bank to accept a transfer of Charleville's business, liabilities and assets would also be unlikely to facilitate a successful resolution of Charleville.

### **Directed Transfer**

- 5.12 As is mentioned at paragraph 5.9, Charleville has sought on three previous occasions to implement a ToE with a suitable transferee credit union. However, on each occasion the proposed ToE failed to proceed to completion. The most recently attempted ToEs failed when Clonmel withdrew from negotiations in March 2017 and ██████████ withdrew from negotiations in September 2017.
- 5.13 RES is of the view that the decision on the part of Clonmel to withdraw from ToE discussions with Charleville may have been influenced by opposition from certain members of Clonmel to the ToE discussions with Charleville. A qualifying group of members from Clonmel requested, pursuant to section 79 of the CUA, that a SGM be convened to discuss the proposed ToE with Charleville. This request, and the decision not to proceed with the ToE process, generated negative publicity for Charleville with regard to its financial difficulties; ultimately calling into question its attractiveness as a potential ToE partner.
- 5.14 It is acknowledged that, since the failure of the proposed ToE with Clonmel, ILCU has, during the course of June 2017, made an additional deposit of ██████████ in a NTMA account in the name of Charleville that can be used to support a ToE with another ILCU-affiliated credit union. This additional deposit by ILCU was expressly for the purpose of addressing the requirement in the May 2017 Direction for Charleville to raise its reserves to 10.0% of total assets, which is the reserve requirement applicable to all credit unions. Furthermore, ILCU's deposit sought to address the second requirement in the May 2017 Direction, namely the requirement for Charleville to raise and maintain an operational risk reserve of 3.0% of total assets to address key risk areas such as: (i) its reserves; (ii) credit risk; (iii) viability; and (iv) issues with ██████████, which were discovered during due diligence reviews. It is therefore conceivable that a potential transferee may regard Charleville as a more attractive potential partner for a ToE in light of this additional potential SPS funding from ILCU.
- 5.15 RES acknowledges that, since the failure of the proposed ToE with Clonmel, Charleville has attempted to complete a ToE process with ██████████. However, due to viability concerns regarding Charleville's business and the impact on the combined entity and the fact that: "█████████ would require the ILCU to agree to underwrite the P&L of the combined entity for a minimum of 4 years to allow the business to stabilise and grow. Based on projected losses this could cost in the region of €1m plus," ██████████ withdrew from the ToE process. In addition, it is reasonable to conclude that the concerns as identified by ██████████ in reviewing Charleville's financial projections would be reiterated by any potential

transferee credit unions and calling into question the likelihood of Charleville concluding a ToE process in the near term.

5.16 Accordingly, RES has formed the view that, notwithstanding the additional funding recently made available by ILCU, Charleville is unlikely to be able to identify a suitable transferee, or to successfully implement a ToE if a potentially suitable transferee is identified, for the following reasons:

- (a) the size of Charleville's business means that there are a relatively limited number of potential transferees that would have the scale, size and financial and operational capability to accommodate a ToE with Charleville, and in particular to successfully integrate the two businesses, their respective workforces, IT and other systems;
- (b) any due diligence exercise conducted by any potential new transferee is likely to identify similar issues and risks as previously identified in the GT Due Diligence Report;
- (c) the level of negative publicity generated with respect to Charleville at the time of, and since, the failure of ToE negotiations with Clonmel represents an obstacle to any future proposed ToE as a consequence of the damage this may have inflicted on Charleville's reputation as a potential ToE partner;
- (d) concerns regarding Charleville's viability and the negative impact that this could have on the balance sheet and profitability of a merged entity; and
- (e) it is entirely possible that any potential transferee which could be identified would require additional support from ILCU, and may insist that additional support is required to avoid the potential dilutive effect of the ToE on its post-ToE capital position, and underwrite the profitability of the combined credit union for a period post-transfer. Such support may or may not be forthcoming from ILCU.

5.17 Finally, RES is of the view that each of the difficulties that have arisen for Charleville with respect to the identification of potential suitable transferees and the implementation of a ToE would also very likely arise in the context of any proposed directed transfer under Part 5 of the 2011 Act. Accordingly, RES has formed the view that neither a ToE, nor a directed transfer of Charleville's business, liabilities and assets to another credit union under Part 5 of the 2011 Act, is currently a feasible resolution option for Charleville.

### ***Special Management***

5.18 RES has also considered the prospect of the appointment of a Special Manager to Charleville under Part 6 of the 2011 Act. However, RES is of the view that the issues faced by Charleville are predominantly financial in nature, in particular relating to its reserve shortfall, rather than governance issues that a Special Manager would usually be engaged to address. Therefore, it is reasonable to conclude that a Special Manager would not be able to address and rectify Charleville's financial position, and on that basis, this resolution approach is not viewed as viable.

### *Winding-up*

5.19 Under the 2011 Act, the Central Bank may present a petition for the winding-up of a credit institution (including a credit union) under any of the five grounds specified in section 77 of the 2011 Act, being:

- (a) that in the opinion of the Central Bank, the winding-up of that credit institution would be in the public interest;
- (b) that that credit institution is, or in the opinion of the Central Bank may be, unable to meet its obligations to its creditors;
- (c) that that credit institution has failed to comply with a direction of the Central Bank;
  - (i) in the case of the holder of a licence under section 9 of the Central Bank Act 1971, under section 21 of that Act, or
  - (ii) in the case of a building society, under section 40 (2) of the Building Societies Act 1989, or
  - (iii) in the case of a credit union, under section 87 of the Credit Union Act 1997;
- (d) that the credit institution's licence or authorisation (as applicable) has been revoked and (in the case of the holder of a licence under section 9 of the Central Bank Act 1971) that it has ceased to carry on banking business;
- (e) that the Central Bank considers that it is in the interest of persons having deposits (including deposits on current accounts) with that credit institution that it be wound up.

5.20 Having considered:

- (a) Charleville's financially distressed position and its continuing breach of regulatory directions, including most recently the May 2017 Direction;
- (b) the fact that Charleville has as at the date of this Report failed to provide the Central Bank with a meaningful plan to address its reserve shortfall;
- (c) that Charleville's future viability remains in question; and
- (d) the alternative resolution options available to the Central Bank under the 2011 Act,

RES is of the view that the presentation of a petition for the winding-up of Charleville is the appropriate course of action for the Central Bank to take in the circumstances.

## 6. GROUNDS FOR LIQUIDATION

6.1 In the opinion of RES, three of the grounds for liquidation, as set out in paragraph 5.19 above, are relevant to the Central Bank's consideration as to whether it has met the grounds to petition for the winding up of Charleville, namely that:

- (a) Charleville has failed to comply with a direction of the Central Bank issued under section 87 of the CUA;
- (b) it is in the interests of persons having deposits with Charleville that it is wound up; and
- (c) a winding up of Charleville would be in the public interest.

6.2 RES is of the view that the Central Bank is entitled to present a petition for the winding-up of Charleville on each of the grounds outlined above, and that the existence of any one of these grounds would justify such course of action.

6.3 RES's analysis as to each of these grounds is set out in detail below.

### ***Breach of Directions***

6.4 As set out above, one of the grounds for liquidation is that the credit institution failed to comply with a direction of the Central Bank made pursuant to section 87 of the CUA. RES has set out below the reasons why it is of the view that Charleville has failed to comply with a direction of the Central Bank made pursuant to section 87 of the CUA.

### ***The June 2016 Direction***

6.5 On foot of regulatory concerns, and following a letter issued to Charleville on 22 December 2015 indicating an intention to issue a regulatory direction, the Registrar issued the June 2016 Direction pursuant to section 87 of the CUA. The June 2016 Direction directed Charleville as follows in relation to its reserves:

- (a) *"The Credit Union must raise and maintain its regulatory reserve requirement (as set out in the Regulations) to at least 10% of the assets as at 31 March 2016 and in order to do so must raise an amount of €2,409,000 in solvency support. This solvency support must be in place no later than 4pm on 5 July 2016 and this support must be provided in cash form only and lodged to a bank account in the name of the Credit Union.*
- (b) *The Credit Union is required to provide to the Central Bank a statement in writing setting out the steps it will take to ensure continued compliance with its obligation to maintain a regulatory reserve requirement of at least 10% of the assets. This statement must be provided to the Central Bank on or before 5 July 2016."*

6.6 Charleville in an email to RCU on 5 July 2016 confirmed that it had raised the required [REDACTED] in solvency support and restored its 10.0% reserve requirement. However, this support was provided by ILCU in the form of a deposit with the NTMA, which was not available to Charleville on an unrestricted basis and could only be released to Charleville on the completion of a ToE with another ILCU-affiliated credit union. Accordingly, such funding could not be taken into account when calculating Charleville's reserves.

- 6.7 On 21 July 2016, Charleville submitted a PR for the period ended 30 June 2016, which reported that it then held reserves of 4.9%. Every PR submitted by Charleville since then has also recorded reserves of less than the 10.0% reserve requirement specified by the June 2016 Direction. The Revised Financial Statements submitted by Charleville to RCU for the financial year ended 30 September 2016 also reported reserves of 3.3% of total assets. The June 2017 PR reported reserves of 3.5% of total assets.
- 6.8 Accordingly, on the basis of the above, RES is satisfied that Charleville has failed to comply with the June 2016 Direction.

#### ***The May 2017 Direction***

- 6.9 On foot of regulatory concerns, and following a letter issued to Charleville on 7 April 2017 indicating an intention to issue a regulatory direction, the Registrar issued the May 2017 Direction pursuant to section 87 of the CUA directing Charleville as follows:
- (a) *“The Credit Union must raise its regulatory reserve requirement (as set out in the Regulations) to a minimum of 10% of the total assets as at 31 March 2017 and in order to do so must raise an amount of €3.14m in solvency support. This support must be provided in cash form only and lodged to a bank account in the name of the Credit Union”.*
  - (b) *The Credit Union must raise and maintain a minimum additional reserve of 3% of the total assets of the Credit Union and in order to do so must raise an amount of €1.27m in solvency support and thereafter demonstrate a capacity to maintain the additional reserve at that level. All reserves that are held as additional reserves must have the characteristics, set out in regulation 3 of the Regulations”.*
- 6.10 Charleville was required to comply with the May 2017 Direction by 18 May 2017. Following Charleville’s request, RCU extended this deadline to 16 June 2017. In a letter dated 13 June 2017, Charleville advised that it had received additional SPS support from ILCU, lodged into an account in the NTMA in the name of the credit union. In a further letter dated 15 June 2017, Charleville advised that this support was conditional on the credit union completing a ToE process with a suitable ILCU-affiliated credit union. Again, as this funding, was not, and is not, available to Charleville on an unrestricted basis and can only be released to Charleville on the completion of a ToE with another ILCU-affiliated credit union, RES is satisfied that such funding cannot be taken into account when calculating Charleville’s current reserves.
- 6.11 On 21 July 2017, Charleville submitted the June 2017 PR, wherein it reported that it has reserves of 3.5% of total assets.
- 6.12 On the basis of the foregoing, RES is satisfied that Charleville has failed to comply with the May 2017 Direction or to provide a plan setting out how it will comply with the terms of the May 2017 Direction.
- 6.13 Having regard to the foregoing, RES is of the view that, as Charleville has failed to comply with both the June 2016 Direction and the May 2017 Direction, the Central Bank has grounds pursuant to section 77(c)(iii) of the 2011 Act to present a petition for the winding-up of Charleville.

### ***Interest of Persons Having Deposits***

- 6.14 As set out above, one of the grounds for the presentation of a petition for the winding up of a credit institution under section 77 of the 2011 Act is that the Central Bank considers it to be in the interests of persons having deposits in that credit institution that it be wound up. RES has set out below why it is of the view that, on balance, a winding up of Charleville would be in the interests of persons having deposits in Charleville.

### ***Members are not aware of the full extent of the current circumstances of Charleville***

- 6.15 In February 2017, there was widespread media coverage in relation to the proposed ToE between Charleville and Clonmel. There was further press coverage following the announcement of the cessation of the ToE discussions between Clonmel and Charleville in March 2017, including articles published in both the Irish Independent and the Irish Examiner on 29 March 2017.
- 6.16 Notwithstanding this press coverage, the members of Charleville are not aware of Charleville's current or recent financial position, and have no knowledge of the impact of loan and premises impairments, which have further eroded its reserves. Furthermore, members are not aware of Charleville's constrained income generating capacity, which calls into question its ongoing viability.
- 6.17 Given its severely weakened financial position, and to prevent the potential destabilising consequences that might arise were its financial position made public, Charleville has been unable to hold an AGM since 22 August 2012 (held in respect of the financial years ended 30 September 2010 and 30 September 2011).
- 6.18 The Draft 2015 EisnerAmper Asset Review Report stated that Charleville's members have not received a dividend since the financial year ended 30 September 2007, dividends being, in the case of credit unions, the equivalent of interest payments received by depositors in banks and other credit institutions. As a result, Charleville's members are indirectly out of pocket, and indeed, they could benefit from a higher rate of return by putting their money into another credit institution paying dividends or deposit interest, especially where there is no realistic possibility of Charleville providing a dividend to its members in the near future.
- 6.19 Charleville entered into exploratory talks with Clonmel in late 2016 to determine if there was a business case for a strategic alignment, which would benefit members of both credit unions, and lead to a stronger combined entity. However, due to a number of unresolved issues, including Premises impairments, ██████████ in relation to ██████████ and transferee member resistance, this ToE process did not complete. On 22 March 2017, Clonmel indicated to RCU that it did not intend to proceed with a voluntary ToE with Charleville. On 28 March 2017, Charleville and Clonmel issued a joint press release in respect of their decision not to proceed with the proposed ToE: *"Clonmel CU and Charleville CU entered into exploratory talks in late 2016. These discussions were subject to a confidentiality agreement. Both Boards were confident that a combined entity would have been in the best interest of all our members. At this stage a comprehensive Due Diligence review has now been completed. However, the two CUs did not reach agreement on the finer details of a post merged entity and have now made the decision not to proceed with the proposed Transfer of Engagement."*

- 6.20 Charleville entered exploratory talks with ██████ in July 2017 to determine if a ToE was possible. However, due to concerns regarding Charleville's financial projections and profitability in the near term and the detrimental impact this would have on the combined entity, ██████ decided to withdraw from the process in September 2017. This is currently not in the public domain. However, if it became known that Charleville failed to complete a third transfer so soon after the failure of ToE discussions with Clonmel, it could give rise to concerns amongst Charleville's membership. Furthermore, additional negative publicity may make Charleville less attractive to potential transferee credit unions.
- 6.21 There is no reasonable prospect that Charleville will either be able to pay a dividend or hold an AGM in the foreseeable future because in order to hold an AGM, it will be necessary for Charleville to disclose the full extent of its distressed financial position and weak cost/income profile and outlook to its members. Members are likely to be concerned that the ██████ ToE failed due to issues regarding Charleville's unsustainable cost base, impaired income generating capacity and viability, which could lead to the withdrawal of member confidence resulting in the rapid destabilisation of Charleville and potentially lead to a run on savings and deposits.

***A pay-out will result in depositors obtaining alternative retail financial services***

- 6.22 It is not possible to identify the number of Charleville's members with alternative banking relationships with other credit institutions. However, it is likely that a portion of the members of Charleville do not have access to other bank accounts. As such, the liquidation of Charleville is likely to lead to some of Charleville's members not having access to alternative retail financial services in the short term. However, it is important to note that Charleville's members may be able to avail of alternative retail financial services locally; retail-banking services are available in the town of Charleville, with both an AIB and Bank of Ireland branch present. In addition, there is a Post Office in Charleville, where members can avail of retail banking services. A pay-out will result in members availing of the services of a fully functioning financial institution/entity.

***A pay-out will result in depositors availing of the services of a fully functioning financial institution/entity***

- 6.23 It is not in the interest of the members of Charleville to have their savings/deposits lodged with an entity that is not fully functioning and that cannot offer members full access to the range of services usually offered by credit unions.
- 6.24 It is in the interest of Charleville's members to have access to a fully functioning financial institution/entity, which is managed on a prudent basis. As such, a pay-out would result in members of Charleville depositing their savings with such an institution, offering full credit union/financial services to members.

***Access of Charleville's members to their deposits***

- 6.25 On the appointment of a provisional liquidator, all eligible deposits (in the form of members' savings and deposits) would be covered under the DGS up to €100,000 per depositor<sup>8</sup>. Any members' savings or deposits not covered by the DGS would only be repaid

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<sup>8</sup> The DGS Regulations address who is to be identified as the person to be compensated in respect of certain types of deposit (e.g. those to which more than one person is entitled and those where the named depositor is not absolutely entitled to the deposit).

by a liquidator to the extent that liquidation resources are sufficient to repay such savings or deposits, ranking on a *pari passu* basis alongside general creditors in the liquidation. It is important to note that as the DGS will be a preferential creditor under the 2014 Act, it is unlikely that any depositor that does not receive a full payment from the DGS would be entitled to any proceeds from the liquidation, unless there is full repayment of creditors.

- 6.26 Following the appointment of a provisional liquidator, it is intended that a compensation payment would be made to a member in respect of that member's duly verified eligible deposits by means of a crossed cheque (i.e. a cheque that, in general, could only be lodged to an account, not cashed) posted to that member's address within 20 working days. The DGS aims to issue compensation to duly verified eligible depositors, as early as possible, within the statutory deadline.
- 6.27 If any of Charleville's members are deemed ineligible under the DGS, they will rank as general creditors of Charleville in liquidation. Whether or not there are members that are ineligible will be determined following an invocation of the DGS in accordance with the European Union Deposit Guarantee Scheme Regulations 2015 (S.I. No. 516 of 2015) (the "DGS Regulations").
- 6.28 However, having considered the aforementioned factors and taking into account certain concerns identified in the aforementioned paragraphs, RES is of the opinion that it is in the interests of depositors that Charleville is liquidated and, in particular, for the following reasons:
- (a) The DGS pay-out will result in members depositing their savings with other institutions that are not financially distressed, unlike Charleville;
  - (b) The DGS pay-out will result in members accessing, through alternative financial institutions, the full range of financial services that can reasonably be expected by members of a credit union, which is not the case for Charleville's members at present; and
  - (c) The DGS pay-out will result in members having to deposit their savings with other institutions that may result in Charleville's members receiving a return on their savings either by means of a dividend or interest payment, in entities that have annual financial statements approved by their members or shareholders.

#### ***A winding up of Charleville is in the public interest***

- 6.29 As set out above, one of the grounds for liquidation is that in the opinion of the Central Bank, the winding-up of the credit institution would be in the public interest. RES is of the view that, on balance, a liquidation of Charleville is in the public interest for the reasons set out below.

#### ***The indirect consequences of liquidation***

- 6.30 It is not possible for Charleville to be wound up on the same day that the Central Bank files a petition for the winding up of Charleville because the Central Bank is required, *inter alia*, to place advertisements with respect to the proposed winding up in two newspapers at least seven days prior to the date of the hearing of the petition.



- 6.31 Accordingly, in order to ensure that the liquidation of Charleville is commenced in an orderly manner, RES recommends that the Central Bank should make an application to the Court to appoint a provisional liquidator to Charleville, who will have full control over the assets and operations of Charleville pending the hearing of the winding up petition. It is necessary for a provisional liquidator to be in place during the period between the date of the filing and the hearing of the petition, to avoid a disorderly cessation of the business of Charleville and to enable payments to eligible deposit holders to occur as quickly as possible. The orderly nature of the DGS pay-out process will help to ensure that any potential negative consequences in terms of knock on impacts are limited to the greatest extent possible (although there remains a risk that such consequences could still occur).
- 6.32 Should Charleville be liquidated at a time when it is not actually insolvent, this could be advantageous to members and creditors on the basis that the liquidator may be able to realise the current balance sheet value of Charleville's assets to fully cover all balance sheet liabilities and cover the costs of liquidation. Were this to occur, no member or creditor would be financially disadvantaged by the liquidation, save for the costs of liquidation.

***The orderly liquidation of a credit institution reflects a properly functioning market post crisis***

- 6.33 The liquidation of a failed, or failing entity, is part of the normal functioning of a market economy. However, it is not always possible to liquidate a failed entity without creating serious consequences for the broader economy. It is necessary to judge each situation carefully on an individual basis. During the recent financial crisis, significant amounts of taxpayers' money were used to support banks, which might otherwise have had to be liquidated, due to a fear of systemic consequences for the wider economy should they be allowed to fail. The liquidation of the global investment bank Lehman Brothers in the United States in 2008 showed that significant externalities for the wider financial system and economy could arise from the disorderly failure of a credit institution.
- 6.34 Since the onset of the financial crisis, governments around the world (including in Ireland) adopted a range of policy measures designed to limit the systemic impact of the failure of financial institutions, and to protect their customers in circumstances where they do fail.
- 6.35 Charleville is a failing credit institution, which despite extensive RCU supervisory engagement, has failed to comply with the reserve requirement for a number of years. It is the view of RES, as outlined above, that these financial issues arose due to poor lending practices, including issues surrounding the [REDACTED] for certain loans provided.
- 6.36 Charleville has previously entered into two SPS guarantees with ILCU, receiving a total of c. [REDACTED] in external financial support. Despite this significant amount of financial support, Charleville's capital position has continued to deteriorate. At this point, Charleville is not in compliance with its reserve requirement of 10.0% of total assets, a position which has prevailed for many years with members of Charleville having no knowledge of same.
- 6.37 Charleville has entered into voluntary ToE processes on three occasions. In August 2016, efforts to carry out a voluntary ToE with [REDACTED] failed to complete. In late 2016, Charleville entered into exploratory talks with Clonmel with a view to the completion of a voluntary ToE process (with external financial support made available, conditional on completion of this process). However, this voluntary ToE process also failed to complete. In July 2017, Charleville entered into ToE talks with [REDACTED] with a view to the completion of a

voluntary ToE process (with external financial support made available, conditional on completion of this process). However, this voluntary ToE process also failed to complete.

- 6.38 In light of the above, it is the view of RES that action under the 2011 Act is now appropriate. Given the three failed voluntary ToE processes, it is unlikely that a further voluntary ToE process will successfully complete. The provision of substantial external financial support has not succeeded in raising and maintaining Charleville's reserve requirement. Considering Charleville's financial position, it is the view of RES that it would be wholly inappropriate to forbear further in relation to Charleville, as this may lead to a further destabilisation of its financial position.
- 6.39 As you are aware, the Central Bank has already carried out three directed transfers under the 2011 Act in the credit union sector: Newbridge Credit Union Limited was transferred to Permanent TSB, Howth Sutton Credit Union Limited was transferred to Progressive Credit Union Limited and Killorglin Credit Union Limited was transferred to Tralee Credit Union Limited. More significant are the liquidations of Berehaven Credit Union Limited in July 2014 and Rush Credit Union Limited in November 2016. Although the circumstances differ in many respects, there are similarities in relation to the necessity to liquidate and in this regard, a precedent is available.
- 6.40 It is important to note that there was no contagion in the wider credit union sector arising from the exercise by the Central Bank of its powers under the 2011 Act in those cases. RES believes that an orderly liquidation involving, where required, the prompt pay-out of eligible depositors by DGS facilitated by the appointment of a provisional liquidator is likely to limit the prospect of contagion in that regard (albeit there can be no guarantee that there will not be contagion arising from a liquidation of Charleville).

***An orderly winding up of a credit union serves the interest of the credit union sector and the State***

- 6.41 There exists a general public expectation that the State would intervene rather than let any credit union fail. This is coupled with the public perception that individual credit unions are financially linked to each other. In this regard, the Minister for Finance ("**the Minister**") has, on a number of occasions over the years, expressed his support for the credit union sector, and in particular, during the course of 2013 in the context of the Transfer Order under the 2011 Act that was made by the Court in relation to Newbridge Credit Union Limited. In terms of the provision of support for the credit union sector that underpins that perception, the Minister has provided €250m to support the resolution of credit unions. Of the €250m provided to the Credit Institutions Resolution Fund ("**the Fund**"), some of that money has been expended in effecting the directed transfers of other credit unions, as noted above.
- 6.42 The DGS represents one of the tools of the State to protect depositors and prevent systemic contagion from the failure of a credit institution. In RES's opinion, the public interest is served by an orderly winding-up of an entity such as Charleville, with a prompt DGS pay-out reducing the risk of any potential damage to the wider economy and reducing the need to use taxpayers' funds.
- 6.43 The Oireachtas has provided for a number of options in the 2011 Act, including directed transfer and liquidation. In order to secure the directed transfer of a credit institution, the Central Bank must demonstrate that the intervention conditions are met (which is a relatively high threshold) and that such a transfer is necessary in the circumstances. In contrast, the grounds for applying for the winding up of a credit institution under the 2011

Act are more readily met. It is only in situations where an approach other than liquidation is “necessary in all the circumstances” that the alternative approach can be utilised.

- 6.44 Liquidation in the case of Charleville may also encourage enhanced regulatory compliance across the credit union sector, to the benefit of the sector, its members and the wider public. Charleville has since 2009 been unable to raise its reserve position to the regulatory reserve requirement of at least 10% of total assets. The importance of the regulatory reserve requirement is explained above. It is a situation that the Central Bank cannot allow to continue.

***Summary as to recommendation for liquidation***

- 6.45 As outlined above Charleville is a failing credit institution, not only in relation to its precarious reserves but also because of historic poor lending practices. Charleville’s declining loan book and diminished loan interest and investment income coupled with its high fixed cost based has exacerbated its financial difficulties. Charleville has received external financial support on a number of occasions, none of which has led to a long-term improvement in its reserves. The interests of prudent regulation require that the consequences of historic poor lending practices should not be borne by State funds.
- 6.46 RES recommends the liquidation of Charleville as the appropriate method to provide for an orderly pay out from the DGS, an orderly procedure for the realisation of Charleville’s assets, to facilitate the repayment of available funds to the DGS and other creditors of Charleville.

## 7. REQUIREMENT FOR PROVISIONAL LIQUIDATOR

- 7.1 RES has set out in detail the reasons why Charleville should be liquidated at Section 6 of this Report. RES believes that it is necessary in all the circumstances that a provisional liquidator is appointed immediately, pending the hearing of the petition for the winding-up of Charleville. The primary functions of the provisional liquidator will be to ensure that the winding-up of Charleville commences in an orderly fashion and to provide the necessary information to the Central Bank to facilitate payments to eligible depositors from the DGS fund as soon as possible and in any event, within the statutory deadline of 20 working days.
- 7.2 RES believes that an order for the appointment of a provisional liquidator should be made at the hearing of the petition for the reasons more particularly described in this Section 7 of the Report. Those reasons can be summarised as follows:
- (a) despite regulatory intervention over a prolonged period, Charleville has failed to adequately address its financial position. This is notwithstanding that Charleville has received external financial support on a number of occasions;
  - (b) due to Charleville's failure to address its financial position, Charleville has breached a number of directions issued by RCU and most recently, the May 2017 Direction;
  - (c) Charleville has failed to complete a voluntary ToE process on three separate occasions. To date, Charleville has not identified a further suitable transferee credit union that is prepared to enter into formal negotiations on ToE;
  - (d) while Charleville is not currently insolvent (from a balance sheet or cashflow perspective), there is a question over the sustainability and viability of its business on a standalone basis, and there remains a risk that its financial position could deteriorate further, resulting in an increased risk of insolvency in the short to medium term; and
  - (e) Charleville has failed to put forward any reasonable proposal that would enable it to comply immediately and in full, and on a sustainable basis with its obligation under the May 2017 Direction.
- 7.3 RES also believes that compelling and urgent grounds exist to justify the appointment of a provisional liquidator. These reasons are more particularly described in the section below.
- 7.4 There is a real risk of a run on deposits at Charleville once it becomes public knowledge (by way of the obligatory advertisement of the petition) that a petition for the winding-up of Charleville has been presented. If a run on deposits were to commence, RES is of the view that it would be very difficult, if not impossible, to bring a halt to such run, which could ultimately, result in an unmanaged failure of Charleville. RES believes that the appointment of a provisional liquidator would materially reduce the risks outlined above because:
- (a) a provisional liquidator would be able to safeguard and secure the assets and Charleville's books and records pending the hearing of the winding-up petition;

- (b) the appointment of a provisional liquidator will trigger the Central Bank's obligation to make DGS payments to all eligible depositors within 20 working days – a provisional liquidator plays a fundamental role in providing the Central Bank with the necessary information to enable it to make a prompt payment of eligible deposits under the DGS;
  - (c) an unmanaged failure of Charleville could cause unnecessary hardship to members who rely on those funds to meet their day-to-day living expenses. The appointment of a provisional liquidator would ensure the safeguarding of those deposits and would facilitate timely repayment of all eligible deposits under the DGS; and
  - (d) if a provisional liquidator is not appointed, and DGS payments cannot therefore be made promptly, there is a material risk of: (a) an unmanaged failure of Charleville; and (b) that public confidence in the DGS would be undermined, which is essential to the stability of the financial sector generally.
- 7.5 Deposits not exceeding €100,000 are fully within the scope of the DGS. RES understands that no member of Charleville has aggregate eligible savings that exceed €100,000. Accordingly, RES expects that all of the savings of each member of Charleville should be repaid in full under the DGS within 20 working days of the appointment of the provisional liquidator.
- 7.6 RES acknowledges that the appointment of a provisional liquidator will have a potentially terminal effect on Charleville's business and may result in the permanent cessation of its trade, regardless of the outcome of the full hearing of the petition. Nonetheless, RES is of the view that the appointment of a provisional liquidator is essential to protect members and ensure an orderly winding up of Charleville for the reasons set out in more detail at paragraph 7.2 and paragraph 7.12.

***Possibility of a run or forced closure if a provisional liquidator is not appointed***

- 7.7 RES believes that it is very likely that the presentation and filing of any petition for the winding-up of Charleville will become public knowledge very shortly thereafter. Although the Central Bank is not required to serve the petition on Charleville, or arrange for the advertisement of the petition (in at least two daily newspapers and *Iris Oifigiúil*) prior to the date falling seven clear days before the return date (in accordance with the Rules of the Superior Courts), the Central Bank's practice with respect to the winding-up of credit unions is to serve the petition on the credit union as soon as possible after it has been filed with the Central Office of the High Court. The reason for this practice is that RES believes that it is not in the public interest for the Central Bank to withhold the fact that a winding-up petition has been filed with respect to a credit union from its directors and members unless there are clear and compelling reasons to do so, not least because there is always some risk that the filing of the petition may be leaked.
- 7.8 Even if the Central Bank were to decide not to disclose to Charleville in advance that it had decided to present a winding-up petition, and to wait until the date immediately prior to the seven-day notice period before serving and advertising the petition, clearly the imminent winding up of Charleville would be in the public domain for at least those seven days prior to the return date.

- 7.9 RES is of the view that once the fact of the presentation of the winding-up petition becomes public there would be a very material risk, if not a strong likelihood, that this information, and the imminent prospect of an interruption in members' access to savings, would precipitate a "run" on Charleville, and the widespread attempted withdrawal of savings and deposits by members of Charleville. This would likely result in further material damage to the financial position of Charleville.
- 7.10 Furthermore, RES is of the view that should such a run occur, it would be very difficult, if not impossible, to bring a halt to such a scenario without causing the unplanned closure of Charleville in a disorderly manner. RES believes that there is a very material risk that the combination of a run on deposits at Charleville, following by the unplanned forced closure of its operations to bring an end to such a scenario, could have contagion effect elsewhere in the credit union sector and therefore create serious risk of stability for the financial services sector.
- 7.11 The risk of a run in respect of Charleville is heightened by the fact that Charleville's members are not aware of the true financial position of the credit union. Charleville's last AGM took place on 22 August 2012, and Charleville's last set of published financial statements were for the financial year ended 30 September 2011. The news that a petition had been filed by the Central Bank for the winding-up of Charleville may cause many members to seek to withdraw their savings from Charleville.
- 7.12 RES is of the view that the appointment of a provisional liquidator to Charleville on the date that the petition is presented and filed would substantially avert the risks outlined above, including the risk of a damaging run or uncontrolled and disorderly closure of Charleville, for the following reasons:
- (a) a provisional liquidator, being an independent Court-appointed practitioner with proven experience in dealing with corporate entities in financial difficulty, would be able to manage the cessation of Charleville's business in an orderly, planned and controlled manner, thereby mitigating the risk of a disorderly closing of the business and reducing any confusion that may ensue;
  - (b) a provisional liquidator would also be able to manage and effectively communicate the effect of the action taken by the Central Bank to all stakeholders at Charleville, including its Board, employees and members;
  - (c) a provisional liquidator would also have the ability to safeguard, secure and preserve Charleville's assets, books and records pending the hearing of the petition, and would be able to make appropriate applications to Court where necessary to achieve this objective; and
  - (d) most importantly, the appointment of a provisional liquidator will result in the invocation of the DGS and enable the provisional liquidator to immediately begin work on the provision of information to the Central Bank to enable eligible deposits to be repaid from DGS funds within the prescribed period of not more than 20 working days.

***Role of provisional liquidator in facilitating timely DGS pay-out***

- 7.13 The appointment of a provisional liquidator to a credit institution commences the period within which DGS compensation payments are required to be made in respect of eligible deposits held within that credit institution.
- 7.14 The appointment of a provisional liquidator to Charleville will trigger the Central Bank's obligation to make payments under the DGS to members of Charleville as quickly and efficiently as possible, thereby ensuring the Central Bank fulfils its obligations under the DGS Regulations.
- 7.15 As outlined above, RES is of the view that if a provisional liquidator were not appointed to Charleville, it is highly probable, due to the uncertainty created for members, that pending the hearing of the petition that the Registrar would be required to direct Charleville to cease business in order to avoid an unmanaged failure. This would also constitute an event which would trigger the obligation to make compensation payments under the DGS. On this basis, the DGS would be required, subject to limited exceptions, to make a compensation payment to duly verified eligible depositors within 20 working days. However, in order to make such payments the DGS would require a list of all of the eligible savers and depositors in Charleville and the amounts that they are due under the DGS.
- 7.16 In the opinion of RES, there is a material risk that Charleville would not be able to carry out the work necessary to facilitate this process in the extremely short time-frame required. The primary reason for this is that in order for DGS payments to be made the Central Bank must have access to specific files relating to the deposits of the credit institution.
- 7.17 In contrast, if an experienced insolvency practitioner is appointed as provisional liquidator, he or she would be in a position to immediately obtain control over the operations and business, as well as the books and records, of Charleville. A provisional liquidator would also be in a position to effectively communicate with and reassure key employees and contractors that they will be paid for the work that they will be required to do to facilitate a DGS pay-out.

***Consequences for the credit union sector generally of an unmanaged failure in Charleville***

- 7.18 In addition to the potentially damaging consequences of an unmanaged failure of Charleville, such an event could also have negative consequences for the credit union sector as a whole. Members of other credit unions might become concerned about the prospect of a run, unplanned closure and delayed DGS pay-outs in their own credit unions, especially where negative information about a credit union (including financial information) is in the public domain.
- 7.19 Any uncertainty or delays over the timing of DGS pay-outs to eligible depositors would also risk undermining public confidence in the DGS, which is essential to the stability of credit unions and deposit-taking institutions generally.
- 7.20 This risk would be substantially mitigated by the appointment of a provisional liquidator to manage and control the closure and ensure that the DGS was facilitated with the assistance it requires to ensure a successful and efficient pay-out.

***Requirement for the provisional liquidator to have the power to facilitate DGS payments***

- 7.21 As outlined above, if the Central Bank decides to make an application to the Court for the appointment of a provisional liquidator to Charleville, and the Court is satisfied to make

such an order, this will commence the period within which eligible deposits must be repaid to members under the DGS Regulations.

- 7.22 RES is of the view that, given the tight timeframe within which such payments must be made under those regulations, it is of critical importance that the Court also grants the provisional liquidator the power to take all necessary steps to ensure that those payments are made. RES notes that the 2011 Act specifies and requires that the first objective of a liquidator is to facilitate the Central Bank in ensuring the efficient and effective operation of the DGS. This can be contrasted with the general position with respect to the liquidation of companies, where the achievement of the best result for creditors as a whole is considered to be the primary objective of the winding up. However, under the 2011 Act, the interests of the creditors is subordinate to the primary objective of ensuring the efficient and effective operation of the DGS. RES notes that the interests of creditors are a key consideration for the Court in a compulsory liquidation.
- 7.23 RES is of the view therefore that it is critically important that a provisional liquidator is granted the necessary powers to facilitate the making of DGS payments to members as quickly and efficiently as possible, and that if such powers are not granted to a provisional liquidator, there is a very real and material risk that the DGS process will be seriously delayed, if not ineffective.



**8. RECOMMENDATION AND NEXT STEPS**

- 8.1 RES believes that for all of the reasons set out above, it is necessary to liquidate Charleville in order to protect the interests of Charleville's members, to preserve confidence in the credit union, and wider banking sector, as a whole and to avoid the risk of a disorderly closure of the credit union, should a run on deposits occur.
- 8.2 In order to avoid the real risk of an unplanned closure or damaging run on deposits once the filing of the winding-up petition becomes known, RES recommends that an application for the appointment of a provisional liquidator should be made on the day of filing the winding-up petition. Such an application for a provisional liquidator is necessary to allow the preparation of a file to support the DGS pay-outs, in a timely manner, to support the credibility of the DGS, and to protect the assets of the credit union.
- 8.3 If, having considered all of the information in this Report, you determine: (a) that liquidation is the appropriate course of action in respect of Charleville; and (b) whether the Central Bank has sufficient grounds on which to seek to have a provisional liquidator appointed to Charleville, RES will request that our external legal advisors instruct Counsel in relation to this matter, in preparation for issuing a petition to the High Court.

